Management Accounting
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An Introduction-1
Lecture 1

Welcome students, I am Dr. A. K. Sharma from the Department of Management Studies, IIT Roorkee. My area of interest is finance and accounting and this time I am offering a course management accounting, right. Management accounting, we will discuss everything in detail in this course about the different techniques of accounting which are useful for the managerial use, for the managerial decision making in the organisations, in the business organisations.

And I would like to say clarify the doubts and the differences between the three different types of accounting that is the say financial accounting, cost accounting and management accounting. When we talk about the accounting many people get confused about that we have financial accounting, cost accounting and we have management accounting, right. So if we have financial accounting what is a need of cost accounting?

If we have cost accounting and financial accounting, what is a need of management accounting? So why these three disciplines of accounting are there or they have emerged over a period of time, what was the use? What was the requirement? What was understanding behind developing the three different sets of accounting or the courses of accounting or the areas of accounting or disciplines of accounting so that is we are going to discuss here and we are going to clarify.

Earlier, I have offered a course that is financial analysis and reporting. So that is the say earlier that was based upon financial accounting if you have the basic idea of financial accounting if you know something about the cost accounting or may be not the cost accounting but if you have some basic idea of the financial accounting, if you have studied financial accounting some time earlier, then I think it would be very easy for you to understand what is the management accounting.

And you would be able to clarify and differentiate also that what is the financial accounting? And what is the management accounting? And why there is a need for management accounting? What are issues involved in the management accounting? What are the managerial problems we can solve with the help of management accounting? How the management accounting has evolved over a period of time?

And what are the different techniques of say studying the subjects called as management accounting, right? So here we are to discuss for the next say thirty hours (the), this this course is thirty hours course and we will have 60 lectures of half an hour each. So I would try to cover almost each and every aspect of management accounting and like to make it interesting with the help of some say problems, cases and we will be solving it here we will be discussing here.

We will talk about the conceptual things with regards to different topics of management accounting, how we can use those different techniques and the concepts of management accounting in the managerial decision making quantitatively as well as qualitatively? And finally where this say subject or area of learning takes us our organisations or our firms and how it is useful, right?

So, when we talk about the different branches of accounting, you must have heard about you must have this much of background am sure that, there are the three branches of accounting financial accounting, cost accounting and management accounting. So, why there is need for three different branches of accounting and what is the purpose, and what are the different purposes that these three branches of accounting serve?

We have first of all financial accounting, then we developed the cost accounting, then we developed the management accounting. So, it has happened over period of time, in a phased manner. This all has happened in a phased manner, depending upon the requirement of business world, depending upon the need necessities of the business world as the business say went on becoming complex or may be very difficult to predict or to say go for decision making or any other kind of business issues.

When complexity of the business increased because of the increased competition, because of the globalisation, because of the liberalisation of different economies, when the firms starting moving from one economy to the another economy from home economy to the host economy then they had the say plethora of issues that their different challenges different economies, different markets, different people, different customers have different problems different issues.

How to resolve them? How to fulfil their requirements? And even we have to find out that what are the expectations of market in the time to come? How the market is going to behave in which the company or the companies are operating? How those markets are going to behave? How those customers are going to behave? How the demand with regard to one particular product of service is going to be?

How to go for pricing of the products in the competitive economy? Similarly, then, how to say take decision about the say different aspects like the inventory then like say credentials say serving different kind of needs of the customers spread over the diverse markets all around the globe? You must be agreeing with me that for any effective business organisation these days only one economy or the one market is not just sufficient or is not say, they will not expand from one economy to other economy.

Means they are not satisfied with the one market. They are into the one market because that market is not safe for many companies. If they are operating in one market and they feel that they are safe in market, God knows that tomorrow some big multinational company comes in that area and they have to lose the market. So, they have to look forward for the alternative markets not within the country but outside the country also.

So there are different decisions which they have to take over a period of time. And accounting is a discipline which helps managers and different stakeholders of the businesses to take very relevant and useful decisions. For example, I am saying that say in India we have companies like say in the electrical sector you talk about, we have the company very big name Anchor. And Anchor was one of once upon time very big name, very effective company but tame came when this market was liberalised, we accepted the globalisation.

Many American and the Japanese companies entered this market and finally Anchor found it very difficult to survive in the market. And finally the company was taken over by the Panasonic. So it means a big joint, a big company which was a leader in the Indian market once upon a time and today it is acquired company, it is sold company. It means they could not sustain the competition put forward by the multinationals.

