5.18 MANAGEMENT ACCOUNTING (section 8.10)

The two important functions of management are planning and control. Planning is the process of setting goals and developing ways to achieve them. It includes the important process of budgeting which is the relating of goals to the specific means for achieving them. Control is determined whether the goals are being met and, if not, what can be done.

Management Accounting is the term used throughout this section to include product costing and budgetary planning and control. Costing was covered in the old syllabus to some extent in Manufacturing and Departmental Accounts and in the valuation of unsold stock in Consignment Accounts.

In general, this section of the syllabus deals with manufacturing organisations. It is not concerned with contract, process or service costing. The syllabus concentrates on Job/Batch costing whereby products are made to order or for stock. There is an emphasis on Product Costing, Break-even and "what if?" analyses. The process of arriving at budgets/estimates and of comparing them with actual outcomes is included but "Standard Costs and Variances" are not part of the syllabus.

It would be helpful if students had a sound knowledge of final accounts before being introduced to Management Accounting. Some previous exposure to ratio analysis and cash flow statements is also desirable.

Prior work on such areas as manufacturing accounts, stock and departmental accounts which overlap with Cost/Management Accounting could provide an effective introduction to this section. In fact, several of the topics which are included in the Management Accounting section can easily be introduced in these earlier sections. For example, aspects of product costing can be dealt with effectively along with manufacturing accounts. Likewise, when doing departmental accounts it is a relatively easy step to think about how much the firm would need to purchase in a particular period if they were to satisfy a sales growth of, say, 10% and to build up their inventories in the next period by, say, 25% (assuming that gross margins were to remain constant or to change by a specified percentage).

Teachers may wish to take the opportunities earlier in the syllabus to adopt a managerial perspective and to introduce simple cost/management accounting computations before progressing into the management accounting module formally.

Indeed some may have the concepts and techniques which are embodied in it virtually completed before they arrive at it. In any event every opportunity should be taken in earlier sections of the syllabus to raise management issues/questions and conduct appropriate analyses.

The budgeting aspect of this section links very closely with several areas of financial accounting, such as control accounts, profit and loss accounts and balance sheets. The main difference is that budgets, which are a key weapon in planning and control, try to project what the future financial reports are likely to look like, whilst the traditional accounting model records the actual outcomes. In many cases the actual financial results arrived at in the normal way form the basis for the budgets of a future period.

The following is a summary of areas of study and depth of treatment of these areas within the section of the syllabus.

- The nature and scope of management accounting
- The relationship of management accounting to financial accounting
- The role of management accounting in an organisation
- Manufacturing and non-manufacturing costs
- Direct and indirect costs
- Product costs and period costs
- Fixed and variable costs
- Mixed step-fixed and step-variable costs (HL only)
- Controllable and uncontrollable costs (HL only)
- Product costing
    - Direct materials (FIFO only to be used for calculations)
    - Direct labour (on actual basis)
    - Factory overhead
    - Allocation
    - Apportionment
    - Absorption
    - A working knowledge of labour hours and machine hours bases
- cost –volume-profit analysis
    - Concept of contribution
    - Break-even point
    - Margin of safety

- Break-even charts
- Limitations
- Sensitivity analysis (HL only)

  (in this section it is not intended to test multiple product mix)

- Nature, objectives and advantages of budgeting
- Role of line management in budget formulation and the identification of the principal budget factor
- Preparation of the master budget and supporting subsidiary purchases, direct labour, factory overhead, non-factory expense and closing stock budgets. Cash budgeting. Budgeted profit and loss account and balance sheet.
- Comparison of actual with budget
- Flexible budgeting, in role and operation and the recognition of the impact of fixed and variable costs (HL only).

Students will be assessed on their ability to:

- Define management accounting and explain its relationship to financial accounting
- Discuss the different types of cost behaviour patterns that can arise in an organisation
- Compute break-even points, contribution margin and margin of safety, and to draw a break-even chart.
- Compute the cost of a product
- Prepare a master budget together with subsidiary budgets
- Outline the importance of budgetary control in an organisation (HL only)