BUS 338 Managerial Accounting

# Overview and Introduction to Managerial Accounting

By


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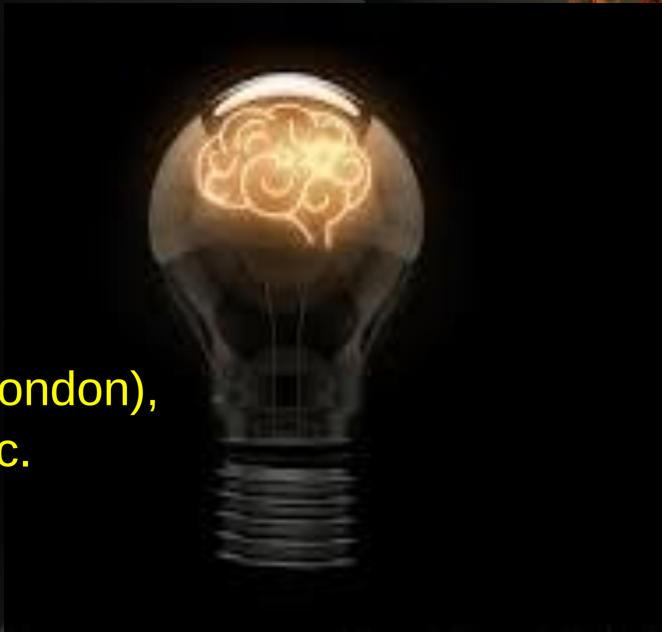

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# Course Overview

***What is Managerial accounting?***

Managerial accounting is popularly known as ***Management Accounting***. Therefore the two terms are used interchangeably.

There are many definitions of managerial or management accounting by various researchers and organizations, however, the most popular definition is given by the Chartered Institute of Management Accountants (CIMA):

"Management Accounting- as an integral part of management is concern with identifying, presenting, and interpreting information used for:

- Formulating Strategy
- Planning and controlling activities
- **Decision making**
- Optimizing the use of resources
- Disclosure to shareholders and other external parties
- Disclosure to employees, and
- Safeguarding assets

# The Users of Accounting Information

Accounting can be viewed as a language that communicates economic information to various parties (known as stakeholders) who have an interest in the organization.

- A stakeholder is any person, organization or group that has a direct or indirect interest in a company. Stakeholders fall into several groups (e.g. managers, shareholders and potential investors, employees, suppliers and customers, creditors and the government)

- Each of these stakeholder groups has its own requirements for information:

- Managers require information that will assist them in their decision-making and control activities; for example, information is needed on the estimated selling prices, costs, demand, competitive position and profitability of various products/services that are provided by the organization.

- Shareholders require information on the value of their investment and the income that is derived from their shareholding. Likewise, potential investors are interested in their potential returns.

# The Users of Accounting Information

- Employees require information on the ability of the firm to meet wage demands and avoid redundancies, as well as their potential for continued employment.

- Creditors and the providers of loan capital require information on a firm’s ability to meet its financial obligations.

- Analyst and government agencies such as the Central Statistical Office collect accounting information such as the details of sales activity, profits, investments, stocks, inventories, dividends paid, etc.

- Government taxation authorities require information on the amount of profits that are subject to taxation.

All this information is important for determining policies to manage the company.

# The Users of Accounting Information

As you can see, there are many different users of accounting information who require information for decision-making. The objective of accounting is to provide sufficient information to meet the needs of the various users at the lowest possible cost.

Therefore, the users of accounting information can be divided into two categories:

- ✓ Internal users within the organization, such as managers and other employees who need this information to operate their part of the business.

- ✓ External users such as shareholders, creditors and regulatory agencies outside the organization, to make necessary informed decisions regarding the company.

From this classification, we can distinguish between two branches of accounting, which reflect the internal and external users of accounting information.

# Differences between Managerial Accounting and Financial Accounting

Managerial accounting is concerned with the provision of information to people ***within the organization*** to help them make better decisions and improve the efficiency and effectiveness of existing operations, whereas financial accounting is concerned with the provision of ***information to external parties outside the organization***, including the general public.

As such, managerial accounting could be called ***internal reporting*** and financial accounting could be called ***external reporting***.

The major differences between managerial accounting and financial accounting are:

- **Legal requirements**: While there are statutory requirements for public limited companies to produce annual financial accounts, management accounting, by contrast, is entirely optional and information is produced only if the benefits it offers to the management exceed the cost of collecting it.

