Introduction to Cost Accounting, Planning & Control Course

Prof. Antonio Chirico

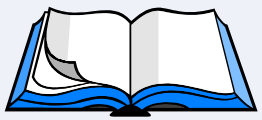
chirico@economia.uniroma2.it

Dept. of Management and Law – A.Y. 2024/2025

1

Managerial Accounting Basics

Management accounting (or managerial accounting) is a field of Accounting that provides economic and financial information for managers and other internal users.



2

Definition of Management Accounting

Management accounting is concerned with the provisions and use of accounting information to managers within organizations, to provide them with the basis to make informed business decisions that will allow them to be better equipped in their management and control functions.

Definition of Management Accounting

- *Provision of information required by management for planning, organising and control* - for such goals as:
  - recording, analysing and reporting actual costs and inputs of products, services and processes
  - evaluating stocks of raw materials, W-I-P and finished goods
  - working with other functions
  - establishing standards of performance
  - establish cost, revenue and quantity with budgets
  - (plus) evaluating alternative opportunities

Managerial Accounting Basics

The activities that are part of managerial accounting are as follows:

1 Explaining manufacturing and non manufacturing costs and how they are reported in the financial statements.

2 Computing the cost of rendering a service or manufacturing a product.

3 Determining the behavior of costs and expenses as activity levels change and analyzing cost-volume-profit relationships within a company.

Managerial Accounting Basics

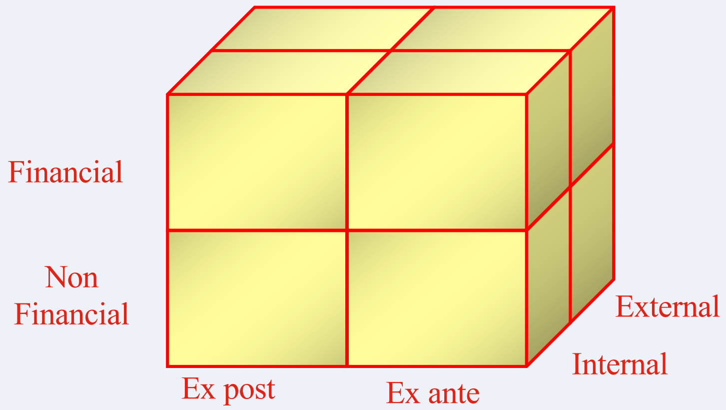
The activities that are part of managerial accounting are as follows:

4 Assisting management in profit planning and formalizing the plans in the form of budgets.

5 Providing a basis for controlling costs and expenses by comparing actual results with planned objectives and standard costs.

6 Accumulating and using relevant data for management decision making.

Three-Way Classification Scheme of Information



Cost Accounting and Managerial Accounting

Cost Accounting:

Cost Accounting is the process of accounting for costs which begins with recording of income and expenditure or the bases on which they are calculated and ends with the preparation of statistical data.

Managerial Accounting:

It is the process of identifying, measuring, accumulating, analyzing, preparing, interpreting, and communicating information that managers use to fulfill organizational objectives

Cost Accounting and Managerial Accounting

Base	Cost Accounting	Managerial Accounting
Meaning	Cost Accounting is a process of ascertaining the cost	Managerial accounting is one which enables management in doing its functions efficiently.
Objects	The primary object of Cost accounting is to determine the records, cost of products and services.	Managerial accounting is aims at representation of cost data or accounting information for management use.
Scope	The scope of Cost accounting is not wide, it is apart of Managerial accounting	Managerial accounting has wider scope. It includes Financial accounting, Cost accounting an statistics etc.
Principles	Under this system of cost accounting certain principles are followed.	No principles is followed under the system of managerial accounting.
Parties	Both parties, internal and external have interested in costing	Managerial accounting is specially designed for management or internal use.
Principles and formats	Cost accountancy have some established and set accounting principles and formats	it is not so in the case of the management accounting

9

What are the main distinguishing features of managerial accounting?

10

Differences Between Financial and Managerial Accounting

FINANCIAL ACCOUNTING	MANAGERIAL ACCOUNTING
Primary Users of Reports	
External users, who are stockholders, creditors, and regulatory agencies.	Internal users, who are officers, department heads, managers, and supervisors in the company.
Types and Frequency of Reports	
Classified financial statements. Issued quarterly and annually.	Internal reports Issued as frequently as needed.
Purpose of Reports	
To provide general-purpose information for all users.	To provide special-purpose information for a particular user for a specific decision.

Differences Between Financial and Managerial Accounting

FINANCIAL ACCOUNTING	MANAGERIAL ACCOUNTING
Content of Reports	
Pertains to entity as a whole and is highly aggregated (condensed). Limited to double-entry accounting system and cost data. Reporting standard is generally accepted accounting principles.	Pertains to subunits of the entity and may be very detailed. May extend beyond double-entry accounting system to any type of relevant data. Reporting standard is relevance to the decision to be made.
Verification Process	
Annual independent audit by certified public accountant.	No independent audits.

Differences Between Financial and Managerial Accounting

So, FA must follow GAAP and prescribed format

MA need not to follow GAAP and
any prescribed format

FA is mandatory for external reports

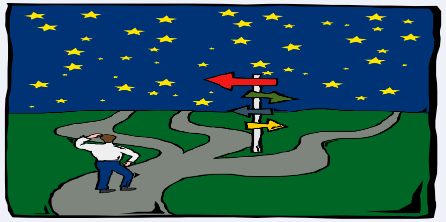
MA is not mandatory but it's usefull

Ethical Standards for Managerial Accountants

- Managerial accountants recognize that they have an **ethical obligation** to their companies and the public.
- To provide guidance for managerial accountants in the performance of their duties, the **Institute of Management Accountants** (IMA) has developed a code of ethical standards, entitled *Standards of Ethical Conduct for Management Accountants*.
- This code divides the managerial accountant's responsibilities into 4 areas:
  - competence,
  - confidentiality,
  - integrity, and
  - objectivity.

Ethical Dilemmas in business organizations

Managers must choose an alternative and there are:
- Significant value conflicts among differing interests.
- Real alternatives that are all justifiable, and
- Significant consequences on stakeholders in the situation.



15

Unethical Behavior Temptations

1. Emphasis on short-term results:
Pressure to meet expected profit numbers.

2. Ignoring the small stuff:
Large misdeeds often result from many small ones.

3. Economic cycles:
A downturn market can reveal what a upturn market conceals.
Vigilance in all stages of economic markets maintains high ethical standards.

4. Accounting rules
Avoid creative interpretations of the rules.
Practice full and fair disclosure to ensure company's performance.

16

Ethical Climate of Business

The corporate scandals experienced over the last few years have shown us that unethical behavior in business is wrong in a moral sense and can be disastrous in the economy. In addition to Sarbanes-Oxley, there will likely be more reforms in corporate governance and accounting.

Why Have Ethical Standards?

Ethical standards in business are essential for a smooth functioning advanced market economy.

↓

Without ethical standards in business, the economy, and all of us who depend on it for jobs, goods, and services, would suffer.

↓

Abandoning ethical standards in business would lead to a lower quality of life with less desirable goods and services at higher prices.

The Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 was intended to protect the interests of those who invest in publicly traded companies by improving the reliability and accuracy of corporate financial reports and disclosures. Six key aspects of the legislation include:

❶ The Act requires both the CEO and CFO to certify in writing that their company's financial statements and disclosures fairly represent the results of operations.

❷ The Act establishes the Public Company Accounting Oversight Board to provide additional oversight of the audit profession.

❸ The Act places the power to hire, compensate and terminate public accounting firms in the hands of the audit committee.

❹ The Act places restrictions on audit firms, such as prohibiting public accounting firms from providing a variety of non-audit services to an audit client.

19

The Sarbanes-Oxley Act of 2002

❺ The Act requires that a company's annual report contain an internal control report that is accompanied by an opinion from the company's audit firm about the fairness of that report.

❻ The Act establishes severe penalties for certain behaviors, such as:

- Up to 20 years in prison for altering or destroying any documents that may eventually be used in an official proceeding.
- Up to 10 years in prison for retaliating against a "whistle blower."

20

IN BUSINESS

SPILLED MILK AT PARMALAT

Corporate scandals have not been limited to the United States. In 2003,Parmalat, a publicly traded dairy company in Italy, went bankrupt. The CEO, Calisto Tanzi, admitted to manipulating the books for more than a decade so that he could skim off $640 million to cover losses at various of his family businesses. But the story doesn't stop there. Parmalat's balance sheet contained $13 billion in nonexistent assets, including a $5 billion Bank of America account that didn't exist. All in all, Parmalat was the biggest financial fraud in European history.

Source: Gail Edmondson, David Fairlamb, and Nanette Byrnes, "The Milk Just Keeps on Spilling," *BusinessWeek,* January 26, 2004, pp. 54–58.

21

What are the main three broad functions of management?

22

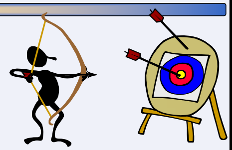
Management Functions

The management of an organization performs three broad functions:

- Planning
- Directing and motivating
- Controlling

Management Functions: Planning

- **Planning** requires management to
  - **look ahead**, and
  - **establish objectives**.



- These objectives are usually quite diverse, but a key modern management objective appears to be to **add value** to the business under its control.
- **Value** is usually measured by
  - the trading price of the company's stock and
  - the potential selling price of the company.

Planning and Programming: what's the difference?

- Planning involves the analysis of conditions, setting goals, and developing methods of reaching those goals.
- Programming or Scheduling, in most cases, relates to the development of an actual program of projects and policies to reach that goal.

In a business case, this generally involves setting a budget to undertake projects that move the business toward its goal.

Planning and Programming

In other words planning is the process of identifying all activities necessary to complete the project while programming is the process of determining the sequential order of activities, assigning planned duration and determining the start and finish dates of each activity.

Planning is a prerequisite to programming because there is no way to determine the sequence until they are defined.

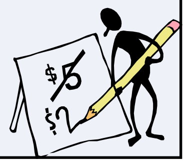
Management Functions: Directing and Motivating

- **Directing and motivating** involves **coordinating** diverse activities and human resources to produce a smooth-running operation.
- This function relates to the implementation of planned objectives.
- Most companies prepare **organization charts** to show
  - the interrelationship of activities, and
  - the delegation of authority and responsibility within the company.

27

Management Functions: Controlling

- **Controlling** is the process of keeping the firm's activities **on track**.
- In controlling operations, management determines
  - whether planned goals are being met, and
  - what changes are necessary when there are deviations from targeted objectives.



28

The role of management - Summary

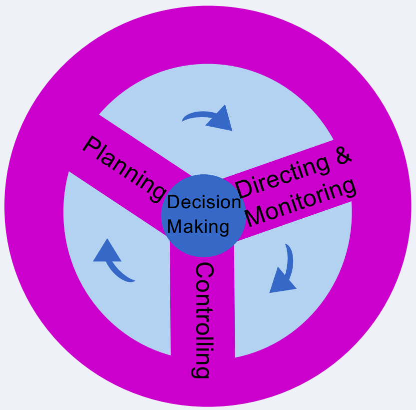
Planning
focus: What will I do?
Common information requirements: prospective costs and revenues,information about competitors and customers,and information about organization capabilities

Organizing
focus: How will I carry out my plan?
Common information requirements: Prospective performance data (such as costs, efficiencies and quality levels) of various approaches to carrying out plans

Controlling
focus: How am I doing and how does performance compare to my plan?
Common information requirements: Product or production systems cost, realized quality or service level of various production systems and performance levels compared to competitors

29

Management Functions Review



30

Decision Making

What is decision making?

It is the purposeful choice from among a set of alternative courses of action designed to achieve some objective.

This is the core of the management process.

31

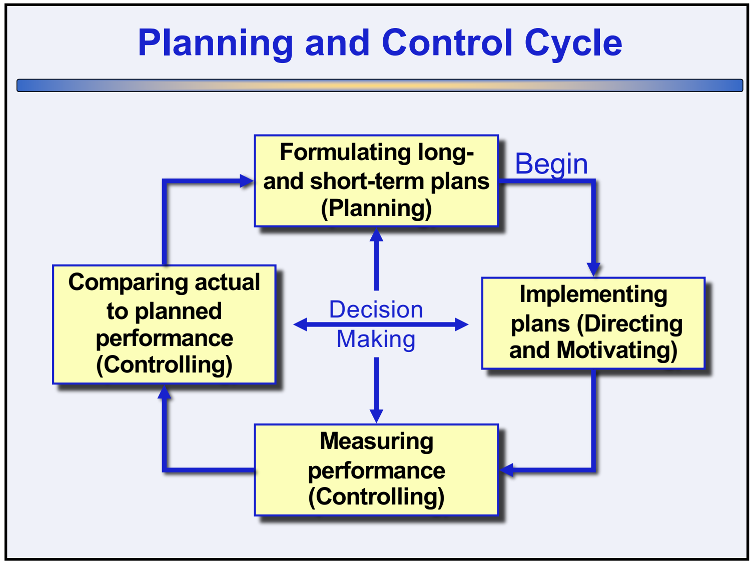
Decision Making

Scorekeeping: Evaluate Organizational Performance

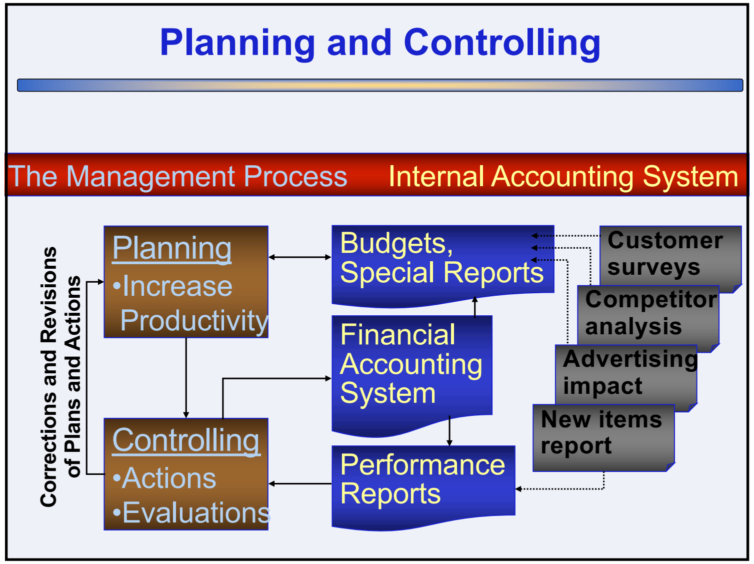
Attention Directing: Compare Actual Results to Expected

Problem Solving: Assess Possible Courses of Action

32


Planning and Control Cycle
Formulating long- and short-term plans (Planning)
Begin
Implementing plans (Directing and Motivating)
Decision Making
Comparing actual to planned performance (Controlling)
Measuring performance (Controlling)

33


Planning and Controlling
The Management Process
Internal Accounting System
Corrections and Revisions of Plans and Actions
Planning
•Increase Productivity
Controlling
•Actions
•Evaluations
Budgets, Special Reports
Financial Accounting System
Performance Reports
Customer surveys
Competitor analysis
Advertising impact
New items report

34

Role of Budgets

- A budget is a quantitative expression of a plan of action and is an aid to coordinating and implementing the plan.
- Budgets are the chief devices for compelling and disciplining management planning.

Role of Performance Reports

Performance reports formalize controls and provide feedback by comparing results with plans and by highlighting variances.

Variances are deviations from the plan.

Performance Reports

Mayfair Starbucks Store, March 31, 20X7

	Budget	Actual	Variance
Sales	$50,000	$50,000	0
Less:			
Ingredients	22,000	24,500	$2,500 U
Store labor	12,000	11,600	400 F
Other labor	6,000	6,050	50 U
Utilities, etc.	4,500	4,500	0
Total expenses	$44,500	$46,650	$2,150 U
Operating income	$ 5,500	$ 3,350	$2,150 U

U= Unfavorable – actual exceeds budget
F – Favorable – actual is less than budget.

37

Managerial Cost Concepts

To perform the three management functions effectively, management needs information. One very important type of information is related to **costs**. For example, questions such as the following need answering:

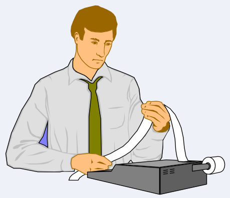
- What costs are involved in making the product?
- If production volume is decreased, will costs decrease?
- What impact will automation have on total costs?
- How can costs best be controlled in the organization?

