

ACC3200

notes

Based on
Management Accounting
8th edition

What's included?

- Comprehensive notes on all subject chapters
- Diagrams to summarise key information
- Important formulae for the exam

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Chapter 1 and 13: Financial performance measures

Business performance measures

Return on investment (ROI)

$$\text{Return on investment} = \frac{\text{profit}}{\text{invested capital}}$$

This can be further broken down into the following formula:

$$\text{Return on investment} = \frac{\text{profit}}{\text{sales revenue}} \times \frac{\text{sales revenue}}{\text{invested capital}}$$

The expanded formula shows two components of ROI: return on sales (amount of sales ending up as profit), and investment turnover (sales dollars generated by investment dollars).

To improve ROI, either or both of these measures can be improved.

Advantages	Disadvantages
Used widely	May encourage myopia (short term focus)
Encourages managers to improve profit and investment turnover	May encourage asset replacement deferment to keep invested capital lower
Is a relative measure for comparing different business units	May not cause goal congruence between managers and owners

The disadvantages listed above can be mitigated by:

- Using multiple financial measures
- Thinking of different ways to measure invested capital
- Using alternative measures

Chapter 14: Non-financial measures

Non-financial performance measures

Financial performance measures are not always actionable and can be limited in their guidance towards future action. Non-financial measures, by contrast, look across all aspects of the firm and assess drivers of future financial performance, i.e., causes. They are thus more actionable and direction-driven.

Some examples include product quality, customer satisfaction, and machine downtime.

Balanced Scorecard (BSC)

The BSC is a management tool that ties together financial and non-financial (hence, balanced) into a single report that covers objectives and goals for all dimensions of the firm. It is built around the firm's strategy and vision, and the objectives that will help the firm fulfil this strategy. A BSC is a useful way to translate a strategy into action.

Components of a Balanced Scorecard

The four typical perspectives (business dimensions) of a BSC are:

- Learning and growth
- Internal business processes
- Customer
- Financial

These can vary throughout different organisations.

Within each perspective there are objectives, and each objective has performance measures used to track the progress of meeting these objectives. Often the performance measures will have targets.

Lag and lead indicators

Performance measures can either be considered "lag", where they report on past progress, or "lead", where they are drivers of future performance.

Chapter 9: Budgeting part 2

Other types of budgeting

Rolling budgets

Rolling budgets are continually updated by adding a new time period (e.g., month) and dropping the last time period. For example, a 12-month rolling budget updates each month by adding the new month and dropping the oldest month.

Zero-based budgets

Zero-based budgets initially set all line items to zero, and reason has to be given for any number to be put in at all. However, this can be very time-consuming and sometimes causes managers to think too narrowly. It also isn't that effective at identifying areas of waste or redundancy.

Budgets for nonprofits and governments

These are similar to regular companies, but there is no sales budget. Instead, there is an allocation of resources received to the different services being provided. Some revenue budgets may exist regarding grants, donations, sponsorships, and the like.

Responsibility accounting

A responsibility centre is a unit in a business whose manager is responsible for its performance to a certain degree. This is part of the responsibility accounting system which divides budgets and performance based on the different responsibility centres in a firm.

Types of responsibility centres

- Cost: costs only
- Revenue: revenue only
- Profit: revenue and costs
- Investment: investments and profit

Controllability

Controllability is key in responsibility accounting because it is the degree of influence that a manager has over certain activities, and is thus often used as a filter for the

Direct material quantity variance

Measures the dollar value variance based on a change in quantity of direct material compared to budgeted amount.

$$\text{Direct material quantity variance} = \text{standard price} \times (\text{actual quantity} - \text{standard material quantity allowed given actual output})$$

Here, the standard quantity allowed means that based on the number of units actually produced, how much direct material should have been used according to the standard quantity per unit.

Causes of this variance could be the quality of the material, subpar maintenance of machines, or wrong standards set.

Direct labour variances

Direct labour rate variance

Measures the dollar value variance based on a change in the cost of direct labour compared to budgeted amount.

$$\begin{aligned} \text{Direct labour rate variance} \\ = \text{actual hours} \times (\text{actual labour rate} - \text{standard labour rate}) \end{aligned}$$

This variance could be affected by using a different employee mix compared to anticipated, or if wage rates changed.

Direct labour efficiency variance

Measures the dollar value variance based on a change in the amount of labour used compared to budgeted amount.

$$\begin{aligned} \text{Direct labour efficiency variance} \\ = \text{standard labour rate} \times (\text{actual labour hours} \\ - \text{standard labour hours allowed given actual output}) \end{aligned}$$

Variances here could be caused by using under- or over-skilled workers, inefficient work scheduling, subpar maintenance, or wrong standards being set.

Activity-based management (ABM) can then be utilised to make the decisions using the information from the customer profitability analysis.

Activity-based management (ABM)

ABM uses cost information from ABC to make decisions about activities, cost drivers, and performance, to improve overall value.

Process of ABM

1. Group activities into processes
2. Identify non-value-added activities
3. Determine cost drivers of these NVAAs
4. Investigate root cause cost drivers
5. Eliminate these root causes
6. Introduce performance measures to monitor progress of ABM

Customer performance measures

Customer performance measures help the business assess the value it creates for customers and vice versa. These can include measures that track market share, customer acquisition, customer retention, customer satisfaction, customer profitability.

Managing time

Time is a driver of costs and revenues, so it is important to track it for the sake of SCM. How long are resources tied up? How fast can we produce units? What are our delays? And so on.

Some typical time measures that business track are:

- Time to develop new product
- Time to break even on new product
- Reliability of scheduled deliveries
- Customer order response time (order receipt, production time, delivery time)

Some drivers of bad time management are poor quality products, bottlenecks in production processes, inefficient inventory management, poorly structured R&D for new products, and poorly structured ordering, producing, and delivery processes.

The supplier performance index (SPI) can also be used to evaluate supplier costs relative to purchase price.

$$\text{Supplier performance index} = \frac{\text{total supplier activity costs}}{\text{total purchase price}}$$

Supplier performance measures

There are many supplier performance measures, ranging across criteria of delivery, quality, cost, relationships, and more. Respectively, these could be:

- Percentage of ordered delivered on time
- Percentage of orders rejected due to bad quality
- Targets to help suppliers reduce their own manufacturing costs
- Supplier satisfaction surveys

Inventory management

Firms hold inventory (as opposed to simply being a conduit for selling to customers) so that they can deal with uncertainties, qualify for large volume discounts, or avoid future price increases or small order costs.

The way to manage how much inventory is held is by trying to balance:

- Ordering costs: incremental cost of making an order
- Carrying costs: cost of holding inventory in business
- Shortage costs: cost of being out of stock

Economic order quantity (EOQ)

Total annual cost

$$\begin{aligned} &= \left(\frac{\text{annual requirement}}{\text{order quantity}} \times \text{cost per order} \right) \\ &+ \left(\frac{\text{order quantity}}{2} \times \text{annual carrying cost per unit} \right) \end{aligned}$$

EOQ gives an “optimal” order quantity to minimise order and carrying costs.

$$\text{Economic order quantity} = \sqrt{\frac{2 \times \text{annual stock requirement} \times \text{cost per order}}{\text{annual carrying cost per unit}}}$$

Assumptions that underly EOQ are many, and they are one of its key critiques: