

CHAPTER 1: FUNDAMENTALS OF MANAGEMENT ACCOUNTING

LEARNING OUTCOME

At the end of the chapter, you should be able to:

- TLO A1a : **Describe** the purpose and role of cost and management accounting within an organisation.
- TLO A1b : **Compare** and contra financial accounting with cost and management accounting.
- TLO A1c : **Outline** the managerial processes of planning, decision making and control.
- TLO A1d : **Explain** the differences between strategic, tactical and operational planning.
- TLO A1e : **Distinguish** between data and information.
- TLO A1f : **Identify** and explain the attributes of good information.
- TLO A1g : **Explain** the limitations of management information providing guidance for managerial decision-making.



Introduction

This chapter explains the purposes and roles of management accounting for an organisation in the managerial process of planning, monitoring and control, and decision making; and showing the differences between management accounting and financial accounting.

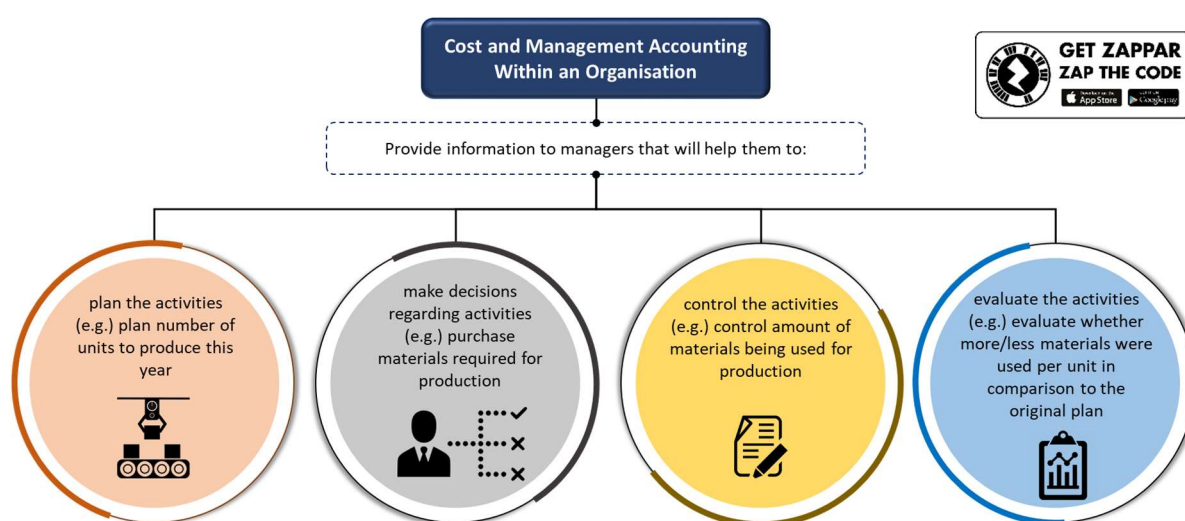
It also includes a brief introduction of data and information, and their differences.

1.1 Purpose and Role of Cost and Management Accounting Within an Organisation

Learning Outcome (ACCA Study Guide Area A)

A1a: Describe the purpose and role of cost and management accounting within an organisation.

Diagram 1.1: Purpose and role of cost and management accounting within an organisation



In the past, internal reporting for management functions was carried out manually and periodically as a by-product of the accounting system. Thus, internal reporting gave delayed and very limited information to management. Applications were then developed to assist the management in payroll, accounts payable and accounts receivable, sales, inventories and other functions.

The term "Management Information System" or "MIS" refers to a planned system of gathering, processing, storing and disseminating information necessary to carry out the management functions.

The Cost and Management Accountant may, for instance, use the MIS for the following purposes:

- Data collection
- Costing products and services
- Pricing for new products and services
- Short term and long-term decisions
- Preparation of budget statements
- Analysis of variances between the actual and budgeted results
- Ad-hoc reporting



Check Understanding

Topic 1.1 Purpose and Role of Cost and Management Accounting Within an Organisation

Learning Outcome (ACCA Study Guide Area A)

A1a: Describe the purpose and role of cost and management accounting within an organisation.

1. What is the purpose of management information?
 - A. Planning, control and decision-making only
 - B. Planning, control, decision-making and research and development
 - C. Planning only
 - D. Planning and control only

2. Which of the following are uses of the management accounting function?
(May have more than one answer)
 - A. Improving performance
 - B. Preparing financial statements
 - C. Assist in setting selling prices
 - D. Ascertain costs

1.2 Comparison Between Financial Accounting and Cost and Management Accounting








Learning Outcome (ACCA Study Guide Area A)

A1b: Compare and contrast financial accounting with cost and management accounting.

