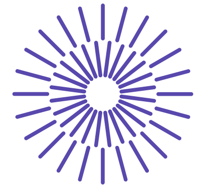
TECHNICAL UNIVERSITY OF LIBEREC



New Opportunities for the Development of Education at the Technical University of Liberec

Specific objective A2: Development in the field of distance learning, online learning and blended learning

NPO_TUL_MSMT-16598/2022

Learning Material for VM New Challenges for Management Accounting.

Chapter 1: Introduction to Managerial Accounting

Ing. Lenka Strýčková, Ph.D.

Funded by the European Union
NextGenerationEU

CZECH RECOVERY PLAN

MINISTRY OF EDUCATION, YOUTH AND SPORTS

Chapter 1: Introduction to Managerial Accounting

Learning objectives

1. Distinguish financial accounting from management accounting.
2. Understand how management accountants support strategic decisions.
3. Describe the set of business functions in the value chain and identify the dimensions of performance that customers are expecting of companies.
4. Explain the five-step decision-making process and its role in management accounting.
5. Describe three guidelines management accountants follow in supporting managers.

Key words

budget, costs, cost accounting, financial accounting, managerial accounting, planning, strategic decisions, value chain

Contents

1.1	Financial vs. Managerial Accounting	2
1.2	Strategic Decisions	3
1.3	Value Chain	4
1.4	Decision-Making Process and its Role in Management Accounting	5
Summary		8
References		8

1.1 Financial vs. Managerial Accounting

Managerial (Management) Accounting measures, analyzes, and reports financial as well as nonfinancial information necessary for fulfilling the organizational goals. It helps management in the processes of decision making, planning and control, and so on.

Management accounting information plays a vital role in development of business ideas, communication, and implementation of strategies. Managers can use the information to coordinate product design, production, and for marketing decisions and to evaluate performance.

Cost accounting is concerned with cost accumulation for inventory valuation to meet the requirements of external reporting and internal profit measurement, whereas **managerial accounting** relates to the provision of appropriate information for decision making, planning, control and performance evaluation. It is apparent from an examination of the literature that the distinction between cost accounting and management accounting is extremely vague with some writers referring to the decision-making aspects in terms of 'cost accounting' and other writers using the term 'management accounting'; the two terms are often used synonymously.

Financial Accounting measures and records business transactions and provides financial statements that are based on Generally Accepted Accounting Principles (GAAP). The information is used not only by the internal users of an organization, such as managers, but also by external users such as suppliers, investors, bank, government, and so on. (Figure 1.1 summarizes the major differences between management accounting and financial accounting.)

	Management Accounting	Financial Accounting
Purpose of information	Help managers make decisions to fulfill an organization's goals	Communicate organization's financial position to investors, banks, regulators, and other outside parties
Primary users	Managers of the organization	External users such as investors, banks, regulators, and suppliers
Focus and emphasis	Future-oriented (budget for 2013 prepared in 2012)	Past-oriented (reports on 2012 performance prepared in 2013)
Rules of measurement and reporting	Internal measures and reports do not have to follow GAAP but are based on cost-benefit analysis	Financial statements must be prepared in accordance with GAAP and be certified by external, independent auditors
Time span and type of reports	Varies from hourly information to 15 to 20 years, with financial and nonfinancial reports on products, departments, territories, and strategies	Annual and quarterly financial reports, primarily on the company as a whole
Behavioral implications	Designed to influence the behavior of managers and other employees	Primarily reports economic events but also influences behavior because manager's compensation is often based on reported financial results

Figure 1.1 Differences between Management and Financial Accounting
Source: DATAR, S. M., RAJAN, M. V. Managerial Accounting, Making Decisions and Motivating Performance

Cost management is used to describe the approaches and activities of managers to use resources to increase value to customers and to achieve organizational goals. Decisions such as whether to enter new markets, implement new organizational processes, and change product designs form a part of cost management decisions.

Cost management is not only about reducing costs. It has a broad focus and includes taking decisions such as to incur additional costs with the goal of enhancing revenues and profits.

1.2 Strategic Decisions

Strategy specifies how an organization matches its own capabilities with the opportunities in the marketplace to accomplish its objectives. It provides ways to successfully face competition and sustain business. It also helps identify opportunities that an organization can explore profitably.

