WHAT IS MANAGEMENT ACCOUNTING?

MANAGEMENT ACCOUNTANTS
- Support managers in the process of making decisions
- Identify problems and help solve them
- Apply accounting concepts and techniques to real world problems
- Explain accounting
  - While accounting staff & processes may be found at the corporate level to help determine the organisation’s overall strategy, they are also found in operating divisions
  - Managers from other functional areas may also undertake management accounting activities
    - E.g. customer service & warehouse managers

MANAGEMENT ACCOUNTING
- The processes and techniques that focus on the effective and efficient use of organisational resources to support managers in their tasks of enhancing both customer value and shareholder value
  - CUSTOMER VALUE: the value that a customer places on particular features of a product
    - Increased sales & market share (shareholder value)
  - SHAREHOLDER VALUE: the value that shareholders, or owners, place on a business
    - Increased profitability
    - Increased share price
    - Dividends
  - When conflict arises, shareholder value usually prevails
- Types of cost information that can be produced to assist managers and other employees within organisations with:
  - Planning
  - Control
  - Decision making

MANAGEMENT ACCOUNTING SYSTEMS
An information system that produces the information required by managers to create value and manage resources
- Regular basis
- Can include:
  - Costs of producing goods & services
  - Information for planning & controlling operations
  - Information for measuring performance
- Ad hoc basis
  - To satisfy the short-term & long-term decision-making needs for management
  - External information may also be necessary

MANAGEMENT ACCOUNTING INFORMATION
Focus on the needs of managers within the organisation
- Managers need information that is much more detailed than that found in financial reports to make decisions, solve problems, and plan for the future
- EXAMPLES:
  - Estimates of the costs of producing goods & services
  - Information for planning & controlling operations
  - Information for measuring performance
  - Information for determining future plans & strategic direction
    - Difficult to extract this information from financial reports
- Great flexibility
  - Accounting standards only apply to external reports
  - Focus is on the needs & nature of resources managed
- Factors influencing design of a management accounting system
  - Nature of resources managed varies
  - Differences in production or service technologies
  - Organisational structure & size
  - External environment in which the organisation competes
  - Level of sophistication of computer systems
    - Senior managers
      - Need information that provides them with an overview of the entire organisation
    - Middle managers
      - Require more detailed information about their areas of responsibility
    - Operational managers
      - Need information to help them manage their specific operations on a day-to-day basis
      - To help ensure performance targets are met
Differences between Management Accounting Information & Financial Accounting Information

- **Management Accounting**: focuses on the information needs of managers inside the organisation
- **Financial Accounting**: the practice of preparing & reporting accounting information for parties outside the organisation

<table>
<thead>
<tr>
<th><strong>Users of Information</strong></th>
<th><strong>Management Accounting</strong></th>
<th><strong>Financial Accounting</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal: managers &amp; employees at all levels</td>
<td>No accounting standards or external rules imposed</td>
<td>External: shareholders, creditors, banks, securities exchange, trade unions, &amp; government agencies</td>
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</tbody>
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<table>
<thead>
<tr>
<th><strong>Regulations</strong></th>
<th><strong>Management Accounting</strong></th>
<th><strong>Financial Accounting</strong></th>
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</thead>
<tbody>
<tr>
<td>No accounting standards or external rules imposed</td>
<td>Information generated to satisfy managers information needs</td>
<td>Accounting standards and corporations law regulate the content of external financial reports</td>
</tr>
</tbody>
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<thead>
<tr>
<th><strong>Source of Data</strong></th>
<th><strong>Management Accounting</strong></th>
<th><strong>Financial Accounting</strong></th>
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<tbody>
<tr>
<td>Both financial &amp; non-financial data drawn from many sources – core accounting system, physical &amp; operational data from production systems, and market, customer &amp; economic data from sources external to the organisation</td>
<td>Financial data almost exclusively drawn from the organisation’s core transaction-based accounting system</td>
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<thead>
<tr>
<th><strong>Nature of Information</strong></th>
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</thead>
<tbody>
<tr>
<td>Past, current &amp; future-orientated; subjective; relevant; timely; and supplied at various level of detail to suit managers’ specific needs</td>
<td>Past, reliable, verifiable, not timely, not always relevant &amp; highly aggregated</td>
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### Management Accounting Information