Financial Accounting (FA) and Management Accounting (MA)

Financial Accounting should not be confused with Management Accounting. Even though both Financial Accounting and Management Accounting are prepared using the same data, the data is analysed differently. Differences between Financial Accounting and Management Accounting can be summarised as follows:

Diagram 1.2: Differences in “Financial Accounting” and “Cost and Management Accounting”

| Financial Accounting | | Cost and Management Accounting |
|---|---|---|
| External users: <ul style="list-style-type: none"> Shareholders potential investors tax authorities finance providers financial analysts | Users  | Internal management. |
| Limited companies, by law, <u>must</u> prepare financial accounts. | Legal Requirement  | Entities have no legal obligation to prepare management accounts. |
| Standardised in accordance with the relevant IAS, IFRS and Companies Act requirements. | Format of Presentation  | Management discretion depending on the use. |
| Monetary nature. | Nature of Information  | Include both monetary and non-monetary measures. |
| Historical record of past operations. | Time Horizon  | Include both historical record and future planning tool. |
| <ul style="list-style-type: none"> i. Present the performance of an entity over a period (<u>SOPL</u>) ii. Present the financial position of the entity at the end of the period. (<u>SOPF</u>) | Purpose  | <ul style="list-style-type: none"> i. Aid management record, plan and control the operations ii. Aid internal decision-making process |
| Concentrate on the business as a whole, summarising all transactions from different functions. | Scope  | Focus on specific areas of business operations, such as production and sales. |





Check Understanding

Topic 1.2 Comparison Between Financial Accounting and Cost and Management Accounting

Learning Outcome (ACCA Study Guide Area A)

A1b: Compare and contrast financial accounting with cost and management accounting.

1. In comparison with a financial statement prepared in conformity with generally accepted accounting principles, a managerial accounting report is more likely to:
 - A. Be used by decision makers outside of the business organization.
 - B. Focus upon the operation results of the most recently completed accounting period.
 - C. View the entire organization as the reporting entity.
 - D. Be tailored to the specific needs of an individual decision maker.

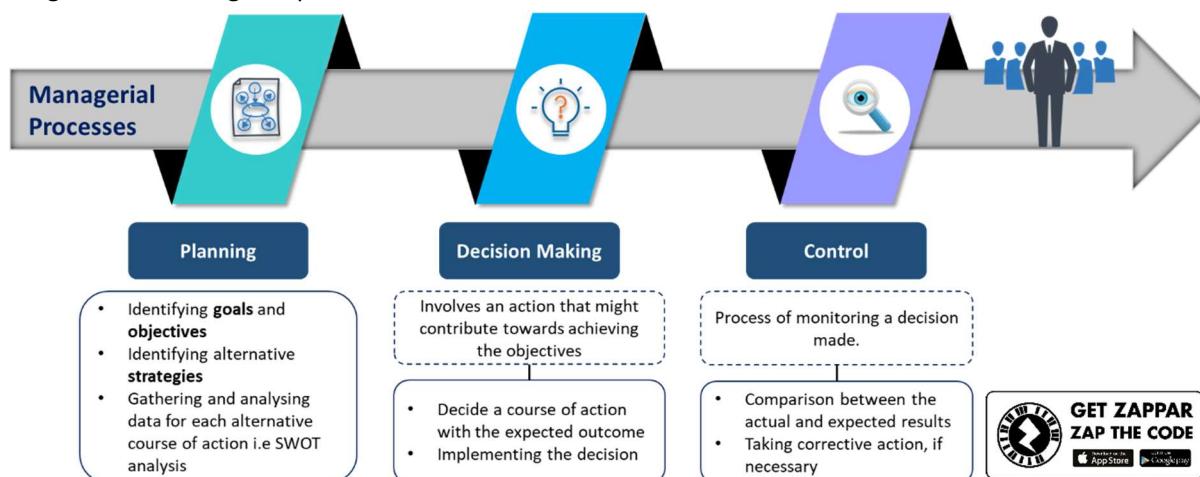
2. Which of the following are characteristics of management accounting information?
 - A. Forward looking
 - B. Legally required
 - C. Concerned with cost control
 - D. Follows clearly defined standards

1.3 Managerial Processes: Planning, Decision Making and Control

Learning Outcome (ACCA Study Guide Area A)

A1c: Outline the managerial processes of planning, decision making and control.