So it means we will have to take many decisions over a period of time and here the data which is called as financial and accounting data that helps us a lot. So accounting, without accounting you cannot think of doing any business. Accounting is, if you talk about financial accounting it is helping us to reporting or to knowing about the results of the business. You must be aware about or you must be knowing it that under financial accounting we prepare the financial statements, we prepare profit and loss account, we prepare the balance sheet, we prepare the cash flow statement, we prepare the funds flow statement.

All these statements what they are? They only have the data. And that data helps us to go for the different management decisions. Now, we talk about that we are say earning the profit whether the profit is sufficient or not we are into the losses. So what is accident of losses? Are we expecting to convert that loss into profit? Because ultimately end result of any business is maximisation of the wealth and we keep on verifying over a period of say one year or twelve months that how the business is doing in past twelve months?

So, financial accounting helps us we prepare financial statements means whatever you do all the business transactions they are converted into the monitory transactions. May be all the transactions are the monitory transactions. Monitory transactions are recorded in the books of account and finally they are taken to the financial statements, profit and loss account, balance sheet, cash flow statement.

And with the help of that we come to know over a period of time how the business has grown? How the business has done? How the business has performed? And if it is say acceptable level of performance then fine but if something needs to be done then ultimately it is accounting which is helping us. So financial accounting you cannot think of doing business without financial accounting, right?

Then we have cost accounting, so cost accounting is branch or the area or the discipline of learning where, we learn about how to cost the products and different type of products and the services? See, ultimately when we are producing a product or generating a service that is only for the customers and it has to go to the market. Now, when it has to go to the market, it has to be sold in the market. And for selling any product or service in the market you need to have or need to fix up a price.

You must be knowing that if I am the producer of the product, if any company is the producer of the product, if any company is generator of any service, creator of any service then what is the cost of creating the service? What is the cost of producing that product? Until and unless you know the real cost of producing that product or generating that service, you cannot price product.

So costing is the basis of pricing. Pricing is not possible without costing. So you need the cost accounting, full-fledged discipline called as cost accounting, which is only dealing with the all different kind of issues with regard to the cost; cost of the product, cost of the services. Until and unless you are you have the cost because cost is the basis of pricing. So, we need the cost accounting because we are in a competitive world so you cannot charge any price of your product whatever you wish to charge. We are in a competitive economy which is called as economy controlled by the customers not by the sellers'.

Economies, today market today they are controlled by the buyers. It is the buyers' market now all around the world, all around the globe. It is not a sellers' market. It is a buyers' market and buyer has multiple options available. Buyer has multiple substitutes available. Supply side has improved a lot. And if any company is not able to fulfil the customers' requirement at a desired place, price and with the say desired properties of the product they will shift to somebody else. They will soon become the former customer to existing company and they will shift to other company.

It is happening, for example, you have seen in telecom sector. Once upon time talk about say 10 – 15 years back we had only one company that is department of telecommunication that was converted to BSNL. But today you see how many companies are there in the market providing you the telecom services. And if you are not satisfied with the service of any company say Airtel you shift to Vodafone, if you are not satisfied with the Vodafone you shift to Jio, if you are not satisfied with Jio even sometime people shift to BSNL.

So, depending upon the service, depending upon the say, the way the service has been provided and foremost thing is the price at which the service is available or the product is available. That is the one important, you can call it is basis of the success or the failure of the products or services. What is the reason? What is the say you can say the reason of the success of the Jio in short span of time?

Jio forced two large companies video this, Vodafone and the idea to join hands, to form a joint venture because for them sustaining the competition put forward by Jio in the market was not possible, Vodafone a UK base company, a large multinational company which has millions of customers all around the globe, they could not sustain the competition put forward by an Indian company.

A new Indian company entering the telecom sector because their services and their quality of service was much-much cheaper as compared to the services of the existing companies. Whether you call it is BSNL, you call it as Airtel, you call it as Vodafone, you call it as idea. Whatever the price and the speed Jio has given to the market, existing company could not do that. It means how the Jio could say serve the market and even serving today at a price other cannot compete with because they know how to cost their service?

