

① MANAGEMENT ACCOUNTING TECHNIQUES

INTRODUCTION

Management accounting is the provision and interpretation of information required by management for different operational purposes including;

- (i) Formation of policy
- (ii) Planning of activities over all time scales
- (iii) Control of the organisation
- (iv) Decision making
- (v) Performance appraisal

The management accounting function at its basic level thus includes the gathering of relevant data, its analysis and the communication of results to management.

Financial accounting is concerned with the provision of information to external bodies outside the organisation. Management accounting is concerned with the provision of information for the purpose of decision making. Cost accounting provides information which may be used in both financial accounting (for stock evaluation) and management accounting (for planning and control).

Major Aspects of Management Accounting.

1. A Future Bias

Much of the information supplied by the management accountant will have relevance to the future i.e. in the following circumstances;

- (i) Pricing policy
- (ii) Decision making
- (iii) Planning
- (iv) Policy formation

Due to this the management accountant will not always be concerned with historical cost information, and will use historical information only in as much as it is a guide to the future. Given the future bias the management accountant may be interested in the following areas:-

- (i) Forecasting future costs and revenues
- (ii) Estimation of future inflation rates
- (iii) Consideration of market reaction to things like prices
- (iv) Assessment of government policy and its effects on the firm.

2. Economic Reality

Where costs and other financial information are used for decision making and planning the future activities of the firm, it is vital that the information used is relevant. In this respect many accounting conventions will have to be ignored because costs used must reflect economic reality.

Example 1.

Bargepole has stored in its warehouse 1,000 tons of commodity X which cost Bargepole £1,000 two years ago, but now has a net realisable value of £200. Bargepole is considering whether or not to use commodity X in the production of a product Y. Which cost would Bargepole use in order to make a decision?

3. Goal Congruence.

Management accounting systems of planning and control should motivate groups to genuine participation, good communications and feedback. What we are basically saying is that the Management Accountant should not ignore people in the planning process, etc.

Examples - Budgeting
 Divisional Performance Evaluation

4. Use of Statistics and Operational Research.

Because management accounting is concerned with planning and decision making it can make use of statistics and operational research. For example the use of statistics may aid the accountant in refining the solutions he presents to management. Below are some possible uses of statistics and operational research in management accounting;

- (i) Statistical forecasting - for costs and sales prediction
- (ii) Linear programming - for resource allocation problems
- (iii) Economic Order Quantities - for the control of stocks
- (iv) Probability - for decision making purposes.

5. Uncertainty about the Future.

Due to the fact that management accounting has a future orientation, then it, by definition, deals with uncertainty. For example in planning the price of a product in one years time, *you* will be uncertain about wage rates, materials costs, inflation rates, demand, and the general economic climate. There may thus be a need to incorporate uncertainty into a given analysis of a problem, and in interpretation there may be a need to use probability data and other statistical techniques.

6. The centrality of decision making.

Virtually all aspects of the managerial task involve decision making either directly or indirectly.

It should be noted that decision making problems have a quantitative and a qualitative aspect. In the real situation a great deal of information may have to be presented regarding the qualitative side of a decision, e.g. the effect of redundancies or segment elimination on the remaining workforce. etc.

Despite this several decision making problems will need an analysis of quantitative information in the first instance e.g.

Long term strategies

- acquisitions.
- new product lines.
- new capital equipment decisions.

Short term strategies

- product planning
- pricing
- make or buy
- segment elimination.

Each decision making problem relies on cost and revenue information which is specified in economically relevant terms.

The decision making process consists of the following stages:

1. Objectives definition (Definition of problem)

It is vital that decisions are always made with objectives in mind. For example, it may be a mistake to price a product to maximise profits, if we wish to maximise market share.

2. Consideration of alternatives (Building of model)

This process will depend upon the time that the organisation has available to find alternatives. The idea of satisficing is important here also.

3. Evaluation of alternatives (Gather relevant data)

This process is essentially the work of the management accountant i.e. quantitative comparisons between alternatives providing the decision taker with a relevant financial base on which to act.

Evaluation must always take into account risks and uncertainty (e.g. future inflation and economic fluctuations). The management accountant must also consider:

- economically relevant costs and revenues
- use of decision rules and models
- use of probability and decision trees
- cost-volume-profit analysis
- linear programming.

4. Selection of alternative (Solve model)

On the basis of a decision rule an alternative is chosen

5. Interpret the chosen alternative in relation to the real problem

The alternative (or model) chosen may be simplified versions of the real ones.

6. Implement the decision

7. Control

This is where the actual outcome of implementing the decision is compared with the expected outcome. If it is significantly different then an investigation is carried out to find the cause and thus rectify.

The Changing Role of the Management Accountant

The nature of the modern enterprise means that the management accountant is not the only person who supplies information to management. For example, there may now be a need to work in conjunction with operational researchers, economists and business specialists. Management accounting must also now take account of computers, especially in analysing the right information at the right time. The use of some management accounting techniques in the U.K. has been heavily criticised by Kaplan in the U.S., and other academics in the U.K.