Companies follow one of the two broad strategies:

1. **The cost leadership strategy:** Companies provide quality products or services at low prices by judiciously managing costs.
2. **The product differentiation strategy:** Companies advocate organizational growth by offering differentiated or unique products or services that appeal to customers at prices higher than those charged by competitors.

Strategic cost management describes cost management that specifically focuses on strategic issues. It occurs when strategies are applied to meet organizational goals.

Managers can formulate strategy with the help of management accounting information by:

- identifying important customers, and becoming more competitive and delivering more value to them,
- identifying substitute products that exist in the marketplace; their specialties that have helped them to sustain competition; price , cost, and quality offered by the substitute products,
- finding the most critical capability of the organization, and the way in which such capabilities can be leveraged for building new strategies,
- managing cash flows to fund strategy, raising additional funds, if needed.

1.3 Value Chain

Value chain is a sequence of business functions in which customer usefulness is added to products. Different companies create value in different ways – cost and efficiency, quality, innovation, building consumer brand, etc.

There are six primary business functions in a **value chain** which are:

1. Research and development (R&D) is the first step taken before an organization commences business. It aids in generating and experimenting with ideas related to new products, services, or processes.
2. Design of products and processes is important to ensure customer acceptance of products or services. It includes detailed planning, engineering, and testing of products and processes.
3. After R & D and designing of product the actual production activities starts. Production comprises several activities such as procuring, transporting and storing ("inbound logistics"), coordinating, and assembling ("operations") resources to produce a product or deliver a service.
4. The goods produced must be made available to the customers at the right time. Hence, the need for marketing. Marketing (including sales) stand for promoting and selling products or services to customers or prospective customers.
5. Distribution activities are necessary to deliver the products or services to the customers at the right time and at the right prices. Distribution activities involve processing orders and shipping products or services to customers ("outbound logistics").
6. Customer service activities are mostly undertaken after a sale is complete. It refers to the provision of after-sales service to customers.

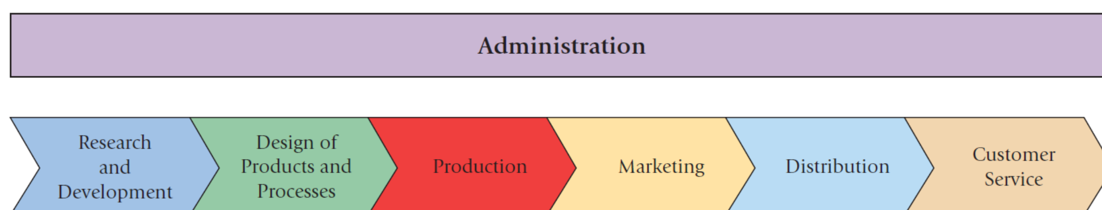


Figure 1.2 The Value Chain
Source: DATAR, S. M., RAJAN, M. V. Managerial Accounting, Making Decisions and Motivating Performance

Supply chain describes the flow of goods, services, and information from the initial sources of materials and services to the delivery of products to consumers, regardless of whether those activities occur in the same organization or in other organizations.

1.4 Decision-Making Process and its Role in Management Accounting

Companies generally face rising production or service costs. This requires the management to take decisions punctually. **The process of decision making** can be broken down into five simple steps.

These steps help to organize the activities needed to be undertaken to achieve organizational goals.

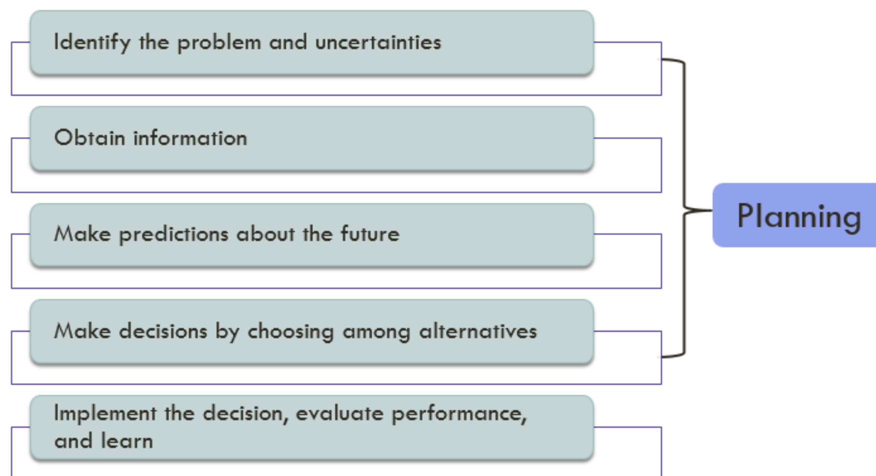


Figure 1.3 Decision-Making Process in Management Accounting
Source: DATAR, S. M., RAJAN, M. V. Managerial Accounting, Making Decisions and Motivating Performance

Step 1: Identify the problem and uncertainties.

