CMS Notes

Lecture 1

Management vs. financial accounting

- **Management accounting** measures and reports financial and non-financial information that assist managers in fulfilling the goals of the organisation. This information is used for decision making by those **internal** to the organisation.
- **Financial accounting** focuses on reporting to shareholders and regulatory bodies and is guided by generally accepted accounting principles. This information is used for decision making by those **external** to the organisation.

Management accounting systems (MAS)

Management accounting systems are tailored to the needs of an individual organisation, however the following are common components of MAS:

- Cost accounting system

Used to estimate the costs of goods and services, activities, departments etc.

- Budgeting system
  Used to estimate revenues and costs for organisational units
- Performance measurement system (PMS)
  Monitors financial and non-financial (e.g. quality, environmental, innovation)

performance by tracking actual performance against budgeted targets

- Cost management system
  Provides information to actively manage resources and increase organisational value

The role of management accountants

The **conventional role** of the management accountant is to prepare information for use by decision makers. Accounting is the main "quantitative" form of information in a business used to plan, coordinate and evaluate the diverse range of activities of an organisation is involved in.
In many firms the management accountant takes on a more **contemporary role** as a business partner or specialist advisor to support decision-making.

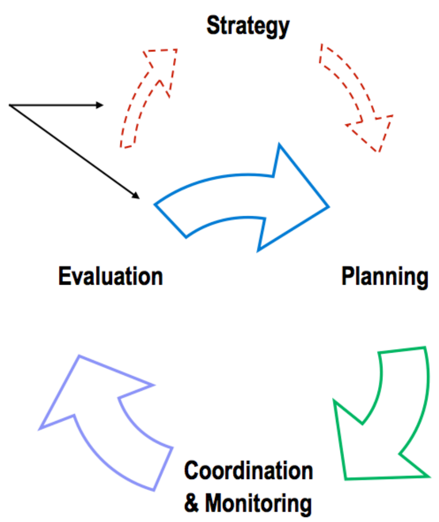
- Less involved in processing accounting transactions, more involved in interpreting and advising on key decisions (e.g. restructuring, new business opportunities)
- Involved in the development and implementation of strategy
- Require not only accounting skills but also business competency skills (e.g. leadership, communication, problem solving)

The most important use of accounting is to provide information that is useful for decision making. But what are the decisions or purposes that accounting information is useful for?

- Strategic planning of an organisations' future
- Resource allocation and planning decisions
- Control of operations and activities
- Performance measurement and evaluation of people
- Meeting external regulatory and legal reporting requirements.

This diagram depicts the **control cycle**.
Feedback is central to the control cycle. It involves examining past performance to find ways to improve future performance, including:

- Changing targets and goals
- Searching for new methods of operating
- Revising predictions about the future
- Adjusting the reward and compensation system
- Attention directing
- Problem solving



In 2004 Qantas introduced the low-cost airline Jetstar to compete with Virgin Blue.
In 2006 the operation of Australian Airlines is ceased.

Strategy
1) Differentiation
Creating competitive advantage through differentiation (e.g. innovation, product customisation, intensive marketing) meaning you can increase prices and margins.

2) Cost Leader
Pursuing the lowest cost of production. Requires efficient processes and aggressive cost management. Economies of scale are usually employed.

Resources and Planning
New planes, staff, terminals, inventory (e.g. food and beverages – how many to stock per flight?)

Control
Increased focus on efficiency and minimal cost. Competing through cost means that margins are small – cost information needs to be accurate!

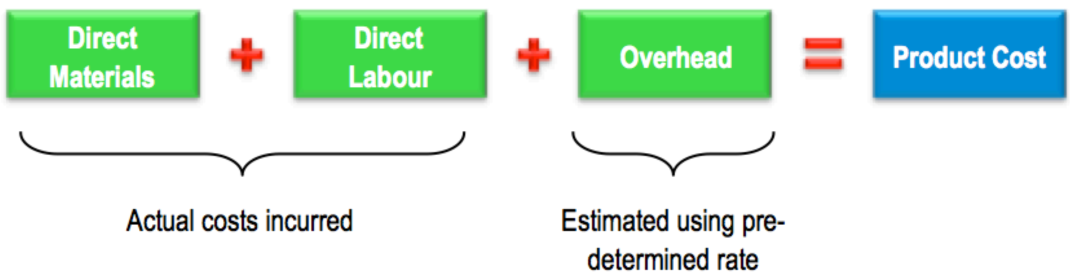
Performance evaluation
Success of venture requires both financial (profit, return on investment) and non-financial (safety, customer satisfaction, market share) outcomes to be met.

Product costing
When costing "cost objects" a major consideration concerning costs is whether the cost has a direct or indirect relationship to a particular cost object.