So it means, if you want to sell the product in the market in such a competitive market, you have to price the product in such a way, that it is highly competitive; it is full of all the properties and attributes. Still, it is highly competitive and people have the reasons to accept it and it is not happening in one sector. Everywhere there is a huge competition; you talk about manufacturing sector, you talk about electronics, you talk about automobiles, and you talk about domestic that is the consumer products.

So, consumer products, consumer durables, automobiles mean the industrial products everywhere there is competition. So, to fight the competition and to sustain in the competitive situation, we will have to learn how to cost the products and not only to cost the products but too minimise the cost of the product without compromising the quality. And if you have the basis of the costing of your products that ultimately becomes what was the basis of the pricing of the products? So, you need cost of accounting full-fledged branch of learning that what the cost accounting is?

And then we talk about the management accounting. Management accounting is not at all a discipline in itself. It has no techniques of its own like financial accounting. It has proper gap. Generally agreed accounting principles, then it has its own ways and means to develop a full-fledged subjects and the basis of the different techniques of the financial accounting. Under financial accounting, we prepare, we have the transaction business transaction. We take those transactions to the journal leisure trial balance and then we take them to the financial statements.

We prepare the cash flow statement and then we prepare the funds flow statement. So, they all are created, all this information is created under techniques, financial accounting. It is a full-fledged discipline its original discipline and it has its own base and its own techniques and methods. Similarly, if you talk about the cost accounting, cost accounting, it is also a very-very say you can call it as full-fledged fully developed subject. It has its own techniques. It has different techniques for costing the products in different sectors. It has the techniques for costing the products in manufacturing sector.

It has the cost techniques for costing the products in the consumer sector, in the consumer durable sector, in the automobile sector even in the construction industries. We have different costing techniques. So, it has different techniques, different methods and methodologies. So, it is a full-fledged original real discipline of the learning. But, what is management accounting? Like cost accounting and financial accounting, management accounting does not have its own techniques, methods and its own systems.

It borrows the techniques of the financial accounting and the cost accounting. Partly it borrows the techniques and partly it borrows the data, the information which is provided by the financial accounting and which is provided by the cost accounting. It is fully dependent upon the first two branches of the accounting, if there is no financial accounting data; if there is no cost accounting data you cannot use management accounting as a discipline of decision making.

So, entire decision making under management accounting is based upon financial accounting plus cost accounting. Management accounting has different techniques of decision making not of generating any data or information. Data or information generated under the financial accounting and the cost accounting but how to make use of that data for the relevant management decision making? That is how means it can be learned under the techniques of management accounting?

It helps in the decision making not in the generation of any data, any information or any different kind of the quantitative inflow. It only is using the information which is available in the balance sheet and the profit and loss account in the cost statements and with the help of different methods financial accounting and the cost accounting whatever the information is generated that is being used effectively in the management accounting

So here we will learn about that how to make proper use of the financial accounting information? How to make proper use of cost accounting information? And how and in what way this information can be used in the day to day management decision making? Because business is complex, it is not only to cost the product we have to further learn about how to minimise the cost? We have to further learn about how to price the product so minimising the cost pricing the product and using the different type of the costing information about different products and services that we learn in the management accounting.

But without cost accounting management accounting is not possible similarly what information is provided to us by the profit and loss accounts balance sheet and other statements? Financial accounting only provides the historical information that is the profit and loss accounts balance sheet, nothing else; it does not give you anything else. Management accounting starts where the financial accounting ends. Management accounting starts where the cost accounting ends.

So, we have to learn here that the generation of the information not sufficient in today's world. It was earlier but today's world, it is just not possible. Whatever, the information generated under the two sets of the accounting, two major branches of accounting, making the proper rational and effective utilisation of that information, so that very effective management can be facilitated that we will learn in management accounting. Now, what is a need and how this discipline has evolved just in two minutes I will discuss with you.

That initially when we started doing business centuries ago, you must have heard about that we had two accounting systems that is single entry accounting system and the double entry accounting system. Under the single entry accounting system it was very simple accounting system. That on the one side of the statements you are putting all the sources from where the funds are coming in, where the funds are going out. And we are calculating the difference.

We are making only a one entry of anything is coming in business, only one entry if anything is going out of the business, only one entry in the books of accounts. But that was suffering from major limitations that when any transaction happens in the business, it does not have only one or single effect. It has double effect. If material is coming the business cash is going out in leave of that material because that material is not free. We have purchased that so, why not to have double effect of every transaction?

