

### 1.1.4. Objectives of Financial Accounting

Following are the main objectives of financial accounting:

- 1) **Keep Systematic Records:** Accounting is done to keep systematic records of financial transactions. In the absence of a scientific method of accounting, there would have been tremendous burden on the human memory which, in most cases, would have been impossible to bear.
- 2) **Protect Business Properties:** Accounting provides protection to business properties from unjustified and unwanted use. This is possible by providing the following information to the management:
  - i) The amount of owner's fund invested in the business;
  - ii) How much the business owes to others;
  - iii) How much the business has to recover from others; and
  - iv) How much business owns the assets;
- 3) **Ascertain Operational Profit or Loss:** Accounting helps in ascertaining the net profit earned or loss suffered on account of carrying the business. This is done by keeping a proper record of revenues and expenses of a particular period.
- 4) **Ascertain Financial Position of the Business:** The profit and loss account reflects the performance of the business during a particular period. However, it is also necessary to know the financial position, i.e., where do we stand. What we owe and own. The objective is met by balance sheet, which shows the state of affairs of assets and liabilities as on a given date. It serves as barometer for ascertaining the financial health of the business.
- 5) **Facilitate Rational Decision-Making:** Accounting these days has taken itself the task of collection, analysis and reporting of information at the required points of time to the required level of authority in order to facilitate rational decision-making.



### 1.1.5. Functions of Financial Accounting

The functions of financial accounting are as follows:

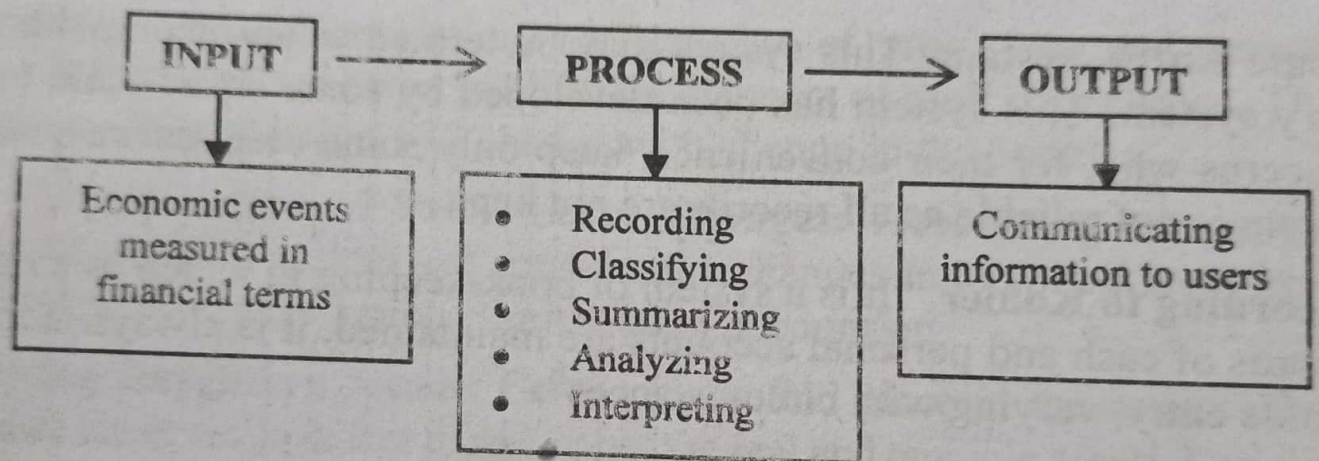
- 1) **Identifying:** Identifying the business transactions from the source documents.
- 2) **Recording:** This is the basic function of accounting. It is essentially concerned with not only ensuring that all business transactions of financial character are recorded but also that they are recorded in an orderly manner. Recording of transactions is done in 'journal' or 'subsidiary books'. The number of subsidiary books to be maintained will be according to the nature and size of the business.
- 3) **Classifying:** Classification is concerned with the systematic analysis of recorded facts, with a view to group transactions or entries of one nature at one place. This is done in the book called "Ledger". The Ledger contains different pages of individual account heads under which all financial transactions of similar nature are collected.