<table>
<thead>
<tr>
<th><strong>SUPPORT ORGANISATION STRATEGIES</strong></th>
<th><strong>SUPPORT OPERATING PLANS</strong></th>
<th><strong>MONITOR &amp; MOTIVATE</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>- Capital budgets</td>
<td>- Operating budgets</td>
<td>- Actual v Planned performance</td>
</tr>
<tr>
<td>- Product development</td>
<td>- Analysis of product mix</td>
<td>- Bonus computations</td>
</tr>
<tr>
<td>- Analysis of potential acquisitions</td>
<td>- Cash flow plan</td>
<td>- Supplier quality</td>
</tr>
</tbody>
</table>

### Financial Accounting Information

<table>
<thead>
<tr>
<th><strong>Shareholder Reports</strong></th>
<th><strong>Other Stakeholder Reports</strong></th>
<th><strong>Government Reports</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>- Financial statements</td>
<td>- Credit reports</td>
<td>- Tax returns</td>
</tr>
<tr>
<td>- New releases</td>
<td>- Inventory reports for suppliers</td>
<td>- Cost reports</td>
</tr>
</tbody>
</table>

### Costing System (Overlap)

- Estimates the cost of goods & services, as well as the cost of organisational units, such as departments
- Product costs are prepared to meet external reporting purposes
- Different product costs may also be produced outside of the financial accounting system, to better managers decision-making needs
  - Managers: may need information about product costs for a range of strategic & operational purposes
    - Setting prices
    - Controlling operations
    - Making decisions about continuation of products
  - Financial: used to value inventory in a manufacturer’s balance sheet & cost of goods sold on the income statement

### Management Accountants within Organisations

**The Accounting Function**

- Chief Financial Officer (CFO)
  - Responsible for both management accounting & financial accounting activities
  - Acts as an adviser to managers
  - Influence resource management decisions across all management levels & functional areas of the organisation

### Management Accounting Processes & Techniques

Contemporary management accounting techniques have developed to support new organisational structures, systems & practises, as a response to a rapidly changing business environment

- Supports the organisation’s formulation & implementation of strategy
- Improving sources of competitive advantage through process improvement & cost management
- Provides information to help manage resources, through systems for planning (budgets) and control (performance measures)
- Provides estimates of the costs of the organisation’s inputs & outputs (goods & services)
- Support both the strategic & operational decision needs of managers
Management accountants:
- Contribute to the formulation & implementation of strategy
- Help managers to improve the organisation’s competitive advantage

**Strategy Concepts**

- **Vision**
  - Describes the desired future state or aspiration of an organisation
  - Used by senior managers

- **Mission Statement**
  - Defines the purpose & boundaries of the organisation
  - Tends to remain the same

- **Objectives** (goals)
  - Specific statements of what the organisation aims to achieve
  - Often quantified
  - Relating to a specific period of time
    - Profitability
    - Growth
    - Cost minimisation
    - Product leadership
    - Innovation
    - Product quality
    - Quality of service
    - Community service
    - Employee welfare
    - Environmental responsibility
  - Objectives often reiterate key themes relating to the mission statement

**Organisational Strategies**

Specify the direction that the organisation intends to take over the long term, to meet its mission and achieve its objectives

- **Formulating strategies** involve major decisions based on:
  - **In What Business Will We Operate?**
    - **Corporate Strategy:** decisions about the types of businesses in which to operate, which business acquire and divest, & how best to structure and finance the organisation
      - What products & services should we launch or discontinue?
      - What strategic alliances & business networks should we enter into?
      - What should we invest or divest in?
  - **How Should We Compete In That Business?**
    - **Business (Competitive) Strategy:** the way a business competes within its chosen market
      - If an organisation consists of several different business units, each with its own distinct market, each unit will develop a competitive strategy
      - **Competitive Advantage:** advantages that a business may have over another that are difficult to imitate
        - **Cost Leadership**
          - Economies of production
            - Produce more, for long periods, costs reduce
          - Superior process technologies
          - Tight cost control
            - Gulf-air
        - **Product Differentiation**
          - Superior quality
          - Customer service
          - Delivery performance
          - Product features
  - **What Systems & Structures Should We Have In Place To Support Our Strategies?**
    - **Strategy Implementation:** putting plans into place to implement and support a chosen business strategy
      - Performance measurement systems compare actual outcomes to budgets or other targets
      - E.g. introducing new structures and systems, such as setting up new business units, implementing new production processes
CONTRIBUTING TO STRATEGY