- **Direct costs** are those that are related and can be traced easily/economically to the cost object. These costs are assigned to the cost object directly, based on the measured quantity of the resources consumed.
- **Indirect costs** (also called **overheads**) are those that are related to a particular cost object that cannot be traced easily/economically to the cost object. Indirect costs are allocated to the cost object using a cost allocation method.
- **Prime Costs** includes all direct manufacturing costs (i.e. DL +DM)
- **Conversion Costs** comprise all manufacturing costs for transforming direct materials into finished goods (i.e. MOH + DL)
- **Period costs** are non-product costs that are expensed in the period in which they are incurred.

Categorizing costs
Whether a cost is categorized as direct or indirect depends on the cost object.

Product costing
In a **normal** costing system (using **absorption** costs), product costs are comprised of *actual* direct costs and *allocated* indirect costs:



A common means of pricing is the **cost-plus** method:

Product cost x (1+ Markup %) = Product price

MA in specific industries

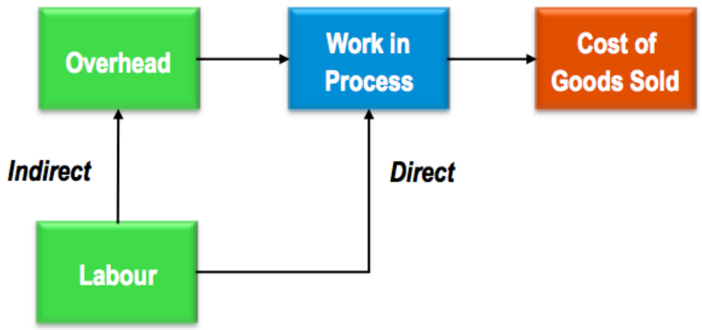
There are three main industry sectors:

- Services
- Merchandising
- Manufacturing

We will be generally concerned with manufacturing companies in CMS, but you need to understand the basics of all three.

Costing systems – Service sector

Service sector companies provide services or intangible products to their customers – for example, legal profession, accountants, banks, insurance companies etc.
These companies do not have any tangible products at the end of the accounting period. Labour costs are typically the most significant cost category, often being as high as 70% of total costs.

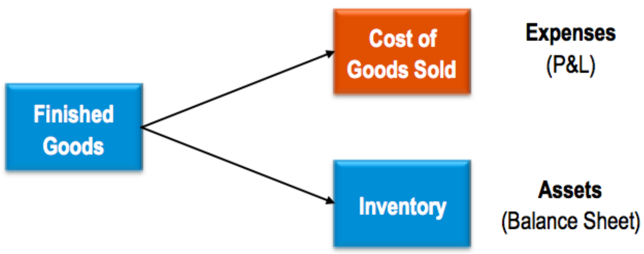


Although there exists WIP Inventory there is no inventory of Raw Materials and Finished Goods in the service sector.

Costing systems – Merchandising sector

Merchandising firms provide tangible products that they have previously purchased in the same form from their suppliers (e.g. supermarkets). Merchandising and manufacturing firms differ from service firms in their holding of inventory.

- Capitalised inventoriable costs include the purchase of goods held for resale (not sold by the end of the accounting period), and the manufacturing costs associated with the acquisition and conversion of raw materials into completed goods.
- Capitalised inventoriable costs become expenses and are included as part of COGS when the inventory items are sold.



Manufacturing Sector Companies

The manufacturing sector differs from the merchandising sector in that the products sold to customers are converted to a different form from that of the products purchased from suppliers.
Manufacturers typically have the following **inventory** (balance sheet) accounts:

1. *Raw Materials (RM)*
   Materials used in the production process.

