

**Accounting**  
**Building Business Skills**

Paul D. Kimmel

Chapter Twelve:  
Introduction to Management  
Accounting

PowerPoint presentation by Kate Wynn-Williams  
University of Otago, Dunedin  
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**Learning Objectives:**

- Explain the distinguishing features of management accounting.
- Identify the three broad functions of management.
- Define the three classes of manufacturing costs.
- Distinguish between product and period costs.

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**Learning Objectives:**

- Explain the difference between a merchandising and a manufacturing statement of financial performance.
- Indicate how cost of goods manufactured is determined.
- Explain the difference between a merchandising and a manufacturing statement of financial position.

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**Learning Objectives:**

- Describe contemporary developments in management accounting.
- Prepare a worksheet and closing entries for a manufacturing entity (appendix).

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**Management Accounting Basics**

- Management accounting has internal focus, providing information for managers, department heads, supervisors and others within the entity
  - different purposes to financial statements prepared for parties external to the entity

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**Management Accounting Basics**

- Management accounting techniques and analyses used in all types of business:
  - service, merchandising, manufacturing
  - proprietorships, partnerships, companies
  - profit-making, non-profit-making

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## Management Accounting Basics

- Similarities to financial accounting:
  - deals with economic events of an entity
  - results of economic events need to be quantified and communicated to others
  - companies often unwilling to disclose commercially sensitive information

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## Management Accounting Basics

- Differences to financial accounting:
  - reports are internally generated, as often as the need arises
  - reports are special purpose, for specific needs
  - content of reports not governed by financial reporting standards
  - reports not verified by external auditors

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## Management Accounting Basics

| Financial accounting  | Main users of reports  | Management accounting  |
|---|--|--|
| <ul style="list-style-type: none"> <li>• External users, who include shareholders, creditors and regulatory agencies.</li> <li>• Classified financial statements.</li> <li>• Issued quarterly (for some entities), 6-monthly and annually.</li> <li>• To provide general-purpose information for all users.</li> <li>• Pertains to entity as a whole and is highly aggregated (condensed).</li> <li>• Limited to double-entry accounting system and cost data.</li> <li>• Reporting standard is generally accepted accounting principles.</li> <li>• Annual independent audit by external auditor.</li> </ul> | <ul style="list-style-type: none"> <li>• Internal users, who are officers, department heads, managers and supervisors in the business.</li> <li>• Internal reports.</li> <li>• Issued as frequently as the need arises.</li> <li>• To provide special-purpose information for a particular user for a specific reason.</li> <li>• Pertains to subunits of the entity and may be very detailed.</li> <li>• May extend beyond double-entry accounting system to any type of relevant data.</li> <li>• Reporting standard is relevance to the decision to be made.</li> <li>• No independent audits.</li> </ul> | <ul style="list-style-type: none"> <li>• Internal users, who are officers, department heads, managers and supervisors in the business.</li> <li>• Internal reports.</li> <li>• Issued as frequently as the need arises.</li> <li>• To provide special-purpose information for a particular user for a specific reason.</li> <li>• Pertains to subunits of the entity and may be very detailed.</li> <li>• May extend beyond double-entry accounting system to any type of relevant data.</li> <li>• Reporting standard is relevance to the decision to be made.</li> <li>• No independent audits.</li> </ul> |
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## Management Accounting Ethics

- Professional accounting bodies have Codes of Conduct
- Codes have ethical standards for:
  - competence
  - proficiency
  - personal moral integrity
- Purpose is to ensure management accountants act with high standards of ethical conduct

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## Management

- Three main functions:
  - planning: looking ahead and establishing short-term and long-term objectives
  - directing and motivating: implementation of plans by coordinating diverse activities and human resources
  - controlling: keeping entity's activities on track

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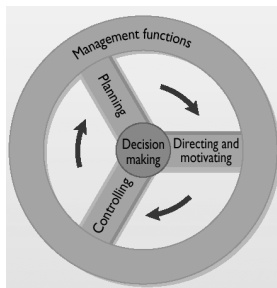
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## Management



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## Management

- Control achieved in various ways
  - personal observation by managers
  - asking questions and evaluating answers
  - for larger organisations, also use records of plans against actual events (e.g. budgets and performance evaluation reports)

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## Management Cost Concepts

- Manufacturing costs – associated with converting raw materials into finished goods:
  - direct materials
  - direct labour
  - manufacturing overheads

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## Management Cost Concepts

Materials:

- direct: can be economically and physically traced to finished goods
  - e.g. flour for bread, steel for cars, cloth for shirts, plastic for toys
- indirect: not directly traceable to specific goods
  - e.g. oil for lubricating machines
  - treated as manufacturing overhead

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## Management Cost Concepts

### Labour:

- direct: can be economically and physically traced to finished goods
  - e.g. bakers in a bakery, typesetters in a printery
- indirect: not directly traceable to specific goods
  - e.g. maintenance crew, supervisors
  - treated as manufacturing overhead

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## Management Cost Concepts

### Manufacturing Overhead:

- indirect costs associated with manufacturing products
  - e.g. indirect materials, indirect labour, depreciation, insurance, maintenance
  - also called factory overhead, burden, indirect manufacturing costs

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## Management Cost Concepts

- Prime costs – direct materials plus direct labour
  - directly associated with manufacture of finished products
- Conversion costs – direct labour plus manufacturing overhead
  - incurred in converting raw materials into finished products

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## Management Cost Concepts

- Product costs – relate directly to finished products
  - expensed as Cost of Goods Sold when finished products sold
- Period costs – not directly part of manufacturing process
  - expensed according to time (financial period costs), not specific goods
  - e.g. selling and administration costs