STRATEGIC PLANNING
- Long-term planning (3-5 years) to achieve the organisation’s objectives, usually undertaken by senior managers
- Corporate strategy & business strategy decisions
  - Deciding how a business competes in its chosen market
- Draws from costing, budgeting & performance measurement systems

IMPLEMENTING STRATEGIES
- Shared implementation responsibility
- Long-term plans link to budgeting system
- Performance measurement systems can compare actual outcomes to budgets and other targets

MAINTAINING COMPETITIVE ADVANTAGE
- Focus objectives & strategies on competitive advantage
  - Low cost:
    - Focus on product costs & tight cost control
  - Differentiation strategy:
    - Focus on measuring and reporting performance relating to differentiation (quality, delivery time, flexibility & innovation)

MANAGEMENT ACCOUNTING FOR PLANNING & CONTROL

PLANNING
- Broad concept that is concerned with formulating the direction for future operations
- Formulating BUDGETS
  - Detailed plan summarising the financial consequences of an organisation’s operating activities for a specific future period
  - Short-term / operational plan
  - Forecast demand for the product, then prepare sales budget, then manufacture, raw materials, labour
- Future-orientated

CONTROLLING
- Putting mechanisms in place to ensure that operations proceed according to plan and that objectives are achieved
- CONTROL SYSTEMS
  - Systems & procedures that provide regular information to assist in control
- Motivate employees to act in the interests of the organisation
  - Setting targets & measuring performance of managers and business units
  - Offering incentives

COSTING FOR DECISION MAKING
- Costing information produced by the financial accounting system may not be adequate for managers’ decisions
- Should include other product-related costs (marketing & customer support)
- Simplistic methods used to value products for reporting purposes are too inaccurate for managers’ decisions
  - Activity-based costing (ABC) to provide more accurate estimates of product costs
- Need ways of categorising, accumulating & analysing costs
  - Job costing systems
  - Process costing systems
  - Hybrid costing systems
  - Activity-based costing systems
- No two cost accounting systems are alike, as organisations differ, so too do costing systems
SOME IMPORTANT CONSIDERATIONS IN THE DESIGN OF MANAGEMENT ACCOUNTING SYSTEMS

BEHAVIOURAL ISSUES
- The ways in which information impacts individual behaviour
  - Managers, internal & external people to an organisation
  - Both expected & unexpected outcomes of management accounting systems
    - Individuals & groups

MOTIVATING MANAGERS & OTHER EMPLOYEES
- Performance measurement systems are a key source of information for motivation
- Measure performance in meeting performance targets
  - Basis for providing rewards
    - Positive feedback
    - Promotions
    - Bonuses
    - Pay rises

COSTS & BENEFITS OF INFORMATION
- Information is a commodity
  - Produced, purchased & consumed

COSTS:
- Salary cost of accounting personnel
- Purchasing & operating computers
- Gathering, processing & storing information
- Time spent by managers to read, understand & use the information

BENEFITS:
- Improved decisions
- More effective planning
- Greater efficiency of operations at lower costs
- Better control
- Improved customer & shareholder value

- Human information-processing limitations
- Need to trade-off costs & benefits of producing and reporting management accounting information
  - Intangible benefits of improved information cannot be determined with accuracy

CONDITIONS & MOTIVATIONS INFLUENCING MANAGEMENT ACCOUNTING DESIGN

CONTINGENCY THEORY
- Assumes that the design of an organisation's management accounting system may be influenced by a range of factors including:
  - External environment
  - Technology
  - Organisational structure
  - Organisational size
  - Strategy
  - Organisational & national culture
    - (Chenhall, 2003)

INSTITUTIONAL THEORY
- States that the design of an organisation's management accounting system may be influenced by the need for legitimacy & the tendency for firms to imitate the 'good practice' from other organisations
  - Access to resources such as labour, finance & technology
    - (Brignall and Modell, 2000; Baxter and Chua, 2003; Collier, 2006)

MANAGEMENT ACCOUNTING RESPONSES TO THE CHANGING BUSINESS ENVIRONMENT
- To improve shareholder value, firms need to increase competitiveness
- Traditional approaches
  - Budgeting systems
  - Costing systems
  - Financial performance measurement systems
- Modern approaches
  - Activity-based costing
    - More accurate method of determining the costs of goods, services, customers, projects & activities within an organisation
  - Economic value added
    - Measure of shareholder value