For example, the expenses may be classified under various heads like Travelling, Communication, Printing and Stationery, Advertisement etc. All the entries in the Ledger shall flow based on the entries passed in the Journal. The ledger accounts will help in knowing the total expenditure under various heads for a given period.

- 4) **Summarizing:** This involves presenting the classified data in a manner, which is understandable and useful to the internal as well as external end-users of financial statements. This process involves preparation of (a) Trial Balance, (b) Income Statement, and (c) Balance Sheet.
- 5) **Analyzing:** It establishes the relationship between the items of the profit and loss account and the balance sheet. The purpose of analyzing is to identify the financial strength and weakness of the business. It provides the basis for interpretation.
- 6) **Interpreting:** This is the final function of the accounting. The recorded financial data is interpreted in a manner that the end-users can make a meaningful judgment about financial condition and profitability of the business operations. The data is also used for preparing the future plans and framing of policies for executing such plans.
- 7) **Communicating:** It is concerned with the transmission of summarized, analyzed, and interpreted information to the users to enable them to make reasoned decisions.

Communication is preceded by an accounting cycle through which the identified and measured transactions and events pass. Accounting performs a basic function of a language, that is, to serve as a means of communication. It is an information system which communicates the accounting information to the users (whether internal or external) to enable them to make reasoned decisions. As an information system, accounting may be viewed as under:

## Financial & Management Accounting



**Figure 1.1: Accounting Functions**



## **1.2. MANAGEMENT ACCOUNTING**

### **1.2.1. Meaning & Definition of Management Accounting**

Management Accounting is comprised of two words 'Management' and 'Accounting'. It is the study of managerial aspect of accounting. The emphasis of management accounting is to redesign accounting in such a way that it is helpful to the management in formation of policy, control of execution and appreciation of effectiveness. It is that system of accounting which helps management in carrying out its functions more efficiently.

**According to Anglo-American Council on Productivity**, "Management accounting is the presentation of accounting information in such a way as to assist management in the creation of policy and the day-to-day operation of an undertaking".

**According to Robert N. Anthony**, "Management Accounting is concerned with accounting information that is useful to management".

**According to T.G. Rose**, "Management Accounting is the adaptation and analysis of accounting information and its diagnosis and explanation in such a way as to assist management".



According to Brown and Howard, "The essential aim of management accounting should be to assist management in decision making and control".

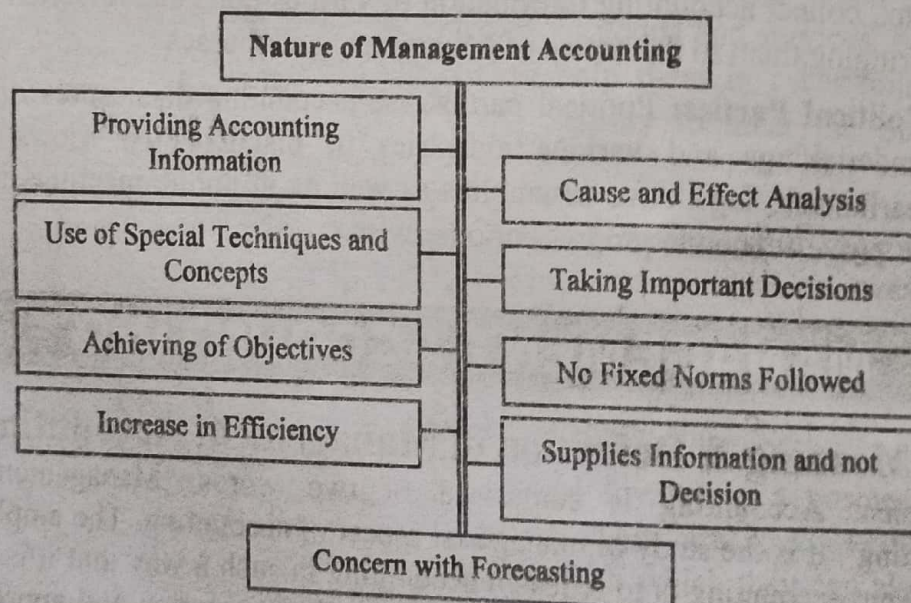
According to the Institute of Chartered Accountants of India, "Such of its techniques and procedures by which accounting mainly seeks to aid the management collectively have come to be known as management accounting".