Diagram 1.3: Managerial processes



Managerial Processes

- **Planning**
 - Identifying **goals and objectives**.
 - Identifying alternative **strategies** that might lead towards achieving the goals and objectives.
 - Gathering and analysing data for each alternative course of action and to carry out SWOT analysis.
- **Decision Making**
Decision making involves Managers who have to make decision between alternative courses of action that might contribute towards achieving the objectives. Management accountant plays a vital role in providing useful information so that informed decision can be made by the managers.
 - Deciding on a course of action (stating the expected outcome).
 - Implementing the decision.

Planning

- A **goal** is a desired end-point, for e.g. to maximise profits.
- An **objective** is a specific, measurable and time-targeted step towards achieving the goal for e.g. to increase company profits by 50% within 6 months.
- A **strategy** is a possible course of action that might lead towards achieving the objective, e.g. to open two new branches at Location A and Location B for better accessibility.

- **Control**

Control is a process of monitoring a decision made. The actual results would be compared to the expected results of the decision, so that corrective actions can be taken when necessary.

- Gathering and analysing data on the actual outcome.
- Comparing and evaluating the actual outcome against the expected outcome.
- If necessary, taking corrective action to bring the actual outcome closer to the expected outcome.



Check Understanding

Topic 1.3 Managerial Processes: Planning, Decision Making and Control

Learning Outcome (ACCA Study Guide Area A, Topic):

A1c: Outline the managerial processes of planning, decision making and control.

- Decision making means:
 - Choosing between alternatives.
 - Controlling business activities.
 - Planning out a strategy.
 - Deciding on usage of resources.
- The following are activities of management, EXCEPT:
 - Planning resources' consumption.
 - Controlling the macro environment.
 - Applying appropriate measures to avoid wastage during production.
 - Choosing the best option between using part-time workers and full-time workers.

1.4 Strategic, Tactical and Operational Planning

Learning Outcome (ACCA Study Guide Area A)

A1d: Explain the difference between strategic, tactical and operational planning.

Diagram 1.4: Strategic, tactical and operational planning

| | Strategic Planning | Tactical Planning | Operational Planning |
|-------------------|-------------------------------------|--|-----------------------------------|
| Planned by | Top management | Middle management | Operational management |
| Time span | Long-term (longer than one year) | Medium-term (within one year) | Short-term (daily and monthly) |
| Scope | Whole organisation | Specific department, division or function | Specific day-to-day task |
| Frequency | Low (Irregular) | Medium (Regular) | High (Frequent) |



Check Understanding

Topic 1.4 Strategic, Tactical and Operational Planning

Learning Outcome (ACCA Study Guide Area A)

A1d: Explain the difference between strategic, tactical and operational planning.

1. The following statements refer to different types of planning in a large organisation:
 - (i) Strategic planning is concerned with both quantitative and qualitative matters.
 - (ii) Tactical planning is concerned with setting long term objectives.
 - (iii) Operational planning is concerned with a time horizon starting one year from now.

Which of these statements is/are correct?

- A. i only.
- B. i and ii.
- C. ii and iii.
- D. ii only.

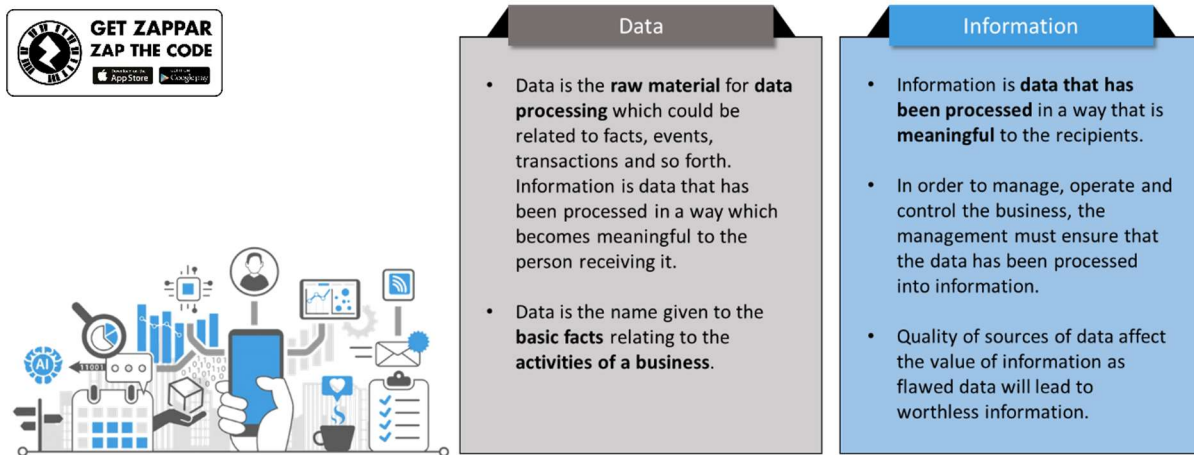
2. _____ is a process by which senior management make medium-term, detailed plans for the next year, for e.g. Employees' productivity measurements.
- A. Operational planning
 - B. Tactical planning
 - C. Strategic planning