# Differences between Managerial Accounting and Financial Accounting

- **Focus on individual parts or segments of the business**: Financial accounting reports describe the whole of the business, whereas management accounting focuses on parts of the organization; for example, the cost and profitability of products, services, departments , customers and activities, etc.

- **Compliance to standards:** Financial accounting statements must be prepared to conform with GAAP of IFRS. In contrast, management accountants are not required to adhere to GAAP or IFRS. Instead, the focus is on serving the management's needs and providing information that is useful to managers in carrying out decision-making, planning and control functions.

- **Time dimension**: Financial accounting reports on what has happened in the past in an organization, i.e. it is ***historical***; management accounting on the other hand, is concerned with ***future information as well as past information***.

- **Report frequency and less emphasis on precision**: A detailed set of financial accounts is published annually and less detailed accounts are published semi-annually. management accounting reports on various activities may be ad hoc investigations or be prepared at daily, weekly or monthly intervals.

# Differences between Managerial Accounting and Cost Accounting

- Managerial accounting measures, analyzes, and reports financial and nonfinancial information that helps managers make decisions to fulfill the goals of an organization. On the other, cost accounting provides information for management accounting and financial accounting.

- Managers use management accounting information to develop, communicate, and implement strategy. On the other hand, cost accounting takes the perspective that collecting cost information is a function of the management decisions being made.

- Cost accounting is concerned with cost accumulation for inventory valuation to meet the requirements of external reporting and internal profit measurement, whereas management accounting relates to the provision of appropriate information for decision-making, planning, control and performance evaluation.

# Strategic Decisions and the Managerial Accountant

***What is a Strategy?***

A strategy specifies how an organization matches its own capabilities with the opportunities in the marketplace to accomplish its objectives. In other words, strategy describes how an organization will compete and the opportunities its managers should seek and pursue.

Companies and Businesses follow one of two broad strategies:

- **Cost leadership strategy**: here the companies provide quality products or services at low prices by judiciously managing their costs. Example are Pegasus airline, the popular “made in China” brands, etc.

- **Product differentiation strategy**: In this strategy, the companies generate their profits and growth on the basis of their ability to offer differentiated or unique products or services that appeal to their customers and are often priced higher than the less-popular products or services of their competitors. Example include; Apple, Gucci, Louis Vuitton, etc.

Deciding between these strategies is a critical part of what managers do. Management accountants work closely with managers in formulating strategy.

# Strategic Decisions and the Managerial Accountant

Management accountant provide information about the sources of competitive advantage of a company, for example, the cost, productivity, or efficiency advantage of their company relative to competitors.