Step 2: Obtain information. Gathering information before arriving at a decision or the best course of action helps managers gain a better understanding of uncertainties.

Step 3: Make predictions about the future. Making predictions about the future requires sound judgment and they must be free of any biases. The predictions should be made keeping in mind the competitor moves and the current market situation.

Step 4: Make decisions by choosing among alternatives. Aligning decisions with strategy enables an organization to achieve its goals. The alternatives must be thoroughly evaluated from a cost-benefit perspective before either accepting or rejecting them.

Steps 1 through 4 are collectively referred to as **planning**. **Planning** comprises selecting organization goals and strategies, predicting results under various alternative ways of achieving those goals, deciding how to attain the desired goals, and communicating the goals and how to achieve them to the entire organization.

Step 5: Implement the decision, evaluate performance, and learn. Management accountants collect information to follow through on how actual performance compares to planned or budgeted performance (also referred to as scorekeeping).

A budget is the quantitative expression of a proposed plan of action by management and is an aid to coordinating what needs to be done to execute that plan. A budget serves as much as a control tool as a planning tool because a budget is a benchmark against which actual performance can be compared.

A control is the comparison of actual performance to budgeted performance. Control comprises:

- taking actions that implement the planning decisions,
- deciding how to evaluate performance,
- providing feedback and learning to help future decision making.

Performance report is a report that compares the difference between actual results achieved and the budgeted results. The difference is expressed as a percentage of budgeted amount and analyzed if it is favorable or unfavorable to the running of the organization. The comparisons may be made among costs or revenues.

The performance report spurs investigation and learning. It motivates managers to investigate into the reasons that led to differing results in comparison with budgeted results.

Learning can lead to changes in goals, strategies, the ways decision alternatives are identified, and the range of information collected when making predictions. It can also lead to changes in managers in rare instances.

Figure 1.4 illustrates how accounting aids decision making, planning, and control at the Daily News.

