

Management Accounting — Definition, Nature and Functions

That part of [accounting system](#) which facilitates the management process of decision-making is called **management accounting**. Basically it is the study of managerial aspect of financial accounting, “accounting in relation to management function”. It shows how the accounting function can be re-oriented so as to fit it within the framework of management activity. It presents accounting information in such a way as to assist management in the creation of policy and in the day-to-day operations of an undertaking. **Management accounting** has the ability to communicate a great variety of facts in a systematic and meaningful manner. [The task of management accounting](#) is not to make decisions; rather it facilitates the process of decision-making. **Management accounting** is a systematic approach to [planning and control functions of management](#). It generates information for [establishing plans and controls](#).

Definition of Management Accounting

According to the Chartered Institute of Management Accountants (CIMA), Management Accounting is “the process of identification, measurement, accumulation, analysis, preparation, interpretation and communication of information used by management to plan, evaluate and control within an entity and to assure appropriate use of and accountability for its resources. Management accounting also comprises the preparation of financial reports for non-management groups such as shareholders, creditors, regulatory agencies and tax authorities”

This definition points out that management is entrusted with the primary task of planning, execution and control of the operating activities of an enterprise. It constantly needs accounting information on which to base its decision. A decision based on data is usually correct and the risk of erring is minimized. The position of the management in respect of its functions can be compared to that of an army general who wants to wage a successful battle. A general can hardly fight successfully unless he gets full information about the surrounding situation and the extent of effectiveness of each of his battalions and, to the extent possible, even the enemy’s intentions. Like a general a successful management too strives to outstrip other competitors in the field by streamlining its operating efficiency. It needs a thorough knowledge of the situation and the circumstances in which the firm operates. Such knowledge can only be gained through the processed financial data rendered by the accounting department on the basis of which it can take policy decision regarding execution, control, etc. It is here that the role of management accounting comes in. It supplies all sorts of accounting information in the form of such statements as may be needed by the management. Therefore, management accounting is concerned with the accumulation, classification and interpretation of information that assists individual executives to fulfill organizational objectives.

Management accounting is the process of:

1. **Identification** — the recognition and evaluation of business transactions and other economic events for appropriate accounting action.

2. **Measurement** — the qualification including estimates of business transactions or other economic events that have occurred or may occur.
3. **Accumulation** — the disciplined and consistent approach to recording and classifying appropriate business transactions and other economic events.
4. **Analysis** — the determination of resources for and the relationships of the reported activity with other economic events and circumstances.
5. **Preparation and Interpretation** — the meaningful coordination of accounting and/or planning data to identify a need of information, presented in a logical format, and, if appropriate, including conclusions drawn from those data.
6. **Communication** — the reporting of pertinent information to management and others for internal and external uses.

Nature of Management Accounting

The term management accounting is composed of 'management' and 'accounting'. The word 'management' here does not signify only the top management but the entire personnel charged with the authority and responsibility of operating an enterprise. The task of management accounting involves furnishing accounting information to the management, which may base its decisions on it. It is through management accounting that the management gets the tools for an analysis of its administrative action and can lay suitable stress on the possible alternatives in terms of costs, prices and profits, etc. but it should be understood that the accounting information supplied to management is not the sole basis for managerial decisions. Along with the accounting information, management takes into consideration or weighs other factors concerning actual execution. For reaching a final decision, management has to apply its common sense, foresight, knowledge and experience of operating an enterprise, in addition to the information that is already has.

The word 'accounting' used in this phrase should not lead us to believe that it is restricted to a mere record of business transactions i.e., book keeping only. It has indeed a 'macro-economic approach'. As it draws its raw material from several other disciplines like costing, statistics, mathematics, financial accounting, etc., it can be called an interdisciplinary subject, the scope of which is not clearly demarcated. Other fields of study, which can be covered by management accounting, are political science, sociology, psychology, management, economics, statistics, law, etc. A knowledge of political science helps to understand authority relationship and responsibility identification in an organization. A study of sociology helps to understand the behaviour of man in groups. Psychology enables us to know the mental make-up of employers and employees. A knowledge of these subjects helps to increase motivation, and to control the actions of the people who are ultimately responsible for costs. This builds a better employer-employee relationship and a sound morale. The subject of management reveals the processes involved in the art of managing, a knowledge of economics assists in the determination of optimum output in the forecasting of sales and production, etc., and also makes it possible to analyze management action in terms of cost revenues, profits, growth, etc. It is with the help of statistics that this information is presented to the management in a form that can be assimilated. The subject of management accounting also encompasses the subject of law, knowledge of which is necessary to find out if the management action is ultra-vires or not. It is, therefore, a wide and diverse subject.

Management accounting has no set principles such as the double entry system of bookkeeping. In place of generally accepted accounting principles, the philosophy of cost benefit analysis is the core guide of this discipline. It says that no accounting system is good or bad but it can be considered desirable so long as it brings incremental benefits in excess of its incremental costs. Applying management accounting principles to financial matters can arrive at no single perfect solution. It is, therefore, an inexact science, which uses its own conventions rather than standardized principles. The facts to be studied here can be interpreted in different ways and the precision of the inferences depends upon the skill, judgement and common sense of different management accountants. It occupies a middle position between a fully matured and an infant subject.

Since management accounting is managerially oriented, its data is selective in nature. It focuses on potential opportunities rather than opportunities lost. The data is operative in nature catering to the operational needs of a firm. It details events, monetary and non-monetary. The nature of data, the form of presentation and its duration are mainly determined by managerial needs. It is quite frequently reported as it is meant for internal uses and managerial control. An accountant should look at his enterprise from the management's point of view. Whenever he fails to do that he ceases to be a management accountant.

Management accounting is highly sensitive to management needs. However, it assists the management and does not replace it. It represents a service phase of management rather than a service to management from management accountant. It is rather highly personalized service. Finally, it can be said that the management accounting serves as a management information system and so enables the management to manage better.

Functions of Management Accounting

The basic function of management accounting is to assist the management in performing its functions effectively. [The functions of the management](#) are planning, organizing, directing and controlling. Management accounting helps in the performance of each of these functions in the following ways:

- **Provides data:** Management accounting serves as a vital source of data for [management planning](#). The accounts and documents are a repository of a vast quantity of data about the past progress of the enterprise, which are a must for making forecasts for the future.
- **Modifies data:** The accounting data required for managerial decisions is properly compiled and classified. For example, purchase figures for different months may be classified to know total purchases made during each period product-wise, supplier-wise and territory-wise.
- **Analyses and interprets data:** The accounting data is analyzed meaningfully for effective planning and decision-making. For this purpose the data is presented in a comparative form. Ratios are calculated and likely trends are projected.
- **Serves as a means of communicating:** Management accounting provides a means of communicating management plans upward, downward and outward through the organization. Initially, it means identifying the feasibility and consistency of the various segments of the plan. At later stages it keeps all parties informed about the plans that have been agreed upon and their roles in these plans.
- **Facilitates control:** Management accounting helps in translating given objectives and strategy into specified goals for attainment by a specified time and secures effective accomplishment of these goals in an efficient manner. All this is made possible

through [budgetary control](#) and [standard costing](#) which is an integral part of management accounting.

- **Uses qualitative information:** Management accounting does not restrict itself to financial data for helping the management in decision making but also uses such information which may not be capable of being measured in monetary terms. Such information may be collected from special surveys, statistical compilations, engineering records, etc.