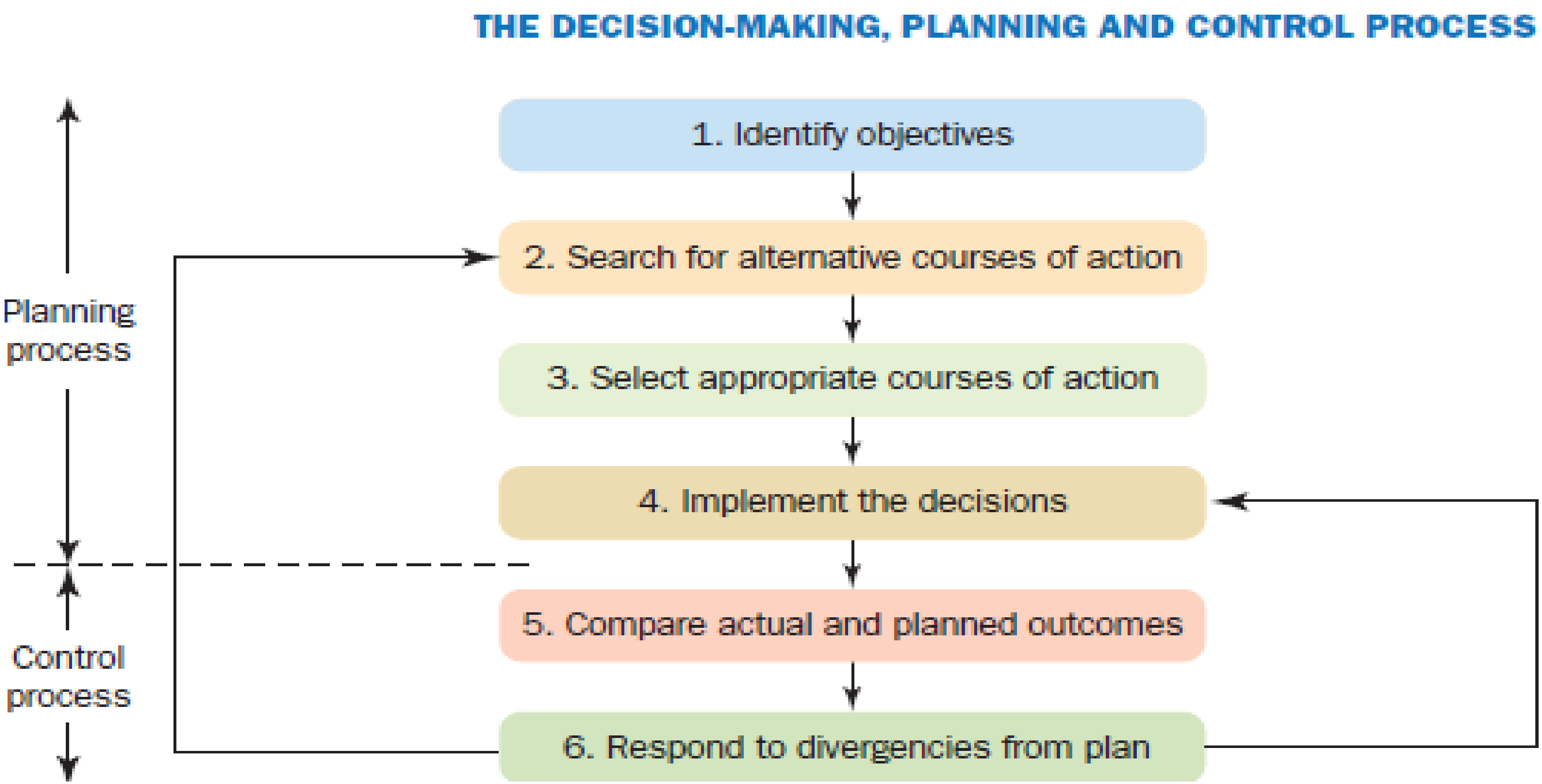
Therefore, Strategic cost management describes cost management that specifically focuses on strategic issues.

Managerial accounting information helps managers formulate strategy by answering questions such as:

- Who are our most important customers, and how can we be competitive and deliver value to them?
- What substitute products exist in the marketplace, and how do they differ from our product in terms of price and quality?
- What is our most critical capability? Is it technology, production, or marketing? How can we leverage it for new strategic initiatives?
- Will adequate cash be available to fund the strategy, or will additional funds need to be raised?

# Decision Making, Planning, and Control: The Five-Step Decision-Making Process

Information produced by management accountants must be judged in the light of its ultimate effect on the outcome of decisions. It is therefore important to have an understanding of the decision-making, planning and control process.



# Decision Making, Planning, and Control: The Five-Step Decision-Making Process

1. **Identify Objective**: From managerial accounting perfective, the only objective of a business firm is to maximize profits. There are three reasons to concentrate on this objective:

- ✓ It is unlikely that any other objective is as widely applicable in measuring the ability of the organization to survive in the future.
- ✓ It is unlikely that maximizing future profits can be realized in practice, but by establishing the principles necessary to achieve this objective you will learn how to increase profits.
- ✓ It enables shareholders as a group to know how much the pursuit of other goals is costing them.

2. **Searching for alternative courses of action**: The second stage in the decision-making model is a search for a range of possible courses of action (or strategies) that might enable the objectives to be achieved.

# Decision Making, Planning, and Control: The Five-Step Decision-Making Process

If the business is to survive, management must identify potential opportunities and threats in the current environment and take specific steps now so that the organization will not be taken by surprise by future developments.

In particular, the company should consider one or more of the following courses of action:

- ✓ Developing ***new products*** for sale in ***existing markets*** (product development);
- ✓ Developing ***new markets*** for ***existing products*** (market development);
- ✓ Developing ***new products*** for ***new markets*** (diversification).

The search for alternative courses of action involves the acquisition of information concerning future opportunities and environments; it is the most difficult and important stage of the decision-making process.

