
Accounting Fundamentals

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Task 1

Revenue expenditure v/s capital expenditure

Outflow or economic resources excluding distributions to equity participants is termed as expenditure. International Accounting Standards (hereafter referred to as “IFRS”) requires recognition of incomes and expenses incurred in the period to be expensed to Statement of Comprehensive and Other Income for the period unless required or permitted otherwise (IASB. 2007). Consequently, expenses are broadly divided into two categories — Revenue Expenditure and Capital Expenditure. Expenses classified as revenue are expensed to the Income statement and affect the gain or loss of only the particular period. Capital expenditure, on the other hand, are expensed to Statement of Comprehensive and Other Income of multiple periods in the form of depreciation or amortisation depending on the nature of transaction. Meanwhile, the expenses are capitalised and carried as an asset in the Balance Sheet.

Principally, IAS 16-Property, Plant and Equipment and IAS 38-Intangible Assets deals with rules for capitalisation (Epstein,2008). All the expenses involved to bring an asset to the situation and condition available for use as desired by management is initially capitalised. Thereafter, the prime distinguishing factor between treating an expense as revenue or capital is the whether the expense is contributing to an increase in the revenue building capacity of the asset. An expense, which increases the revenue generating capacity of an asset, benefits multiple periods and hence it is capitalised and amortised over multiple periods.

Task 2 a

Cost and management accounting

Cost Accounting and Management Accounting often supplement and complement one another. Cost accounting is the function of collecting, categorising and recording data in a meaningful form to ascertain the cost of a product or service unit wise or for a period of time. On the other hand, management accounting deals with the presentation of information regarding costs, revenue or income of the entity in a format as desired by management to enable informed judgements and decisions (Drury,2019). Cost accounting data, methods and techniques serve as a base for management accounting and reporting.

Specific characteristics of cost and management accounting are outlined below

- **Emphasis on future** — Unlike financial accounting, which is based on historical information, present and future, is given more importance under cost and management accounting (Drury, 2019). Management accounting derives the trend from financial records and extrapolates the same for future period to enable management to take affirmative or corrective actions.
- **Recognition of non-financial variables** — Cost and Management accounting takes into consideration non-financial variables and assigns a monetary equivalent to the same based on assumptions for the future. The non-financial variables include customer behaviour, labour turnover and culture.
- **Improving efficiency** — Since cost and management accounting provide information on a timely basis, they aid in correcting unfavourable deviations and reiterating positive deviations and hence help in improving efficiency.

Cost accounting and Management accounting are similar in many respects

- **Internal reporting** — Both cost and management accounting are meant for internal reporting as opposed to financial accounting which is meant for various external organisations such as banks, government departments and shareholders. Consequently, cost and management reports have no specific format and are prepared in a format to enable management to obtain maximum information to enable timely decisions.
- **Strategic planning** — As both cost accounting and management accounting focus on providing information on a timely basis, they help in formulating strategic plans at the top level (Li, 2018).

Key Differences between Cost Accounting and Management Accounting are as listed below

- **Ambit** — The ambit of cost accounting is narrow as compared to management accounting as cost accounting primarily deals with cost ascertainment. Management accounting, on the other hand, deals with budgeting and tax planning areas of business decisions as well.
- **Operations performed** — Cost accounting deals with allocation and apportionment of costs to arrive at the appropriate cost of a product or service unit wise or for a particular period of time. Management accounting, on the

other hand, is more concerned with the cause and effect relationship of the costs incurred to the benefit derived (Drury, 2019).

Task 2 b

Concepts and practices to develop the short and long-term strategies of organisations

Strategy refers to the entire process of setting goals, determining plan of action to achieve those goals, and gathering resources necessary for the achievement of those goals. Strategies are the guiding force for any business. Strategies need not be long term always: strategies set for the next thirty days to six months are termed as short term strategies. Long term strategies or strategies for the next one to five years form the basis for short term strategies (Li, 2018). As outlined above, cost and management accounting provide the necessary input to management for strategy formulation.

For instance, job costing is a sub-set of cost accounting, which arrives at the cost per unit of a product by the summation of cost incurred on material, labour and overheads. It further differentiates overheads into production overheads, administrative overheads and selling overheads and as a result, we arrive at cost of production, cost of goods sold and cost of sales separately for the product unit wise. Further, management accounting would be helpful in extrapolating this information for a particular time-period, after taking into consideration the factors of demand, customer behaviour, and other macro-economic conditions. These reports provide information to management to strategise their sales in the upcoming period or to formulate strategies to cut costs at the factory, office or marketing level since we have distinct information with respect to production, administrative and selling overheads.

An entity can achieve competitive advantage from either of the two strategies cost leadership strategy or a differentiation strategy (Li, 2018). Cost leadership refers to a position wherein the firm can produce goods or provide services at a cost less than that of its competitors. Strategic cost analysis perceives cost from a cost advantage point of view. The benefit from having cost advantage can be reaped either by lowering the selling price and thereby increasing the sales base or maintain the selling price and enjoy higher margin than its competitors. Differentiation strategy, on the other hand, refers to a position wherein the firm produces specialised products having features distinct from its competitors. Strategic analysis of individual component of cost provides valuable inputs to management on the cost

and benefit relationship between various items of cost on a trial and error basis so as to arrive at an optimum level.