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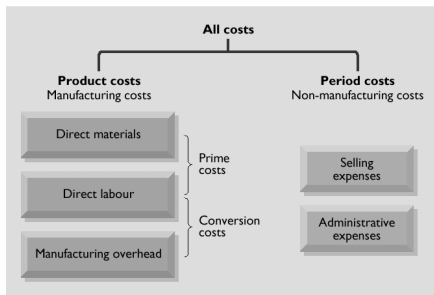
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## Management Cost Concepts



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## Financial Statements

- Statement of Financial Performance: Cost of Goods Sold
  - merchandising entity uses cost of goods purchased
  - manufacturing entity calculates cost of goods manufactured
- Statement of Financial Position: Inventory
  - merchandisers only use one account
  - manufacturers use several accounts, to reflect various stages of production

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## Financial Statements

- Cost of goods manufactured:
  - Goods are at various stages of production at any particular time
  - At start of financial period, value of partially completed goods from previous period = beginning Work in Process Inventory

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## Financial Statements

- During financial period, these goods are completed first, plus new goods started = total current manufacturing costs
- Beginning Work in Process (WIP) Inventory plus total current manufacturing costs = total cost of WIP for the period

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## Financial Statements

- At end of financial period, some goods ready for sale and some not yet finished:
  - partially completed goods = ending Work in Process (WIP) Inventory
- Total cost of WIP less value of ending WIP = cost of goods manufactured

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## Financial Statements

- schedule of cost of goods manufactured – shows each cost element:
  - beginning Work in Process Inventory
  - total manufacturing costs for period
  - total costs of work in process
  - ending Work in Process Inventory
  - cost of goods manufactured

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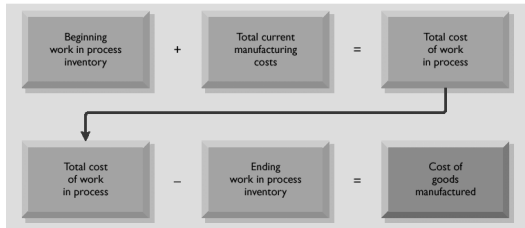
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## Financial Statements



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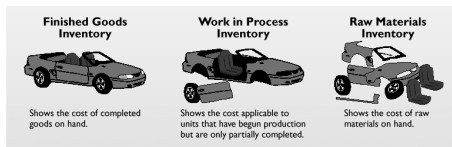
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## Financial Statements

- Current assets:
  - At year end, goods under production are at varying stages of completion
  - Current asset accounts reflects this



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## Contemporary Developments

- Recent changes to business environment leading to expansion of management accounting function:
  - growth of service industries
  - globalisation of business activities
  - technological changes
  - new management approaches

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## Contemporary Developments

- Growth of service industries – new costing and control systems needed:
  - more labour intensive
  - production often replaced by accumulation of labour as basis for costs
  - services consumed as produced, so no inventory
  - difficulties in measuring efficiency, productivity, quality

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## Contemporary Developments

| Service industries  | Service businesses  | Service industries  | Service businesses  |
|---|---|---|---|
| <br>Transport                | Qantas, Air New Zealand, Queensland Rail, Flight Centre, TNT Australia, Owens Group | <br>Professional services  | Solicitors, public accountants, doctors, architects, engineers              |
| <br>Package delivery service | DHL, Allied Express, Wards Skyroad, Australia Post, New Zealand Post                | <br>Financial institutions | National Bank, Macquarie Bank, AMP, ING, Tower NZ, insurance companies      |
| <br>Telecommunications       | Telstra, Optus, Telecom NZ, radio and television networks                           | <br>Health care            | Mayne, Central Sydney Area Health, Health Waikato, hospitals, nursing homes |

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### Contemporary Developments

- Technological changes – affect the way businesses operate:
  - CIM: computer-integrated manufacturing
  - increased automation
  - widespread use of computers
  - scientific discoveries
  - development of new technologies

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### Contemporary Developments

- Globalisation – businesses operate in many different countries:
  - international competition
  - differences in monetary systems
  - differences in legal and accounting systems

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### Contemporary Developments

- New management approaches – in response to changes in business arising from:
  - e-commerce: use of e-mail and internet to conduct business (issues of security, integrity, confidentiality)
  - product life cycle: increased competition (more emphasis on product change and development)

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### Contemporary Developments

- TQC (total quality control) –
  - reduction in manufacturing costs through control of entire process (e.g. defective parts and products, rework costs, warranty obligations)
  - increased emphasis on non-financial measures (e.g. customer satisfaction, number of service calls)

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### Contemporary Developments

- JIT (just in time) inventory control –
  - reduction in costs through control of inventory (reduction or elimination of inventories)
  - goods purchased or manufactured only as required
- ABC (activity-based costing) –
  - reduction in overhead costs through focus on activities creating costs

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### Decision toolkit

- Is the business maintaining control over the costs of production?
- What is the composition of a manufacturing entity's inventory?

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### Financial Statements (Appendix)

Steps in the Accounting Cycle:

- Similarities to merchandising entities:
  - journal entries and posting to ledgers
  - trial balances
  - end-of-year adjusting entries
  - preparation of financial statements from worksheet

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### Financial Statements (Appendix)

- Differences to merchandising entities – worksheet:
  - two additional columns to allow for schedule of cost of goods manufactured (for statement of financial performance)
  - additional accounts for manufacturing cost identification
  - additional inventory accounts (for statement of financial position)

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### Financial Statements (Appendix)

- Differences – closing entries:
  - accounts appearing in schedule of cost of goods manufactured are closed to Manufacturing Summary
  - balance of Manufacturing Summary = cost of goods manufactured in current period
  - Manufacturing Summary is closed to Profit & Loss Summary

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