

Chapter 1: Information for creating value and managing resources

1. What is Management Accounting?

Management accounting refers to 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 and shareholder value

Customer value	Value a customer places on particular features of a product – satisfying customers is critical to achieving increased sales and market share → achieving shareholder value
Shareholder value	Involves improving the worth of a business from the shareholders' or owners' perspective – increased profitability, increased share price and dividends. Where a conflict between increasing customer or shareholder value arises, shareholder value is likely to be given priority

1.1. Management Accounting Systems

A **management accounting system** is an information system that produces the information required by managers to create value and manage resources

- Forms part of an organisation's wider management information systems
- Management accounting information can be provided on a regular basis and can include:
 - Cost estimates for producing goods and services
 - Information for planning and controlling operations
 - Information for measuring performance

1.2. Management Accounting Information

The focus of management accounting is on the needs of managers within the organisation. Because accounting standards apply only to external financial reports, there is **great flexibility** in deciding the type of information that should be generated for managers

Manager's information needs vary, and as the nature of the resources they manage varies, the type of management accounting information required will also vary. Other factors that cause management accounting systems to differ, include:

- Differences in production or service technologies
- Organisational structure and size
- External environment in which the organisation competes
- Levels of sophistication of computer systems

Management accounting information is relevant to managers from the top of the organisations through to managers in operational areas of a business.

- Senior managers = need information that provides them with an overview of entire organisation
- Middle managers = need information on their areas of responsibility
- Operational managers = need information to help them manage their specific operations on a day-to-day basis, to help meet performance target

1.3. Differences between Managements Accounting and Financial Accounting Information

	Management Accounting	Financial Accounting
Uses of information	Internal managers and employees at all levels	External shareholders, creditors, banks, securities exchange, trade unions and government agencies
Regulation	No accounting standards or external rules are imposed. Information is generated to satisfy managers information needs	Accounting standards and corporations law regulate the content of external financial reports
Source of data	Both financial and non-financial data drawn from many sources – the core accounting system; physical and operational data from production systems; and market, customer and economic data from sources external to the organisation	Financial data almost exclusively drawn from organisation's core transaction-based accounting system
Nature of the information	Past, current and future oriented; subjective; relevant; timely; and supplied at various levels of detail to suit manager's specific needs	Past; reliable; verifiable; not timely; not always relevant; and highly aggregated

1.4. Management Accounting and Strategy

Management accounting plays an important strategic role by contributing to the organisation's *formulation and implementation of strategy* and by helping managers *improve the organisations competitive advantage*

Vision	Desired future state or aspiration of an organisation. The vision is often used by senior management to focus the attention and energy of staff throughout the organisations
Mission statement	A statement that defines the purpose and boundaries of the organisation
Objectives	Specific statements of what the organisations aim to achieve, often quantified and relating to a specific period of time. Objectives are often focused on profitability, growth, innovation, quality of service, etc.
Strategies	The direction that the organisation intends to take over the long term, to meet its mission and achieve its objectives. In formulating strategies, decisions are based on the following questions: <ul style="list-style-type: none"> • In what business will we operate • How should we compete in that business • What systems and structures should we have in place to support our strategies?

1.4.1. Organisational Strategies

The first decision involves formulating a corporate strategy. **Corporate strategy** involves making decisions about the types of businesses in which the organisation as a whole will operate

The second type of business decisions involves business strategy. **Business (or competitive) strategy** is concerned with the way that a business competes within its chosen market (e.g. Jetstar would compete with virgin on basis of low cost, while Qantas will continue to be higher quality and full service)

The third type of decision is concerned with strategy implementation. **Strategy implementation** involves planning and managing the implementation of strategies. This can include new structures and systems, such as:

- Setting up new business units
- Implementing new production processes
- Implementing new software packages
- Developing new marketing approaches
- Introducing innovative HRM policies

1.4.2. Competitive Advantage

To create shareholder value, a business must develop and manage its sources of competitive advantage. **Competitive advantage** refers to advantages that a business may have over another, which are difficult to imitate. A firm can gain a sustainable competitive advantage through adopting a **business strategy of cost leadership and product differentiation**