According to N.K. Bose, "Management accounting is accounting for effective management".

According to The American Accounting Association, "Management accounting includes the method and concepts necessary for effective planning, for choosing among alternative business actions and for control through the evaluation and interpretation of performances".

### 1.2.2. Nature of Management Accounting

The nature of management accounting is as follows:



- 1) **Providing Accounting Information:** The collection and classification of data is the primary function of accounting department. The information so collected is used by the management for taking policy decisions. Management accounting involves the presentation of information in a way it suits managerial needs.
- 2) **Cause and Effect Analysis:** If there is a loss, the reasons for the loss are investigated. If there is a profit, the factors directly influencing the profitability are also studied. The figures of profits are compared to sales, different expenditures, current assets, interest payables, share capital, etc. So the study of cause and effect relationship is possible in management accounting.
- 3) **Use of Special Techniques and Concepts:** The techniques used include financial planning and analysis, standard costing, budgetary control, marginal



costing, project appraisal, control accounting, etc. The type of technique to be used will be determined according to the situation and necessity.

- 4) **Taking Important Decisions:** It supplies necessary information to the management, which may base its decisions on it. The historical data is studied to see its possible impact on future decisions.
- 5) **Achieving of Objectives:** In management accounting, the accounting information is used in such a way that it helps in achieving organizational objectives. Historical data is used for formulating plans and setting up objectives. The recording of actual performance and comparing it with targeted figures will give an idea to the management about the performance of various departments.
- 6) **No Fixed Norms Followed:** In financial accounting certain rules are followed for preparing different accounting books. On the other hand, no specific rules are followed in management accounting.
- 7) **Increase in Efficiency:** The purpose of using accounting information is to increase efficiency of the concern. The efficiency can be achieved by setting up goals for each department or section. The performance appraisal will enable the management to pinpoint efficient and inefficient spots.
- 8) **Supplies Information and not Decision:** The management accountant supplies information to the management. The decisions are to be taken by the top management.
- 9) **Concern with Forecasting:** The management accounting is concerned with the future. It helps the management in planning and forecasting.

### 1.2.3. Objectives of Management Accounting

Management accounting has three main objectives that allow managers to make improvements and plan for the future: measuring performance, assessing risks and allocating resources.

- 1) **Measuring Performance:** Management accounting is concerned with measuring performance in businesses. There are two types of performance that are typically measured. The first is employee performance. This can mean assessing whether an employee has been an efficient producer or it can mean using accounting methods to determine if a manager has attained certain goals in order to receive a bonus. The second performance measurement is the measurement of efficiency. This is concerned with how efficiently resources, such as capital, worker hours or materials, have been used. Both types of performance measurement can be used to make corrections in order to improve performance.
- 2) **Assessing Risks:** Risks are an integral part of business. Taking risks can result in major losses, but being constantly risk-averse can result in missed opportunities. An objective of management accounting is to assess risks in order to maximize profits. An example of this would be determining the



percentage of high- risk loans that a bank should make. A management accountant can identify a safe range in which the bank can expect to make profits without running the risk of collapse if the loans are defaulted. It can also be used for assessing the amount of money that should go into certain projects based on their expected return.

- 3) **Allocating Resources:** Resource allocation is important to any organization. Decisions need to be made about which projects to pursue, which products should be produced and how portfolios should be designed. An objective of management accounting is to provide a method for allocating resources. Management accountants will determine the most efficient way to divide resources and maximize profits. **For example,** a management accountant should be able to tell you the most efficient product portfolio for a manufacturer based on resource availability, selling price, manufacturing time and consumer demand. This information is vital to efficient production within an organization