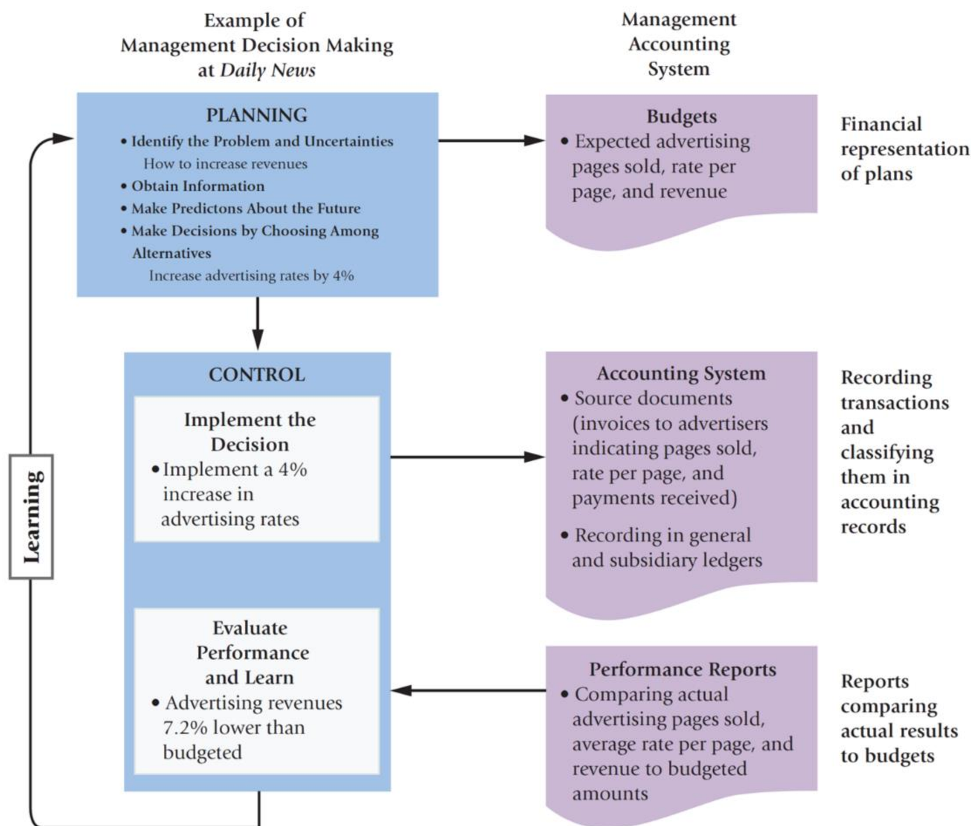


Figure 1.4 Example of Management Decision Making
Source: DATAR, S. M., RAJAN, M. V. Managerial Accounting, Making Decisions and Motivating Performance

There are **three guidelines** that help management accountants provide the most value to their companies in strategic and operational decision-making:

1. **Employ a 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 such decisions. Managers should spend resources if the expected benefits to the company exceed the expected costs. They generally rely on management accounting information to quantify expected benefits and expected costs (although all benefits and costs are not easy to quantify).
2. Give **full recognition to behavioral and technical considerations**: In making important decisions, senior managers keep technical and behavioral considerations in mind.

- **Technical considerations** help managers make wise economic decisions by providing them with the desired information in an appropriate format and at the preferred frequency.
- **Behavioural considerations** must be addressed as management is primarily a human activity that should focus on encouraging individuals to do their jobs better.

3. **Use 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.

   For example, companies generally incur substantial advertising costs. For external reporting to shareholders, advertising costs are fully expensed in the income statement in the year they are incurred as per GAAP. However, for internal purposes of evaluating management performance, the advertising costs could be capitalized and then amortized or written off as expenses over several years.

   Management accountants should have an understanding of the type of cost that they have to analyse and the type of report in which it will be used to treat the cost in the most appropriate manner.

Summary

Managerial (Management) Accounting measures, analyzes, and reports financial as well as nonfinancial information necessary for fulfilling the organizational goals. It helps management in the processes of decision making, planning and control, and so on.

Cost accounting is concerned with cost accumulation for inventory valuation to meet the requirements of external reporting and internal profit measurement.

Financial Accounting measures and records business transactions and provides financial statements that are based on Generally Accepted Accounting Principles (GAAP). The information is used not only by the internal users of an organization, such as managers, but also by external users such as suppliers, investors, bank, government, and so on.

Strategic cost management describes cost management that specifically focuses on strategic issues. It occurs when strategies are applied to meet organizational goals.

References

ATRILL, P., McLANEY, E. *Management Accounting for Decision Makers*. 9th ed. Harlow: Pearson, 2019. ISBN 978-1-292-20458-1.

BHIMANI, A. et al. *Management and Cost Accounting*. 7th ed. Harlow: Pearson, 2019. ISBN 978-1-292-23271-3.

BRAGG, M. S. *Cost Accounting Fundamentals. Essential Concepts and Examples*. 5th edition. Centennial, Colorado: AccountingTools, Inc., 2016. ISBN 978-1-938910-69-2.

BRAUN, K. W., TIETZ, W. M. *Managerial Accounting*. 4th ed. Harlow: Pearson, 2015. ISBN 978-0134128528.

DATAR, S. M., RAJAN, M. V. *Managerial Accounting: Decision Making and Motivating Performance*. 1st ed. Harlow: Pearson, 2015. ISBN: 978-0137024872.

DRURY, C. *Cost and Management Accounting*. 8th ed. Hampshire: Cengage Learning EMEA, 2015. ISBN 978-1-4080-9388-7.

DRURY, C. *Management and Cost Accounting*. 9th ed. Hampshire: Cengage Learning EMEA, 2016. ISBN 978-1-4080-9393-1.

PROCTOR, R. *Managerial Accounting. Decision Making and Performance Management*. 4th ed. Essex: Pearson, 2012. ISBN 978-0-273-76448-9.

WEETMAN, P. *Management Accounting*. 2nd ed. Financial Times/ Prentice Hall, 2010. ISBN 978-0273718451.