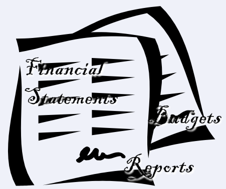
Please, remind you to consider also **revenues**!

38

Accounting Information System

Process of gathering, organizing, and Communicating financial or non financial information



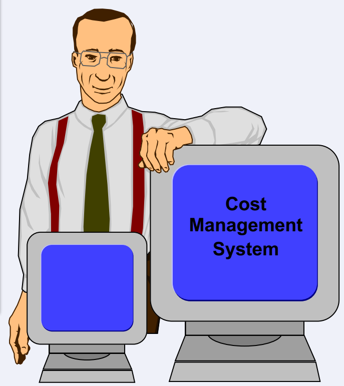


39

Cost Management Systems

Objectives

1. Measure the cost of resources consumed.
2. Identify and eliminate non-value-added costs.



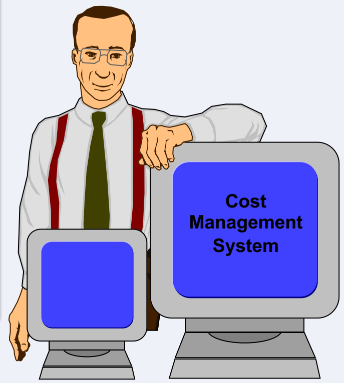
40

Cost Management Systems

Objectives

❸ Determine efficiency and effectiveness of major activities.

❹ Identify and evaluate new activities that can improve performance.



41

Organizational Authority and Responsibility

Line managers: directly involved with making and selling products or services.

Staff managers: Advisory – Support line managers.

Cross-functional teams: found in modern, “flatter” organizations; functional areas work together in decision making process.

42

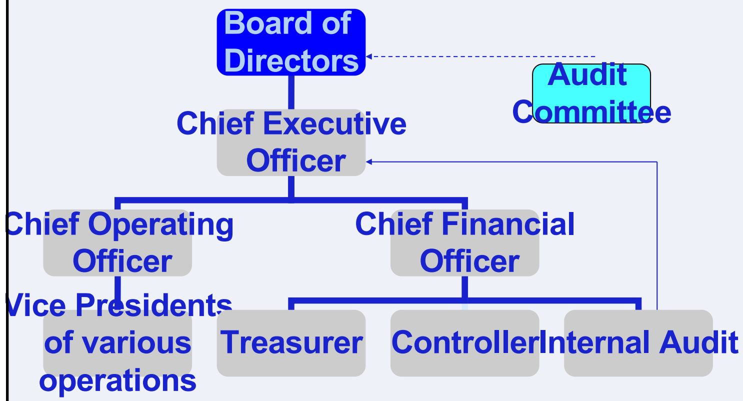
Line and Staff Positions

- A line position is directly involved in achieving the basic objectives of an organization.
  - Example: A production supervisor in a manufacturing plant.

- A staff position supports and assists line positions.
  - Example: A cost accountant in the manufacturing plant.

43

Organizational Structure

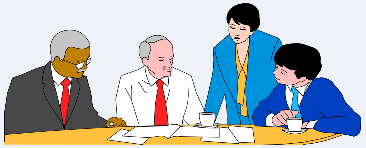


44

The Chief Financial Officer (CFO)

A member of the top management team responsible for:

- Providing timely and relevant data to support planning and control activities.
- Preparing financial statements for external users.



Controller

The chief managerial and financial accountant responsibility for:

- Supervising accounting personnel
- Preparation of information and reports, managerial and financial
- Analysis of accounting information
- Planning and decision making

Treasurer

Responsible for raising capital and safeguarding the organization’s assets.

- Supervises relationships with financial institutions.
- Work with investors and potential investors.
- Manages investments.
- Establishes credit policies.
- Manages insurance coverage

47

Internal Auditor

Responsible for reviewing accounting procedures, records, and reports in both the controller’s and the treasurer’s area of responsibility.

- Expresses an opinion to top management regarding the effectiveness of the organizations accounting system.

48

Corporate Governance

The system by which a company is directed and controlled.

Board of Directors

Incentives and monitoring for

Top Management

To pursue objectives of

Stockholders