# Decision Making, Planning, and Control: The Five-Step Decision-Making Process

3. **Select appropriate alternative courses of action**: In order for managers to make an informed choice of action, data about the different alternatives must be gathered. For example, managers might ask to see projected figures on:

- the potential growth rates of the alternatives under consideration;
- the market share the company is likely to achieve;
- projected profits for each alternative.

The alternatives should be evaluated to identify which course of action best satisfies the objectives of an organization. The selection of the most advantageous alternative is central to the whole decision-making process and the provision of information that facilitates this choice is one of the major functions of management accounting.

# Decision Making, Planning, and Control: The Five-Step Decision-Making Process

4. **Implementation of the decisions**: Once the course of action has been selected, it should be implemented as part of the budgeting and long-term planning process. The budget is a financial plan for implementing the decisions that management has made.

This first four stages represent the decision-making or planning process. The final two stages represent the control process, which is the process of measuring and correcting actual performance to ensure the alternatives that are chosen and the plans for implementing them are carried out.

5. **Comparing actual and planned outcomes**: The managerial function of control consists of the measurement, reporting and subsequent correction of performance in an attempt to ensure that the firm's objectives and plans are achieved. To monitor performance, the accountant produces performance reports and presents them to the managers who are responsible for implementing the various decisions.

6. **Responding to divergences from plan**: This is the process of taking corrective action or modifying the plans if the comparisons indicate that actual outcomes do not conform to planned outcomes.

# Functions of managerial accounting

A cost and management accounting system should generate information to meet the following requirements. It should:

I. **Provide information for planning, control, performance measurement and continuous improvement**

II. **Provide relevant information to help managers make better decisions**: Information is required relating to the profitability of various segments of the business, such as products , services, customers and distribution channels, in order to ensure that only profitable activities are undertaken. Information is also required for making resource allocation and product/service mix and discontinuation decisions.

III. **Allocate costs between cost of goods sold and inventories for internal and external profit reporting**: Accounting rules require that we match costs with revenues to calculate profit. Consequently, any unsold finished goods inventories (work in progress) will not be included in the cost of goods sold, which is matched against sales revenue during a given period. In a firm that produces a wide range of different products it will be necessary, for inventory valuation purposes, to trace the costs to each individual product.

# Key Managerial Accounting Guidelines

Three guidelines help management accountants provide the most value to their companies in strategic and operational decision making:

- **Cost-Benefit Approach**: Managers continually face resource-allocation decisions, such as whether to purchase a new software package or hire a new employee. They use a cost-benefit approach when making these decisions: Resources should be spent if the expected benefits to the company exceed the expected costs.

- **Behavioural and Technical Considerations**: The cost-benefit approach is the criterion that assists managers in deciding on minimum of two alternatives. In making this decision, senior managers consider two simultaneous missions: one technical and one behavioral.

- The technical considerations help managers make wise economic decisions by providing them with the desired information in an appropriate format and at the preferred frequency.

# Key Managerial Accounting Guidelines

- The behavioral considerations on the other hand, encourage managers and other employees to strive for achieving the goals of the organization. Both managers and management accountants should always remember that management is not confined exclusively to technical matters. Management is primarily a human activity that should focus on how to help individuals do their jobs better

- Moreover, when workers underperform, behavioral considerations suggest that management systems and processes should cause managers to personally discuss with workers ways to improve performance rather than just sending them a report highlighting their underperformance.

- **Different Costs for Different Purposes**: A cost concept used for the external-reporting purpose of accounting may not be an appropriate concept for internal, routine reporting to managers.

# Roles of Management Accountant

It is the duty of management accountant to:

- ✓ Plan a profitable future for the business
- ✓ Install and maintain an accounting system to monitor the performance of the business
- ✓ Identify potential problems
- ✓ Record transactions by producing accounting statements
- ✓ Generate information to meet the following requirements:
  - Allocating costs between cost of good sold and inventories for internal and external reporting
  - Helping managers make decision
  - Planning controlling and performance measurement

# Any Question?

# THANK YOU

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# Questions Bank

1. Identify and describe the different users of accounting information.
2. Describe the differences between managerial accounting and financial accounting.
3. How is managerial accounting different from cost accounting?
4. How do management accountants support strategic decisions?
5. Explain each of the elements of the decision-making, planning and control process.
6. How do managers make decisions to implement strategy?
7. Describe the different functions of management
8. What guidelines do management accountants use?
9. List the roles of management accountant