Thus, cost and management accounting can help provide inputs to build both long term and short term strategies for an organisation at the executive level.

Task 3

Responsibilities of Management Accountants

Role of a management accountant is very vast and has no boundaries, they assist in preparation of production or purchase budget at the supervisor level, preparation of variance analysis report and chalking out corrective action for the same at mid managerial level and cash forecast or strategy formulation at the executive level (Chotiyanon , 2019). Thus, the objective of a management accountant is predefined based on strategy adopted for performance evaluate. Depending on the strategy, different department or business units may be classified as cost centre, revenue centre, profit centre or investment centre. In a cost centre, performance is evaluated based on effective utilisation of resources resulting in cost control and hence the primary responsibility of a management accountant in such a setup is cost control.

Let us discuss the specific responsibilities of a management accountant in the context of a profit centre. In a profit centre, profit is the primary criteria for performance evaluation. Profit is influenced by two elements, namely cost and revenue and hence the primary focus in a profit centre is both cost control as well as revenue maximisation (Abraham, 2008). The management accountant is responsible for decisions that affect both the cost as well as the revenue. On the cost factor, tolls that come into play are inventory management, labour turnover analysis, and other cost control strategies. On the revenue factor, tools used are budgetary control, variance analysis and marketing strategies. A retail outlet is a typical example of a profit centre. Profit of a retail outlet can be increased either by procuring items at a lower cost or by selling the same with a higher margin. A profit centre can also be artificial in which case, profit is not earned from the market through sales to external customers, but through divisional transfers (Abraham. 2008). Management accountant is also responsible for such internal negotiation with person responsible for the other department since it is cost for one department and revenue for the other department. Arriving at a mutually acceptable transfer price is crucial for the organisation as a whole.

The specific responsibilities of a management accountant in context of an investment centre are investment or capital decisions. In an investment centre, return on investment is the performance evaluation criteria (Chotiyanon, 2019). However, the management accountant is responsible for all the decisions affecting cost, revenue and profit since they have a direct influence on the return on investment. A management accountant will be responsible for evaluating various investment opportunities using various methods such as the **Net Present Value Method**, **Pay Back Period Method**, or **Internal Rate of Return Method**. The management accountant is also responsible for strategising investments in such a manner so that the return on investment is highest in case of the investment centre for which he is responsible. Investment centres operate at a higher level in an organisation. A large multinational divided on the basis of location is a typical example of an investment centre. Each business unit of a conglomerate is another example of an investment centre.

While profit centre considers profit in absolute terms, investment centre considers the same relatively. To elaborate, if business unit A has a profit of 1,000,000 and business unit B has a profit of 2,000,000 then under profit centre approach, business unit B is likely to receive a better performance evaluation as compared to business unit A. At the same time, if business unit A has capital under its control to the tune of 10 million and business unit B controls capital worth 50 million, then we can safely presume that business unit A has performed better given that its return on investment is 10% while return on investment for business unit B is only 4%. Thus, investment centre approach provides more concrete base for performance evaluation (Abraham, 2008).

Task 4

Management accounting v/s financial accounting

Financial accounting is the function that captures the economic effect of transactions that have a monetary effect on the financial performance or asset-liability situation of an organisation (Bhattacharyya, 2017). Management Accounting, on the other hand, is the function that provides financial information to the management in a timely manner to make informed judgements. Key differences between the two are enumerated below-

- Level of reporting — Financial reporting is always at the top level, that is, for the entire organisation as a whole. Managerial reporting, on the other hand, is more detailed such as cost per unit, product wise profit analysis or customer segmentation.
- Basis of reporting — Financial accounting uses actual transactional data while management accounting, on the other hand, often deals with estimates and extrapolation rather than verifiable information.
- Frequency of reporting — Financial accounting deals with presentation of historical data at the end of each accounting period, which is typically one year. Management reporting is dependent on the requirement of management and consequently, the frequency varies from daily, weekly or monthly (Williams et al, 2015). Certain techniques like the marginal costing reports are prepared as and when required by management. Hence, there is no hard and fast rule with respect to frequency of reporting under management accounting practices.
- Nature of reporting — The primary users of financial accounting reports are external to the organisation. Shareholders obtain information about the wealth created by their investments through the financial accounting reports. Banks, for instance, use the financials to judge the credit worthiness. Management accounting reports are primarily meant for use of management. The reports are used by management for analysis and making informed judgements.
- Focus of reporting — Financial accounting concentrates on the appropriate valuation of assets and liabilities and accurate recording of incomes and expenses in accordance with generally accepted accounting practices and commercial practices. As a result, it takes into consideration adjustments depreciation, amortisation and revaluation (Bhattacharyya, 2017). Management accounting, on the other hand, is concerned with such adjustments, but only with the timing of cash flow and productivity of operations.
- Unit of reporting — Financial accounting measures performance on a single parameter, namely, profit. Constituents of financial accounting, being Balance sheet and the Income statement portray the financial position and the financial performance of an organisation respectively. Management accounting, meanwhile, uses a range of parameters vide a range of tools such as the balance scorecard, performance pyramid, and triple bottom line (Drury, 2019). For instance, under triple bottom line,

performance is measured on three parameters, namely, environmental, social as well as economic parameters.

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