Cost Leadership	A business strategy where a firm is a low cost producer, which allows the business to sell its goods or services at a lower price than competitors <ul style="list-style-type: none"> • Economies of scale in production • Superior process technology • Tight cost control • Cost minimisation - marketing, production, R&D and customer service
Product Differentiation	A business strategy whereby a firm derives competitive advantage from offering goods or services that have characteristics different from those offered by competitors. Differentiation strategies: <ul style="list-style-type: none"> • High quality products (Mercedes) • Strong brand image (Ray ban) • Superior customer service • Product innovation (Apple)

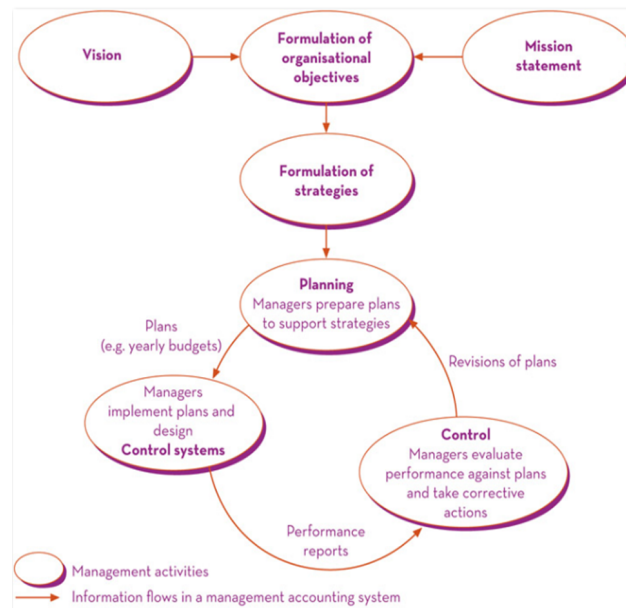
1.5. Planning and Control

Planning is a broad concept that is concerned with formulating the direction for future operations

- Necessary so an organisation can consider and specify all the resources that will be needed in the future
- A **budget** is a detailed plan summarising the financial consequences of an organisation's operating activities for a specific future time period
- Management accounting systems are designed to produce frequently required information (for control purposes), but need to be flexible enough to generate some information that is needed for infrequent or one off decisions

Controlling is the effective resource management must also include systems for control. **Control** involves putting in place mechanisms to ensure that operations proceed according to plan and that objectives are achieved.

- Plans will not be effective unless there is some way of ensuring they are achieved – this is the role of control systems
- **Control systems** are the systems and procedures that provide regular information to assist with control



In providing information for control, an aim of management accounting systems is to motivate employees to act in the interests of the organisations. Setting targets and then measuring performance against those targets can achieve this. When actual performance deviates significantly from expected performance, management can investigate the reasons for this deviation and corrective action can be taken to address performance problems.

Chapter 2: Cost Terms and Concepts

2.1 Management Accounting Information

2.1.1. Components of Management Accounting System

Management accounting systems are tailored to organisations needs but they often include the following:

Costing system	Estimates the <i>cost of goods or services</i> , as well as they cost of organisational units, such as departments
Budgeting system	Used to prepare a detailed plan, which shows the financial consequences of the organisations operating activities, for a specific future time period. The system estimates planned revenues and costs
Performance measurement system	Measures performance by comparing actual results with some target
Cost management system	Focuses on improving the organisations cost effectiveness through understanding and managing the real causes of costs

2.2 Traditional versus Modern Approaches to Management Accounting

2.2.1 Costing Systems

	Traditional Systems	Modern Systems
Costing Systems	Estimate the costs of organisational units, such as departments, and of products (goods or services). In analysing costs they assume that production volume is the only factor that can cause change	Far more detailed. Estimate the cost of the individual activities performed in the organisation and use this information to cost goods and services, customers, organisational unit and other items. Modern costing recognises that production volume can cause costs to change, but so can other factors. These systems are called activity-based costing systems .

