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PAPER-12 Management Accounting

PREVIOUS YEAR – Theory Questions

(June 23 – June 26)

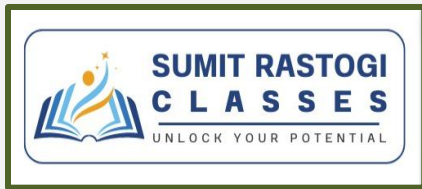
Question. 1

Distinguish between cost accounting and management accounting.

(June 23, Dec. 24)

Answer 1

Basis for Comparison	Cost Accounting	Management Accounting
Meaning	Cost accounting revolves around cost computation, cost control, and cost reduction.	Management accounting helps management make effective decisions about operations of the business.
Application	Cost accounting prevents a business from incurring costs beyond budget.	Management accounting offers a big picture of how management should strategize.
Scope	The scope is much narrower.	The scope is much broader.
Measuring Grid	Quantitative	Quantitative and qualitative
Sub-Set	Cost accounting is one of the many sub sets of management accounting.	Management accounting is the universal set.
Basis of Decision Making	The task of decision making is very less. Even if there is some, it is based on historical information	Historic and predictive information is the basis of decision-making.
Statutory requirement	Statutory audits of cost accounting are a requirement in some specified industries.	The audit of management accounting has no statutory requirement
Dependence	Cost accounting isn't dependent on management accounting to be successfully implemented.	Management accounting is dependent on both cost & financial accounting for successful implementation.
Used For	Management, shareholders, and vendors.	Only for management.



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Question. 2

Write down the differences between Absorption Cost & Marginal Costing. (June 23)

Answer 2

Absorption Costing	Marginal Costing
Both fixed and variable costs are considered for product costing and inventory valuation.	Only variable costs are considered for product costing and inventory valuation.
Fixed costs are charged to the cost of production. Each product bears a reasonable share of fixed costs and thus the profitability of a product is influenced by the apportionment of fixed costs.	Fixed costs are regarded as period costs. The profitability of different products is judged by their P/V ratio.
Cost data are presented in conventional patterns. Net profit of each product is determined after subtracting fixed costs along with their variable cost.	Cost data are presented to highlight the total contribution of each product.
The difference in the magnitude of opening stock and closing stock affects the unit cost of production due to the impact of related fixed cost.	The difference in the magnitude of opening stock and closing stock does not affect the unit cost of production.
In case of absorption, the cost per unit reduces, as production increases as it is fixed cost which reduces, whereas the variable cost remains the same per unit.	In case of marginal costing the cost per unit remains the same, irrespective of production as it is valued at variable cost.

Question. 3

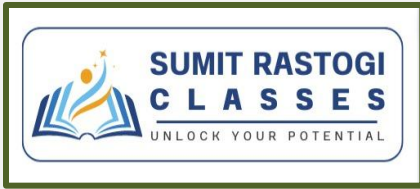
What do you mean by Learning Curve? State the applications of Learning Curve. (June 23)

Answer 3

Learning Curve: A learning curve is a function that measures how labor hours per unit reduces as units of production increase, because workers are learning and becoming expert at their jobs. The management uses this technique to predict how labor hours and labor cost will decrease as more units are produced.

Application of Learning Curve: The areas in which the application of learning curve can help an organization are as follows:

- 1. Improvement of Productivity:** As experience is gained, the performance of workers improves, time taken per unit of production is reduced and thus productivity increases.
- 2. Cost Prediction:** Learning Curve provides better cost predictions to enable organization to quote competitive prices for potential orders.
- 3. Work Scheduling:** Learning curve enables organizations to predict the inputs required more effectively and helps in the preparation of accurate delivery schedule.
- 4. Standards setting:** Organizations prepare budgets & standards considering learning curves to avoid significant variances.



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Question. 4

Briefly discuss the scope of Management Accounting.

(Dec. 23, June 26)

Answer 4

Some of the broad areas considered to be part of 'management accounting' is summarized in the following lines:

- Budgeting, planning and forecasting
- Measuring organizational, divisional and departmental performance
- Comparing results and performance between organizations
- Assisting in the process of increasing effectiveness and efficiency
- Assessing the performance of past and future capital investments
- Advising on decisions about product mix, markets to be served and selling prices
- Advising on decisions on whether to outsource products, components, activities and services
- Advising on decisions involving the investment of scarce funds between a range of possible alternatives
- Assisting in the making of a wide range of strategic decisions

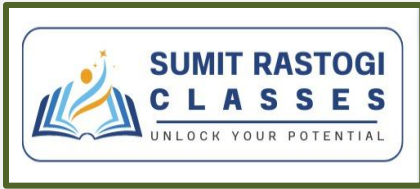
The above-mentioned are some of the relatively precarious activities of the higher-level management.