1.5 Data and Information

Learning Outcome (ACCA Study Guide Area A)

A1e: Distinguish between data and information.

Diagram 1.5: Data and information



Example

Data in this example is a response collected from survey forms that rate customer satisfaction of each of the company products on a scale of 1 to 10 or a record that shows the daily mean temperature for each day in 2008.

Information are tables and charts produced based on data collected from customers to meet certain objectives such as to determine the number of customers who like product A, product B and so on, or an analysis that identifies the mean temperature for the year, the months with the highest and lowest mean temperature, and the days with the highest and lowest temperature in 2008.



Check Understanding

Topic 1.5 Data and Information

Learning Outcome (ACCA Study Guide Area A)

A1e: Distinguish between data and information.

True or False?

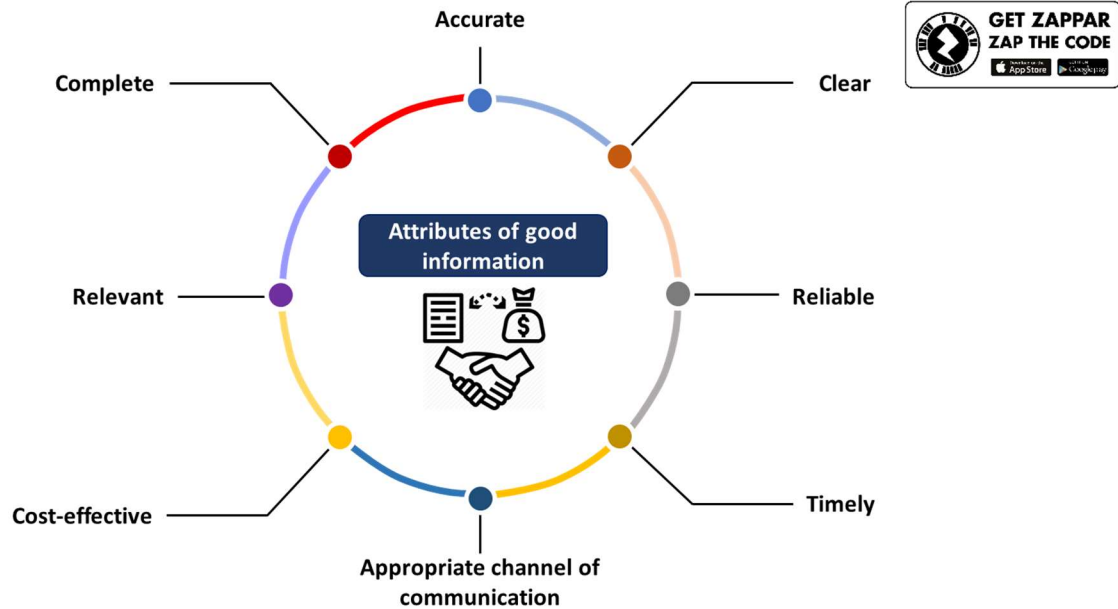
1. Data is information that has been processed in such a way as to be meaningful to its recipients.
2. Data is the raw material for data processing.
3. Data on its own is meaningless.

1.6 Attributes of Good Information

Learning Outcome (ACCA Study Guide Area A)

A1f: Identify and explain the attributes of good information.

