

King Fahd University of Petroleum and Minerals

College of Industrial Management

Department of Accounting & MIS

ACCT 510: Managerial Accounting

MBA Program

Chapter 1

(Lecture Notes)

Management Accounting: Information that creates Value

Objectives and Learning Outcomes

1. appreciating the important role that management information plays in manufacturing, service, non-profit, and governmental organizations
2. discuss the significant differences between management accounting and financial accounting.
3. understand how different people in the organization have different demands for management accounting information.
4. appreciate how management accounting information creates value for organizations and how it relates to operations, marketing, and strategy.
5. explain why management accounting must include both financial and non-financial information.
6. understand why activities should be the primary focus for measuring and managing performance in organizations.
7. appreciate the behavioral and ethical issues faced by management accountants

Management Accounting (definition):

A value adding continuous improvement process of planning, designing, measuring, and operating non-financial and financial information systems that guides management action, motivates behavior, and supports and creates the cultural values necessary to achieve an organization's strategic, tactical and operating objectives.

Be aware this definition identifies:

- Management accounting as providing both financial and non financial information (e.g. number of defective components/items, customer satisfaction).
- The role of management information as supporting strategic (planning), operational control, financial control, performance evaluation and decision making.
- In short, management accounting information is pervasive and useful.
- It is intended to meet specific decision-making needs at all levels in the organization.

Examples of management accounting information:

- The reported expense of an operating department, such as the assembly dept. of an automobile plant or an electronics company; reporting an expense of an out-patient dept. in a hospital.
- Costs of producing a tone of sugar
- Costs of delivering a service e.g. a surgical operation
- Estimated costs/price of a job e.g. servicing a car.
- Reports on targets achieved by divisions, individuals

- Information about quality of work performed e.g. standards of performance are met, number of defective components/items, internal and external failure costs.
- Information about customers' complaints
- No. of customers served (patients treated in a hospital)
- Profitability of products and divisions.
- Information about targets, performance indicators.
- Management accounting also produces measures of the economic performance of decentralized operating units, such as business units and divisions e.g. ROI, profit margins, asset turnover, return on sales. These measures help senior managers assess the performance of the company's decentralized units.
- Management accounting systems is a key source of information for decision making, improvement, and control in organizations.
- Effective management accounting systems can create considerable value to today's organization by providing timely and accurate information about the activities required for their success.

Changing Focus

- Traditionally, management accounting information has been financial information denominated in a currency such as \$, pound sterling, etc.
- Management accounting information has now expanded to encompass information that is operational or physical (non-financial) information:
 - quality and process times
 - More subjective measurements, such as:
 - customer satisfaction
 - Employee capabilities
 - New product performance

Functions of Management Accounting Information

- Operational control: Provide feedback information about the efficiency and quality of tasks performed
- Product and customer costing: measure the costs of resources used to produce a product or service and market and deliver the product or service to customers
- Management control: provide information about the performance of managers and operating units
- Strategic control: provide information about the enterprise's financial and long-run competitive performance, market conditions, customer preferences, and technological innovations

Financial and Management Accounting: Features & Differences

| | Financial accounting | Management Accounting |
|-------------------------|--|--|
| Audience | External: stockholders, investors, creditors, government, | Internal: managers and directors, employees |
| Purpose | Report on past performance | Provide information for internal use such as planning, decision making and control, performance measurement and feedback |
| Timeliness, | Historical | Current, future oriented |
| Restrictions and format | Regulated, rules driven by generally accepted accounting principles and government authorities | No regulations; flexible; systems and information determined by management to meet strategic and operational needs |
| Type of information | Financial measurements only | Financial plus operational and physical measurements on processes, technologies, suppliers, customers, |

| | | |
|-----------------------|---|---|
| | | and competitors |
| Nature of information | Objective, auditable, reliable, consistent, precise | More subjective and judgmental, valid, relevant, useful |
| Scope | Highly aggregate, report on entire organization | Disaggregate; inform local decisions and actions |

Business Level Strategy and Value Proposition

- A key element of any organization’s strategy is identifying its target customers and delivering what those customers want
- What the organization tries to deliver to customers is called its value proposition
- Value propositions have four elements:
 1. Cost: the price paid by customer, given the product features and competitors’ prices
 2. Quality: the degree of conformance between what the customer is promised and what the customer receives
 - For example a defect free car that performs as promised by the sales person.
 3. Functionality and features- the performance of the product e.g. a meal in a restaurant that provides satisfaction for the price paid
 4. Service: all the other elements of the product to the customers e.g. how the customer is treated

Cost and management accountants have some roles in all of the above (e.g. estimating cost of products and services, setting prices, performance measurement, evaluating success and estimating and measuring cost of quality).

Delivering the value Proposition

- Organizations use processes that they design and manage to the value proposition
- Dell delivers its value proposition by providing customers easy and accessible access to ordering and insisting that suppliers locate close to its assembly facilities
- These steps enable Dell to minimize its inventories and avoid the costs of holding inventory in a rapidly changing industry

Financial Control

- Organizations can use financial and non-financial information to monitor the organization's ability to deliver its chosen value proposition.
- At a higher level, however, organizations use broad measures of financial performance to assess the overall success of the organization chosen strategies

Behavioral implications of management accounting information

- Reaction to measurements
- Introducing or redesigning cost and performance measurement systems
- Participation in decision making and rise of conflicts
- Setting targets

Ethics and the Management Accountant

Companies use two types control systems to foster high ethical standards:

- A belief system: explicit statements, communicated to employees, of the basic values, purpose, and direction of the organization (mission statements)

- Boundary statements: statements that communicate to employees what actions must never be taken; intended to constrain the range of behavior such as bribery, violation of customer's privacy, spying on competitors, producing a defective machinery, manipulation of information, bias towards an individual employee.
- Accounting agencies such as IMA, CIMA, have established ethical norms and codes of professional conduct.

(see lecture notes)