Introduction to Management Accounting (ACF2200) Notes

Langfield-Smith, K., Smith, D., Andon, P., Hilton, R., & Thorne, H. (2018). *Management accounting: Information for creating and managing value* (8th edition). Sydney, New South Wales: McGraw Hill.

Contents:

Week 2 – Chapter 2 – Cost Terms & Concepts

Traditional v Modern Approaches to Costing

Components of management accounting systems	Traditional systems	Modern systems
■ Costing systems	■ Focus on the costs of departments and products* ■ Assume production volume is the only factor that can cause costs to vary	■ Focus on the costs of activities, products, customers and suppliers ■ Recognise that a range of factors can cause costs to vary
■ Budgeting systems	■ Built around departments	■ Built around departments and activities
■ Performance measurement systems	■ Monitor *financial* performance ■ Control what's going on inside the organisation	■ Monitor performance *across a range of critical success factors*, such as quality, delivery and sustainability, not just financial performance ■ Also look at what's happening *outside* the organisation, for example at customers, competitors and broader stakeholders ■ Support the management of both customer value and shareholder wealth
■ Cost management	■ No separate system ■ Costs mainly controlled through the financial performance measurement system	■ Pro-active approaches to managing resources and reducing costs, rather than just controlling them ■ Analyse real causes of costs and eliminate wasteful activities

* Note that 'products' includes both goods and services.

Why is Cost Important?

- Many short-term and long-term decisions require an understanding of costs
- Important source of information for decision-making, managing resources, and creating customer and shareholder value

Classifying Costs – Behaviour

Costs change as the level of activity changes. The level of activity is the level of work performed in the organisation (for example, units produced, kilometres driven, hours worked).

Fixed costs – Remain unchanged in total despite changes in the level of activity. This does not mean that fixed cost cannot change – but if it does change, this is usually unrelated to a change in the level of activity. For example, rent, salaries, insurance, depreciation.

Variable costs – Change in total in direct proportion to a change in the level of activity. For example, wages, materials used in production.

How to Classify a Cost according to Behaviour:

1. Determine the level of activity – usually this is what causes sales to go up or down
2. Question whether the cost is impacted significantly by the level of activity or not – is there a 'direct proportion' effect?
3. If yes – variable; If no – fixed

Week 9 – Chapter 19 – Information for Decisions: Relevant Costs and Benefits

Criteria for Relevant Information

1. **Different under competing courses of action –** Costs and benefits that are the same across all available courses of action need not be considered

2. **Relates to the future –** Consequences of decisions affect the future not the past, so only costs and benefits that relate to the future are relevant
    - Sunk costs are ignored
    - Costs that have already been incurred cannot be changed

Cost	Definition	Relevant / Irrelevant
Incremental Revenue	The additional revenue that will be gained as a result of choosing one course of action over another	**Relevant**
Incremental Costs	The additional costs that arise from choosing one course of action over another	**Relevant**
Out-of-Pocket Costs	Those incremental costs that will be incurred if a particular course of action is selected	**Relevant**
Opportunity Costs	The potential benefit give up when the choice of one action precludes a different action	**Relevant**
Avoidable Costs	Costs that will not be incurred in the future if a particular decision is made	**Relevant**
Unavoidable Costs	Costs that will continue to be incurred no matter which decision alternative is chosen	**Irrelevant**
Sunk Costs	Costs that have already been incurred	**Irrelevant**