Diagram 1.6: Attributes of good information



| Attributes | Explanations |
|---|---|
| Relevant | Information must be relevant to the purpose for which a manager wants to use it. |
| Complete | A user should have all the information he needs for decision making. Without a complete picture, the user may make an unsuitable decision. |
| Accurate | Incorrect information could result in serious and damaging consequences. |
| Clear | Information must be clear to the user. If the user does not understand the information properly, he would not be able to use it correctly. Lack of clarity is one of the causes of communication breakdown. It is therefore important to choose the most appropriate presentation medium or channel of communication. |
| Reliable | Information must be reliable, which includes the sources of the information. Unreliable information would affect the quality of the decision made as the assumption formulated may not be accurate. |
| Timely | Information provided to a decision maker must be timely, which means it is not outdated. Information which is outdated may cause monetary loss within an organisation as the decision made based on that information may not be accurate. |
| Appropriate channel of communication | Information must be channelled to the user using the appropriate channel of communication to facilitate user to understand the information. For example, it is easier for user to understand the graph if it is sent via email rather than through a verbal explanation on the phone. |
| Cost-effective | Information is valuable to an organisation as it assists the user in decision making. However, it is important to ensure that the cost incurred to collect the information does not exceed the value or benefit of the information. |



Check Understanding

Topic 1.6 Attributes of Good Information

Learning Outcome (ACCA Study Guide Area A)

A1f: Identify and explain the attributes of good information.

1. Which of these statements is/are correct?
 - i. Information must be relevant to the purpose for which a manager wants it.
 - ii. Information should be accessible via the appropriate channels of communication and to the right people.
 - iii. The cost of producing information should be greater than the value of the benefits of that information to management.

A. i, ii and iii
B. i and ii only
C. i and iii only
D. ii and iii only

2. Information should be _____ because using incorrect information could cause serious and damaging consequences.

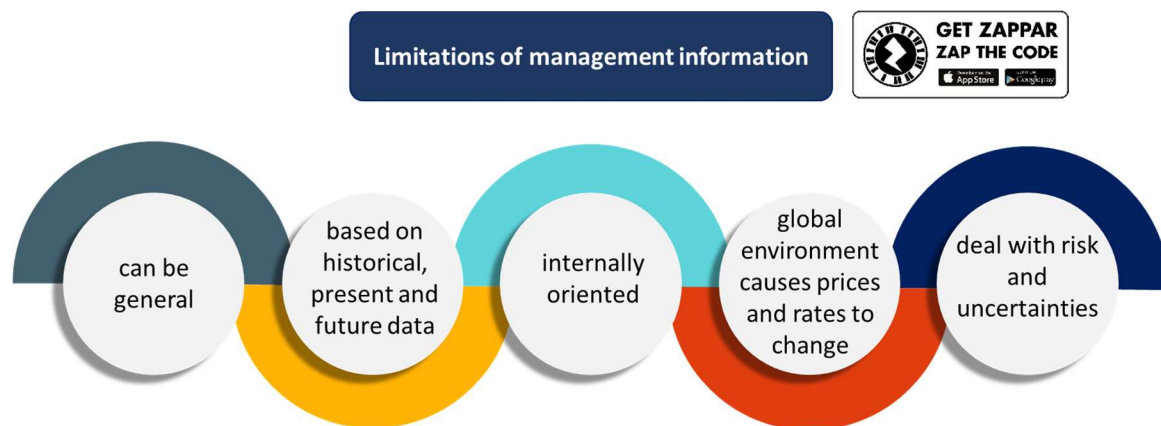
A. Timely
B. Complete
C. Accurate
D. Clear

1.7 Limitations of Management Information

Learning Outcome (ACCA Study Guide Area A)

A1g: Explain the limitations of management information in providing guidance for managerial decision-making.

Diagram 1.7: Limitations of management information



Limitations:

- i. Management accounting information such as monthly management reports are not tailor made for decision making purpose. The information can be general, representing the whole organisation or the division or a function within the organisation.
- ii. Management accounting information are based on historical, present and future data. Decision making require futuristic information that can be used to estimate the possible outcome of a decision.
- iii. Management accounting information are internally oriented. Decision making require assessment of external opportunities and threats.
- iv. Global environment causes prices and rates to change. Changing values directly affect the costing function. Therefore, serves as a limitation.
- v. Decision makers need to deal with risk and uncertainties imposed by uncertain future events and environmental factors. Conventional management accounting information does not provide enough assistance to clarify uncertainties and risk.



