



MANAGEMENT ACCOUNTING FOR BUSINESS

FIFTH EDITION

COLIN DRURY





Part One:

Introduction to Management and Cost Accounting

Chapter One:

Introduction to management accounting





1. Definition of accounting

- the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information.

1. Users of accounting information can be divided into two categories:

- (i) External parties outside the organization (financial accounting).
- (ii) Internal parties within the organization (management accounting).





3. Major differences between financial and management accounting:

- Statutory requirement for public companies to produce annual financial accounts, whereas there is no legal requirement for management accounting.
- Financial accounting reports describe the whole of the organization, whereas management accounting focuses on reporting information for different parts of the business.
- Financial accounting reports must be prepared in accordance with generally accepted accounting principles (e.g. SSAPs).
- Financial accounting reports historical information, whereas management accounting places greater emphasis on reporting estimated future costs and revenues.
- Management accounting reports are produced at more frequent intervals





The changing business environment

1. Organizations have faced dramatic changes in their business environment.
 - Move from protected markets to highly competitive global markets
 - Declining product life-cycles





2. To compete successfully in today's environment companies are:

- Making customer satisfaction an overriding priority.
- Adopting new management approaches.
- Changing their manufacturing systems.
- Investing in AMT 's.

3. Above changes are having a significant impact on the MAS.





Focus on customer satisfaction and new management approaches

1. Key success factors

- Cost efficiency –increased emphasis on accurate product costs and cost management.
- Quality –TQM,quality measures.
- Time – educed cycle time,focus on non-value-added activities.
- Innovation – responsiveness in meeting customer requirements.

Feedback on customer satisfaction.





2. Continuous improvement
 - Static historical standards no longer appropriate. Benchmarking.
3. Employee empowerment
 - Delegate more responsibility to people closest to operating processes and customers.
4. Social responsibility and corporate ethics





International convergence of management accounting

1. Management accounting practices can be observed at the macro or micro levels:
 - Macro refers to concepts and techniques
 - Micro refers to the behavioural patterns of use.
2. Tendency towards globalization at the macro level





3. Drivers of convergence include:

- Global competition
- Information technology (e.g. ERP systems)
- Standardization by transnational companies
- Global consultancy
- Use of global textbooks

4. At the micro level accounting information may be used in different ways due to influence of different national and local cultures





Primary functions of cost/management accounting systems

1. Inventory valuation for internal and external profit measurement
 - Allocate costs between products sold and fully and partly completed products that are unsold.
2. Provide relevant information to help managers make better decisions
 - Profitability analysis
 - Product pricing
 - Make or buy (Outsourcing)
 - Product mix and discontinuation





3. Provide information for planning, control and performance measurement

- Long-term and short-term planning (budgeting)
- Periodic performance reports for feedback control
- Performance reports also widely used to evaluate managerial performance
- Note that costs should be assembled in different ways to meet the above three requirements.





Inventory Valuation and Profit Measurement

1. Consider a situation where a company has produced three products (A,B and C) during the period. The total costs for the period are £40 000. Product A has been sold for £20 000, product B has been completed but is in finished goods stock (inventory),and product C is partly completed. Costs must be traced to products to value stocks and cost of goods sold.

	£	£
Sales	20 000	
Production cost	40 000	
Less Closing stocks (B =£18 000,C =£8 000)	<u>26 000</u>	
Cost of goods sold (A =£14 000)		<u>14 000</u>
Profit		<u>6 000</u>





2. Approximate but inaccurate *individual* product costs may be appropriate for profit measurement for financial accounting.

Example

Production expenses for the period =	£10m
Costs of products sold =	£7m
Cost of products <i>not</i> sold =	£3m

Note focus is on *aggregate* figures for financial accounting.





Cost information for providing guidance for decision-making

In theory cost information computed for stock valuation ought not to be used for decision-making.

Example: Short-term decision

A company is negotiating with a customer for the sale of XYZ. The cost recorded for stock valuation purposes is:

	£
Direct materials	200
Direct labour	150
Fixed overheads	<u>300</u>
	650





The maximum selling price that can be negotiated is £500 per unit for an order of 100 units over the next three months.

Should the company accept the order?

Spare capacity

Additional relevant costs ($100 \times £200$)	£20 000
Additional sales revenue	<u>£50 000</u>
Contribution to profits	<u>£30 000</u>





Operational control and performance measurement

The allocation of costs to *products* is not particularly useful for cost control purposes. Instead, costs should be traced to responsibility/cost centres to the person who is

Example accountable for controlling the costs.

Budgeted costs per unit:

	Product 1	Product 2	Product 3	Total
	£	£	£	£
Cost centre A	10	40	70	120
Cost centre B	20	50	80	150
Cost centre C	30	60	90	180
	60	150	240	450
Budgeted and actual production (units)	1000	1000	1000	





Operational control and performance measurement

Comparison of actual with budgeted costs by products

	Product 1	Product 2	Product 3
Total			
£000	£000	£000	£000
Budgeted cost	60	150	240
450			
(1,000 × £60)			
Actual cost	70	170	270
510			



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By Colin Drury

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Comparison of actual with budgeted costs by cost centres

	Cost centre A £000	Cost centre B £000	Cost centre C £000	Cost centre Total £000
Budgeted cost	120 (1,000 × £120)	150 1.9b	180	
Actual costs	130	150	230	
Variance	10A	-	50A	60A

Notes

1. Performance reports analysed in far more detail for cost centre managers.
2. Should not be used as a punitive device (identify areas where managers need to focus their attention).
3. Non-financial critical success factors are also of vital importance and should be included on the performance reports.