So, after the single entry system we had the double entry system of accounting and todays financial accounting is based upon the double entry accounting system which was developed by the Fra Luca Pacioli. He was an Italian merchant and he developed in the 17th century. He wrote a book on the double entry accounting system and after that the system was understood by all around the world everybody all around the world. And it was accepted as full-fledged discipline of accounting.

I do not want to go in the detail of financial accounting because you know it about. So, here the purpose is just to recall that today whatever the financial accounting information be generate through the profit and loss accounts balance sheet that is based upon the double entry accounting system. And when you enter the transactions into the journal, ledger, trial balance, prepare the profit and loss accounts balance sheet, cash flow statement, fund flow statement, financial accounting ends there.

Maximum is you can analyse that information by calculating certain ratios or by preparing the cash flow statement and fund flow statement but more than that you cannot make better use of the financial accounting. Another limitation of the financial accounting is that it is historical in a nature. When you prepare the profit and loss account may be at the end of year, at the end of three months, at the end of six months; you come to know about the results business when the action has already been taken or the results have already come, you cannot change those results.

If the business has earned the profit and that is not up to the mark, you cannot increase the profit for the previous period. Yes, you can take the actions to improve the things in future. If business has incurred loss and you come to know after twelve months, three or six months you cannot convert that loss into profit. Yes, you can take the appropriate or the corrective measures for the next remaining period of a time of year.

So, another limitation of the financial accounting is it generates very useful information but that entire information is historical in nature. So, initially when the business was not very (pop) a competitive may be in the 17^{th} century, 18^{th} century and in the till the beginning of 19^{th} century or it may be during the 19^{th} century financial accounting serves the purpose. We never thought of having any other say additional branch of accounting.

But over a period of time we started seeing and experiencing the complexities of the businesses because businesses started becoming global over a period of time. Company started moving from one market to another market; one economy to another economy. We had the concept of multinational, international companies, multinational companies' world companies, transnational companies.

So, it intensifies the competition. In India, for example, till 1991 since we were not a globalised economy so only Indian companies were operating into the market whether they were into government sector; public sector private sector. But this market was only open for

Indian companies. Very few foreign companies were operating in the market but in a very restricted manner. But when we opened up this economy for world conglomerates we accepted the globalisation, liberalisation and this economy was made wide open for any multinational company coming to India.

So, it intensified the competition. When it intensified the competition so, it means any product or service which was available to us at any price before opening up of the economy and that service or that product was being provided by the Indian companies, the price they were charging before the globalisation before 1991, they were not able to charge the same price after 1991. Because some efficient and the better player came up in the market. And that player started providing the very efficient, useful products at every lesser and effective price.

So, why people should keep on buying the product from the existing company if it is not able to serve the needs of the people and when efficient product is available at half of the price or more efficient product is available at the same price so people started shifting from the domestic or Indian companies' products and services to the multinational companies. Today, you see in every sector there are the multinational companies operating in India.

You have automobiles, you have electronics, you have consumer durables, you have other consumer durables I mean to say, then you have the consumer sector. Everywhere you are finding the products from the multinational companies and Indian companies are going out of the market. Why? Because they were not able to serve the customers' needs. The price, they charge the quality of the product that they provided, they were not able to serve the needs of the customers.

And when the multinationals came and then the customers of the multinational products, then certainly there was reason to customers shift to the new country multinational. So, it means what happened? Here we realise that the costing system of Indian companies was defective. Similarly, this defective costing system or challenges in that accounting and costing system are not only faced within at the one economy level but even the globally. You must have heard about the Global recession of 1930s.

What is that Global recession of 1930s? What was the impact of that Global recession of 1930 and it how it necessitated the say development of the another discipline of accounting which was later on named as cost accounting that I will discuss with you. So, it means initially we had financial accounting business was not very-very competitive and easy to do the business all around the say same market wherever the companies operating. So, financial accounting serves the need.

But when business became competitive and sometime, because of the world recession purchasing power of the people was affected. Then, it was thought by the businesses all around the globe that the new disciplined should be developed which, helps us to guide how to calculate the cost and minimise cost and that resulted into the development of the second branch of accounting, cost accounting. More about the cost accounting and its development and further movement from the financial accounting to cost accounting and Management Accounting and I will discuss with you in the class. Thank you very much.