Check Understanding

Topic 1.7 Limitations of Management Information

Learning Outcome (ACCA Study Guide Area A)

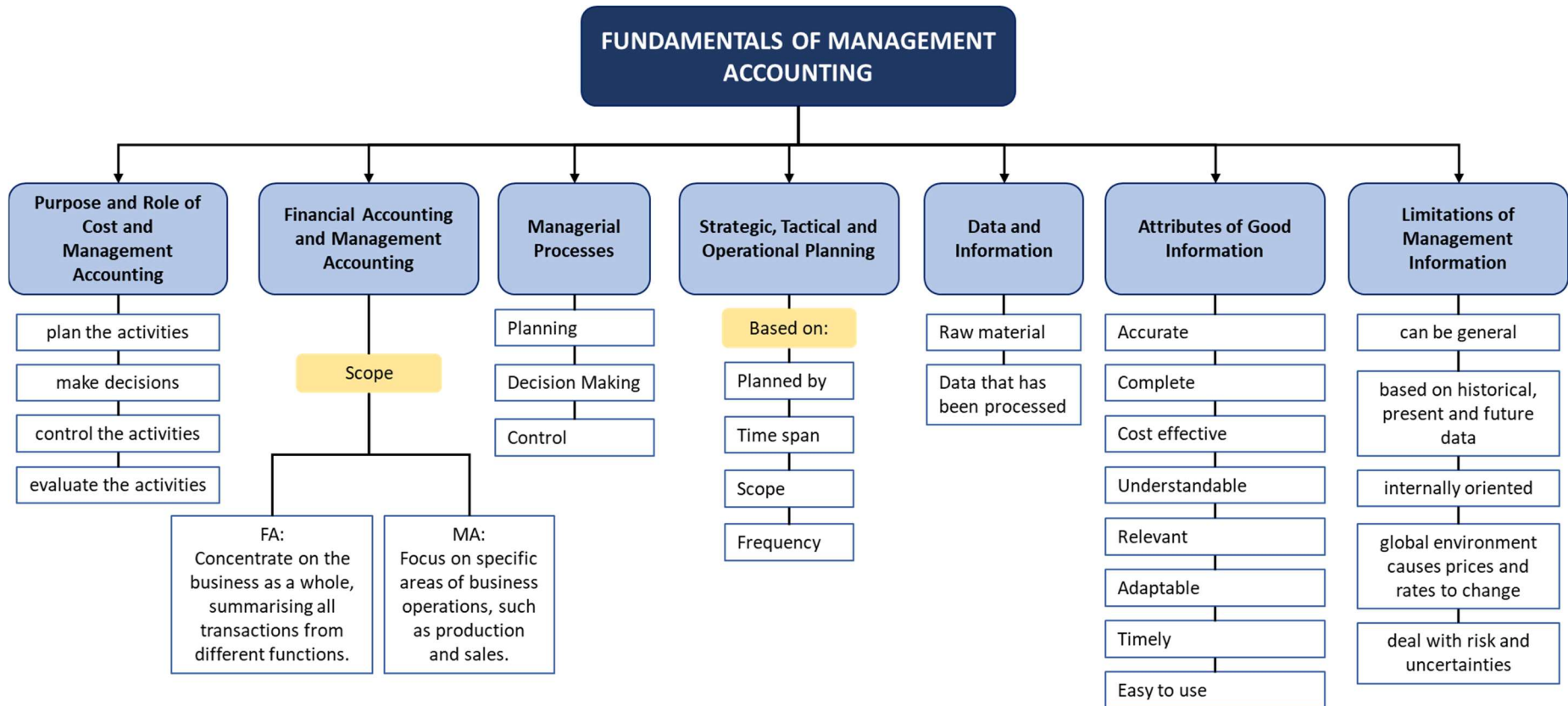
A1g: Explain the limitations of management information in providing guidance for managerial decision-making.

1. Which of the following are weaknesses of management accounting?
(May have more than one answer)
 - A. They do not have a fixed format, making comparisons difficult.
 - B. They have flexible formats that make comparison difficult.
 - C. They are not relevant for decision-making.
 - D. Highly subjective information may skew results.

2. The main limitation of cost accounting information is that:
 - A. It (information) cannot be delayed.
 - B. It must be purely financial.
 - C. It has to be complete.
 - D. It has to be accumulated by cost accountants.

1.8 Chapter 1 Summary

Chapter 1: Summary of Fundamentals of Management Accounting



1.9 Chapter 1 Understanding Checker: Answer

Topic 1.1 Purpose and Role of Cost and Management Accounting Within an Organisation

1. A
2. A, C&D

Topic 1.2 Comparison Between Financial Accounting and Cost and Management Accounting

1. D
2. A, C

Topic 1.3 Managerial Processes: Planning, Decision Making and Control

1. A
2. B

Topic 1.4 Strategic, Tactical and Operational Planning

1. A
2. B

Topic 1.5 Data and Information

1. False
2. True
3. True

Topic 1.6 Attributes of Good Information

1. B
2. C

Topic 1.7 Limitations of Management Information

1. A, B, D
2. C