The fundamental activities of management accounting would include:

- calculating the profitability of products, services and operations,
- allocating costs to products,
- setting inter-divisional transfer prices.

There are also some functions of the management accountant which are focused on delivering critical information to the top-level management for initiating the process of increasing effectiveness and efficiency. Techniques such as activity-based cost management and theory of constraints are examples of such specialized activities.

Some authors also prefer to include capital budgeting decision within the scope of management accounting especially when there is a strategic aspect to it.



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Question. 5

What do you mean by Cost Centre? How is it different from Profit Centre? (Dec. 23)

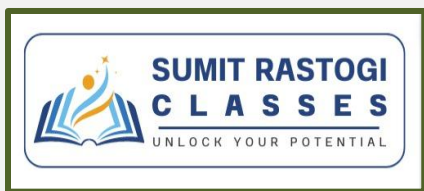
Answer 5

Meaning of Cost Centre

A Cost Centre is defined as a function or department within an organization which is not directly generating revenues and profits to the company but is still incurring expenses to the company for its operations. The contributions made by the cost centers in terms of profits is indirect. For example, a Company's human resource and Accounts departments could be considered as Cost Centers because these units do not generate revenues or charge for services, but they do incur cost.

Cost Centre vs. Profit Centre

Cost Centre	Profit Centre
A Cost Centre is an organizational unit whose manager has the authority only to incur costs and is specifically evaluated based on how costs are controlled.	A Profit Centre is an organizational unit whose manager is responsible for generating revenues and managing expenses related to current activity. Thus, Profit Centre should be independent organizational unit whose managers could obtain resources at the most economical prices.
The objective of Cost Centre is to control the incurrance of expenses.	The objective of Profit Centre is to maximize the Centre's profit.
The Area of Operation of Cost Centre is comparatively narrow.	The Area of Operation of Profit Centre is comparatively wide.
Cost Centres managers are responsible for cost only,	Profit Centres managers are responsible for both costs and revenues.



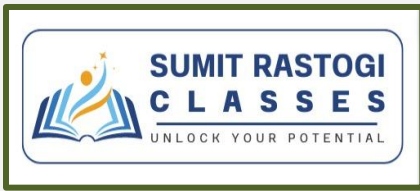
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Question. 6

Describe the differences between Management Accounting and Financial Accounting.
 (June 24/Dec. 25))

Answer 6

Basis for Comparison	Financial Accounting	Management Accounting
Purpose	Financial Accounting classifies, analyses, records, and summarizes the financial transactions of a particular period of the company.	Management accounting helps management make effective decisions about the business.
Application	Financial accounting is prepared to reflect true and fair picture of financial affairs.	Management accounting helps management to take meaningful steps and strategize.
Scope	The scope is pervasive, but not as much as the management accounting.	The scope is much broader.
Information type	Quantitative.	Quantitative and qualitative.
Inter dependence	It is not dependent on management accounting.	Management accounting is basically decision-making accounting and depends on information created by Financial Accounting as well as Cost Accounting.
Statutory requirement	It is legally mandatory to prepare financial accounts of all companies. (for example, in the Indian Context Companies Act 2013, relevant rules of accounting standards furnish the statutory requirements)	Management accounting has no statutory requirement.
Format	Financial accounting has specific formats for presenting and recording information.	There's no set format for presenting information in management accounting.
Users	Mainly for potential investors as well as all stakeholders.	Only for management.
Verifiable	The information presented is verifiable.	The information presented is predictive and not immediately verifiable.



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Question.7

Enumerate the main Concepts of Performance Budgeting.

(Dec. 23)

Answer 7 **Performance Budgeting** is synonymous with Responsibility Accounting which means the responsibility of various levels of Management is predetermined in terms of output or result keeping in view the authority vested with them.

The main concepts of such a system are enumerated below:

- a) It is based on a classification of managerial level for the purpose of establishing a budget for each level. The individual in-charge of that level should be made responsible and held accountable for its performance over a given period of time.
- b) The starting point of the performance budgeting system rests with the organization chart in which the spheres of jurisdiction have been determined. Authority leads to the responsibility for certain costs and expenses which are forecasted or present in the budget with the knowledge of the manager concerned.
- c) The cost in each individual's or department's budget should be limited to the cost controllable by him.
- d) Person concerned should have the authority to bear the responsibility.