2.2.2 Budgeting Systems

	Traditional Systems	Modern Systems
Budgeting Systems	Estimate planned revenues and costs for organisational units, such as departments. Department budgets are aggregated to obtain a budget for the overall organisation.	Modern approach is called activity-based budgeting and is far more detailed and built around activities

2.2.3 Performance Measurement Systems

	Traditional Systems	Modern Systems
Performance Measurement Systems	Provide measures of financial performance. Focus largely on controlling costs, by reporting differences between budgeted and actual costs. Monitor performance within the organisation	Provide measures of performance across a whole range of critical success factors , such as quality, delivery, innovation and sustainability, as well as financial performance. These factors derive from business' competitive strategy and are critical to its survival. Modern systems look at what is happening outside the organisations, analysing competitors, customer satisfaction and stakeholders. Includes balanced scorecard, benchmarking and activity-based performance measures

2.2.4 Cost Management Systems

	Traditional Systems	Modern Systems
Costing Systems	Provide information to help managers control costs, by focusing on differences between accrual and budgeted costs.	Far more pro-active in providing information to manage resources. Developed not only to control costs but reduce them. Identifies and eliminates wasteful activities

Components of management accounting systems	Traditional systems	Modern systems
<ul style="list-style-type: none"> Costing systems 	<ul style="list-style-type: none"> Focus on the costs of departments and products* 	<ul style="list-style-type: none"> Focus on the costs of activities, products, customers and suppliers
<ul style="list-style-type: none"> Budgeting systems 	<ul style="list-style-type: none"> Assume production volume is the only factor that can cause costs to vary Built around departments 	<ul style="list-style-type: none"> Recognise that a range of factors can cause costs to vary Built around departments and activities
<ul style="list-style-type: none"> Performance measurement systems 	<ul style="list-style-type: none"> Monitor <i>financial</i> performance Control what's going on inside the organisation 	<ul style="list-style-type: none"> Monitor performance <i>across a range of critical success factors</i>, such as quality, delivery and sustainability, not just financial performance Also look at what's happening <i>outside</i> the organisation, for example at customers, competitors and broader stakeholders Support the management of both customer value and shareholder wealth
<ul style="list-style-type: none"> Cost management 	<ul style="list-style-type: none"> No separate system Costs mainly controlled through the financial performance measurement system 	<ul style="list-style-type: none"> 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.

2.3 Cost Classifications: Different Classifications for Different Purposes

Before management accountants can classify costs, they need to consider how managers will use the information. Different cost concepts and classifications are used for different purposes. The total dollar amount of cost does not change; only the way we look at it

The same costs can be classified in a number of ways depending on the intended use of cost information

Basis of classification	Cost classifications	Used to:
<ul style="list-style-type: none"> Behaviour (see Chapter 3) 	<ul style="list-style-type: none"> Variable <ul style="list-style-type: none"> Unit level Engineered Fixed <ul style="list-style-type: none"> Committed Discretionary 	<ul style="list-style-type: none"> Plan (budget) costs Control costs Make decisions
<ul style="list-style-type: none"> Traceability 	<ul style="list-style-type: none"> Direct Indirect 	<ul style="list-style-type: none"> Estimate the cost of goods and services Estimate the cost of organisational units, such as departments or activities
<ul style="list-style-type: none"> Controllability (see Chapter 12) 	<ul style="list-style-type: none"> Controllable Uncontrollable 	<ul style="list-style-type: none"> Measure managers' performance Control costs
<ul style="list-style-type: none"> Value chain 	<ul style="list-style-type: none"> Upstream: <ul style="list-style-type: none"> Research and development Design Supply Manufacturing/production Downstream: <ul style="list-style-type: none"> Marketing Distribution Customer service 	<ul style="list-style-type: none"> Analyse cost structures and identify strategies Measure performance Control/manage costs
<ul style="list-style-type: none"> Manufacturing/product costs 	<ul style="list-style-type: none"> Direct material Direct labour Manufacturing overhead 	<ul style="list-style-type: none"> Estimate the cost of products Estimate the cost of goods sold for the income statement, and inventory for the balance sheet
<ul style="list-style-type: none"> Timing of the expense 	<ul style="list-style-type: none"> Product Period 	<ul style="list-style-type: none"> Prepare income statement and balance sheet