Opening RM + Purchases – Closing RM = RM Used

2. *Work in Process (WIP)*

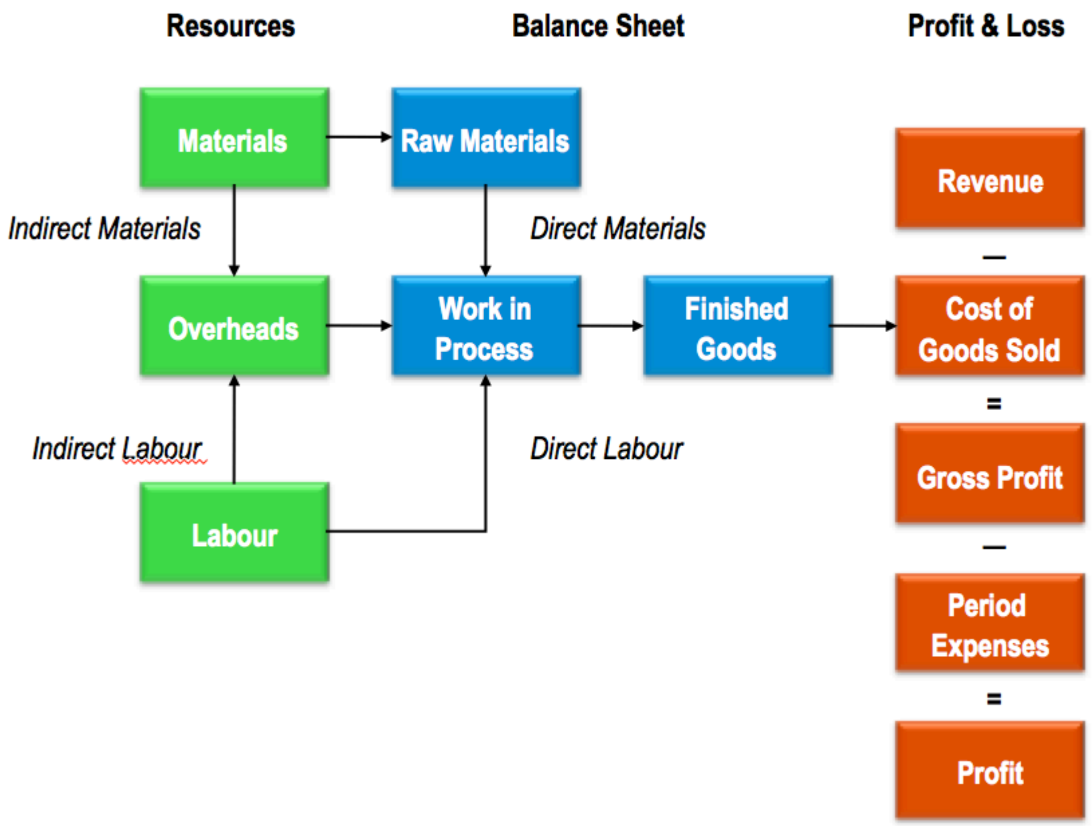
Goods which have been partially completed in the production process.

Opening WIP + New Production – Closing WIP = Cost of Goods Manufactured (COGM)

3. *Finished Goods (FG)*

Goods that have been fully completed which have not been sold.

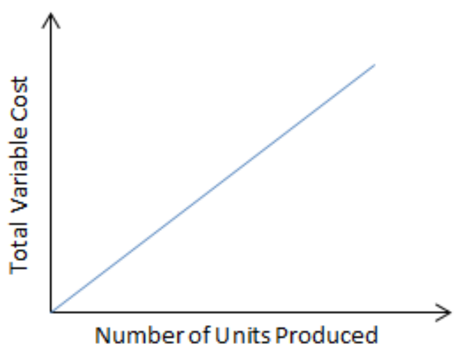
Opening FG + COGM – Closing FG = Cost of Goods Sold (COGS) *Expense on the P&L*

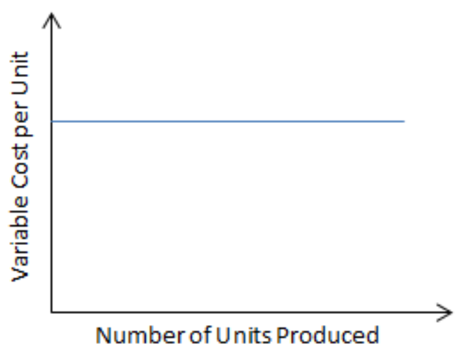


Cost categorization

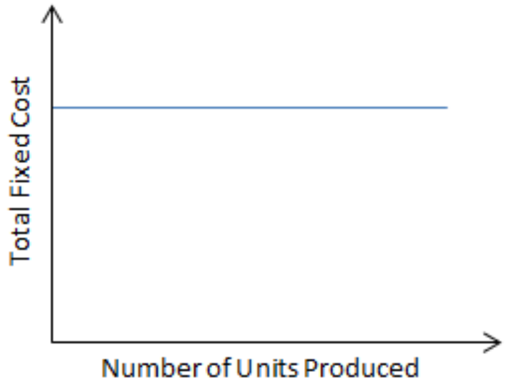
Costs can also be categorized in terms of how they change in relation to an activity (such as production). This is called cost behaviour.

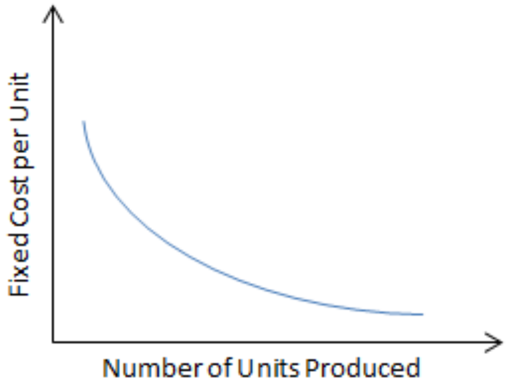
<u>Variable costs:</u>





Fixed costs:


Total Fixed Cost
Number of Units Produced


Fixed Cost per Unit
Number of Units Produced