Question. 8

What do you mean by Responsibility Centre? Explain in brief the various types of Responsibility Centres.

(June 24, June 26)

Answer 8

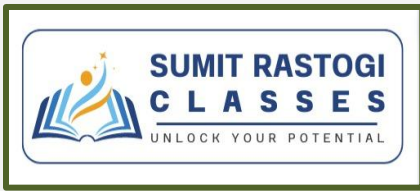
A responsibility centre may be defined as an area of responsibility which is controlled by an individual. A responsibility centre is an activity such as department over which a manager exercises responsibility. Responsibility areas may be departments (drilling or maintenance department), product lines (chemicals or fertilizers), territories (North or South) or any other type of identifiable unit or combination of units.

It should be noted that effective planning and control systems are structured around the implicit or explicit areas of responsibility within the organization. Further, to be held accountable for performance, managers must have clearly defined areas of responsibility—activities they control.

When an entity is divided into segments with managers having responsibility over specific areas, the segmented areas are known as responsibility centers.

Four types of responsibility centers are commonly identified:

- (i) Cost or Expense Center,
- (ii) Profit Center or Earnings Center, and
- (iii) Revenue Center
- (iv) Investment Center.



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(i) Cost Centre

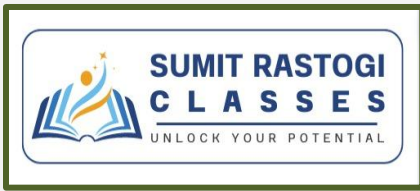
- A cost or expense centre is a segment of an organization in which the managers are held responsible for the cost incurred in that segment but not for revenues.
- According to CIMA, London a cost centre is “a location person or equipment, for which costs may be ascertained and used for purposes of cost control” Responsibility in a cost centre is restricted to cost.
- For planning purposes, the budget estimates are cost estimates; for control purposes, performance evaluation is guided by a cost variance equal to the difference between the actual and budgeted costs for a given period.
- Cost centre managers have control over some or all of the costs in their segment of business, but not over revenues.
- In manufacturing organizations, the production and service departments are classified as cost centre. Also, a marketing department, a sales region or a single sales representative can be defined as a cost centre.
- Cost centre may vary in size, from a small department with a few employees to an entire manufacturing plant. In addition, cost centres may exist within other cost centres.
- E.g. accounting department, repairs & maintenance department

(ii) Revenue Centre

- It is a segment of the organization which is primarily responsible for generating sales revenue.
- A revenue centre manager does not possess control over cost and investment in assets but usually has control over some of the expenses of the marketing department.
- The revenue centre manager will control the selling price; promotion mix and product mix
- The performance of a revenue centre is evaluated by comparing the actual revenue with budgeted revenue, and actual marketing expenses with budgeted marketing expenses.
- E.g. sales department

(iii) Profit Centre

- Also called business centre
- It is a segment of an organization whose manager is responsible for both revenues and costs.
- In a profit centre, the manager has the responsibility and the authority to make decisions that affect both costs and revenues (and thus profits) for the department or division.
- The managers are encouraged to act as if they were running their own separate business.
- The main purpose of a profit centre is to maximize profit by making decisions relating to production volume, product mix, selling price, marketing strategy.
- Profit centre managers aim at both the production and marketing of a product.



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(iv) Investment Centre

- It is responsible for both profits and investments.
- The investment centre manager has control over revenues; expenses and the amounts invested in the center's assets.
- He also formulates the credit policy which has a direct influence on debt collection, and the inventory policy which determines the investment in inventory.
- The manager of an investment centre has more authority and responsibility than the manager of either a cost centre or a profit centre.
- Besides controlling costs and revenues, he has investment responsibility too. 'Investment on assets' responsibility means the authority to buy, sell and use divisional assets.
- E.g. a new hotel being developed.

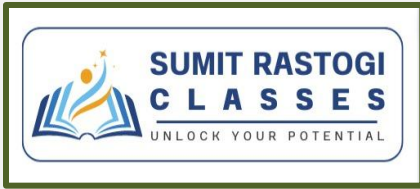
Question. 9

"A responsibility accounting system helps organizational unit managers to conduct the five basic control functions" –In this context, discuss the said control functions. (Dec. 24)

Answer 9

A responsibility accounting system helps organizational unit managers to conduct the five basic control functions. These basic Control Functions are as follows:

- (i) Preparing a plan (e.g., using budgets and standards) and use it to communicate output expectations and delegate authority.
- (ii) Gathering actual data classified in accordance with the activities and categories specified in the plan. The responsibility accounting system can be used to record and summarize data for each organizational unit.
- (iii) Monitoring the differences between planned and actual data at scheduled intervals. Responsibility reports for subordinate managers and their immediate supervisors normally include comparisons of actual results with flexible budget figures. In contrast, responsibility reports can provide comparisons of actual performance to the master budget.
- (iv) Exerting managerial influence in response to significant differences. Because of day-to-day contact with operations, unit managers should be aware of any significant variances before they are reported, identify the variance causes, and attempt to correct them. Top management, on the other hand, might not know about operational variances until it receives responsibility reports. By the time top management receives the reports, the problems causing the variances should have been corrected, or subordinate managers should have explanations as to why the problems were not or could not be resolved.



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- (v) Continuing comparing data and responding; then, at the appropriate time, the process will begin again. Responsibility reports reflect the upward flow of information from operational units to company top management and illustrate the broadening scope of responsibility. Managers receive detailed information on the performance of their immediate areas of control and summary information on all organizational units for which they are responsible. Upper-level managers desiring more detail than is provided in summary reports can obtain it by reviewing the responsibility reports prepared by their subordinates.

Question. 10

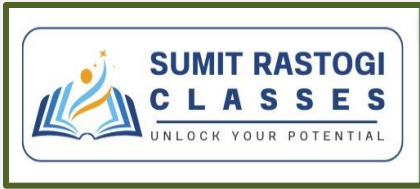
The business world has radically changed from what it used to be a few decades ago and accordingly the role of the management accountant has also changed significantly. In this context, illustrate the functions of management accountant in a dynamic business world.

(June 25)

Answer 10

The functions of a management accountant can be categorized as below:

1. **Planning and Accounting** - Management accountants prepare an accounting system covering costs, sales forecasts, profit planning, production planning, and allocation of resources. It should also include capital budgeting, short-term and long-term financial planning. They also prepare the procedures necessary to implement the plan effectively.
2. **Controlling** - Management accountants assist in the control of an organization's performance using standard costing, budget control, accounting ratios, funds flow statements, cost-cutting initiatives, and assessing capital expenditure proposals and returns on investment.
3. **Reporting** - Management accountants assist the top management in finding out the root cause of an unfavorable operation or event by identifying the real reasons for the adverse events as well as the responsible parties and comprehensively reporting them.
4. **Coordinating** - Management accountants improve an organization's efficiency and profits by providing various coordination tools such as budgeting, financial reporting, financial analysis and interpretation, and so on. These tools aid management by comparing cost and financial records, preparing financial budgets and establishing standard costs, and analyzing cost deviations to enable management by exception.
5. **Communication** - Management accountants create a wide range of reports to communicate results to the superiors. Through published financial statements and returns, they also inform the outside world about their company's success.
6. **Financial evaluation and Interpretation** - Management accountants analyze the data and present it to the management in a non-technical approach, together with their comments and ideas, so that the shareholders and senior management can understand it and make informed decisions.
7. **Tax Administration** - Management accountants are in charge of tax policies and processes. They make the reports that are required by various authorities. Further, they ensure that quarterly tax payments are made in advance, as required by the relevant Act, to prevent the payment of penal interest on late tax payments.



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8. **Evaluation of external effects** - There may be changes in government policy and existing laws. These amendments and policy changes can affect business goals. Management accountants assess the extent of any impact of these external factors on the business and report it to the stakeholder to take necessary precautionary measures.
9. **Economic appraisal** - When the government makes regular announcements about the country's economic situation, management accountants is entrusted with making the economic study and determine the influence of current economic conditions on the company's operations. They compile a report containing their observations and present it to high management.
10. **Asset Protection** - Management accountants separate fixed asset registers for each type and provide internal checks and controls to protect the company's assets. They also create the rules and regulations for each type of fixed asset and get insurance coverage for all types of fixed assets.

Question. 11

Describe the four perspectives of the Balanced Scorecard.

(June 25)

Answer 11

The four Perspectives of the Balanced Scorecard:

1. Financial Perspective

This perspective evaluates the Profitability of the strategy. Because cost reduction relative to competitors, costs and sales growth are key strategic initiatives, the financial perspectives focus on how much of operating income and return on capital results from reducing costs and selling more units.

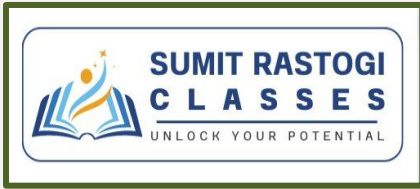
2. Customers Perspective

This perspective identifies the targeted market segments and measures the company's success in these segments. To monitor its growth objectives, number of new customers and customer's satisfaction.

3. Internal business process Perspective

This perspective focuses on internal operations that further the customers' perspective by creating value for customers and further the financial perspective by increasing shareholder value. Chipset determines internal business process improvement targets after benchmarking against its main competitors. The internal business process perspective comprises three sub processes:

- **The innovation process:** Creating products, services and processes that will meet the needs of customers, aiming at lowering costs and promote growth by improving the technology of its manufacturing.
- **The operations process:** Producing and delivering existing products and services that will meet the needs of customers. The strategic initiatives are (A) improving manufacturing quality reducing delivery time to customers and (B) Meeting specified delivery dates.
- **Post sales service:** It provides service and support to the customer after the sale of a product of service. Although customers do not require much post sales service.



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4. Learning & Growth Perspectives: This perspective identifies the capabilities of the organization must excel at achieving superior internal processes that create value for customers and shareholders.

A Company's learning and growth perspectives emphasize three capabilities:

- Employee Capabilities measured using employee education and skill levels.
- Information system capabilities, measured by percentage of manufacturing processes with real-time feedback and
- Motivation measured by employee satisfaction and percentage of manufacturing and sales employees (line employees) empowered to manage processes.

Question. 12

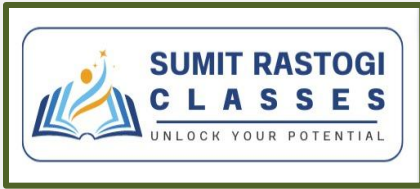
What is the significance of identifying responsibility centres in responsibility accounting?

(June 25)

Answer. 12

Identification of Responsibility Centres:

1. The whole concept of responsibility accounting is focused on identification of responsibility centres.
2. The responsibility centres represent the sphere of authority or decision points in an organization.
3. In a small firm, one individual or a small group of individuals, who are usually the owners, may possibly manage or control the entire organization.
4. However, for effective control, a large firm is usually divided into meaningful segments, departments or divisions. These sub-units or divisions of organization are called responsibility centres.
5. A responsibility centre is under the control of an individual who is responsible for the control of activities of that sub-unit of the organization.
6. This responsibility centre may be a very small sub-unit of the organization, as an individual could be made responsible for one machine used in manufacturing operations, or it may be a very big division of the organization, such as a divisional manager could be responsible for achieving a certain level of profit from the division and investment under his control.
7. However, the general guideline is that "the unit of the organization should be separable and identifiable for operating purposes and its performance measurement possible.



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Question. 13

What are the characteristics of responsibility reporting?

(Dec. 25)

Answer. 13

Characteristics of Responsibility Reporting:

1. Reports should fit the organization chart, that is, the report should be addressed to the individual responsible for the items covered by it, who, in turn, will be able to control those costs under his jurisdiction. Managers must be educated to use the results of the reporting system.
2. Report should be prompt and timely. Prompt issuance of a report requires that cost records be organized so that information is available when it is needed.
3. Reports should be issued with regularity. Promptness and regularity are closely tied up with the mechanical aids used to assemble and issue reports.
4. Reports should be easy to understand. Often, they contain accounting terminology that managers with little or no accounting training find difficult to understand, and vital information may be incorrectly communicated. Therefore, accounting terms should be explained or modified to fit the user. Top management should have some knowledge of the kind of items chargeable to an account as well as the methods used to compute overhead rates, make cost allocations and analyze variances.
5. Reports should convey sufficient but not excessive details. The amount and nature of the details depend largely on the management level receiving the report. Reports to management should neither be flooded with immaterial facts nor so condensed that management lacks vital information essential to carrying out its responsibilities.
6. Reports should give comparative figures, i.e., a comparison of actual with budgeted figures or of predetermined standards with actual results and the isolation of variances.
7. Reports should be analytical. Analysis of underlying papers, such as time tickets, scraps tickets, work orders, and materials requisitions, provide reasons for poor performance which might have been due to power failure, machine breakdown, an inefficient operator, poor quality of materials, or many other similar factors.
8. Reports should be stated in physical units as well as in terms of money since monetary information may give a foreman not trained in the language of the accountant a certain amount of difficulty.
9. Reports may tend to highlight departmental efficiencies and inefficiencies, results, achieved future goals or targets.