PART 1 INTRODUCTION TO MANAGEMENT ACCOUNTING

CHAPTER 1
Management accounting: information for creating value and managing resources

CHAPTER 2
Management accounting: cost terms and concepts

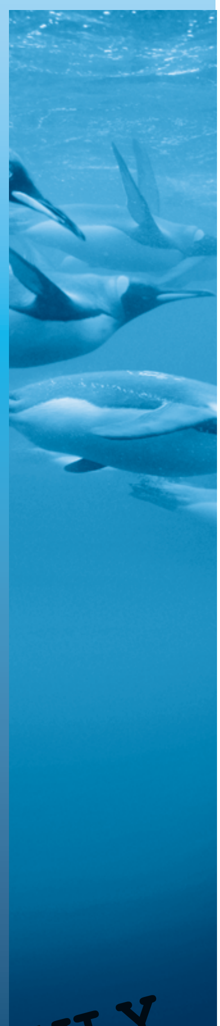
The first part of this book introduces management accounting, its purpose and basic concepts.

In Chapter 1, management accounting is defined as processes and techniques that are focused on the effective and efficient use of organisational resources to support managers in their task of enhancing both customer value and shareholder value. We outline the recent changes in the business environment that have influenced the development of management practices and management accounting systems, and management accounting is distinguished from financial accounting.

The processes and techniques of management accounting that are used to enhance value include systems to support the formulation and implementation of strategy; process improvement and cost management techniques to help develop and manage a firm's competitive advantage; planning and control systems to help managers manage resources; and estimates of the cost of products (goods or services) to support strategic and operational decisions.

In this first chapter we also consider factors that influence the design of a management accounting system, including an awareness of the behavioural implications of management accounting information, and the costs and benefits of designing, producing and using management accounting information. We also recognise that the design of management accounting systems can be influenced by a wide range of factors such as the organisation's competitive environment, strategies, size, and organisational culture, as well as by institutional forces that encourage the adoption of management accounting practices that are used by other organisations. A case study of Wendy's, the successful retailer of speciality ice-cream products, is used to illustrate many of the management accounting concepts.

Chapter 2 introduces some of the basic concepts and terminology used in management accounting. Management accounting systems often include costing, budgeting and performance measurement systems. Contemporary management accounting systems may also include cost management systems, which focus on the identification and elimination of wasteful activities.



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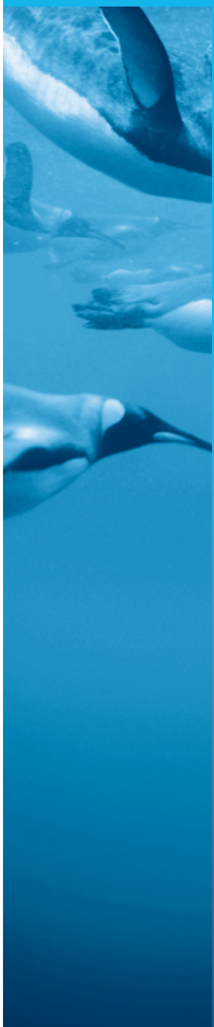

Much of this chapter focuses on the different ways in which costs can be classified and reported to managers. These classifications include variable and fixed costs, direct and indirect costs, and controllable and uncontrollable costs. We use the concept of the value chain to explore the various cost classifications, paying particular attention to the classification of manufacturing costs as direct material, direct labour and manufacturing overhead costs. The essential message in this chapter is that costs can be classified in different ways to meet the different information needs of managers.

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CHAPTER 1

MANAGEMENT ACCOUNTING: INFORMATION FOR CREATING VALUE AND MANAGING RESOURCES

LEARNING OBJECTIVES

After completing this chapter, you should be able to:

1 describe the changes that have taken place in the business environment in recent years;

2 define *management accounting* in terms of value creation;

3 describe the major differences between management accounting and financial accounting information;

4 explain where management accountants are located in organisations;

5 describe the major processes that management accounting systems use to create value and manage resources;

6 explain the basic concepts of strategy and how management accounting systems can support strategies;

7 recognise how various management accounting techniques have been developed to support a firm's competitive advantage;

8 explain how planning and control mechanisms can be used to support resource management;

9 explain how costing systems can provide information to support a range of operational and strategic decisions;

10 describe the factors that may influence the design of management accounting systems including behavioural issues, cost–benefit trade-offs and the implications of contingency and institutional theories;

11 identify the organisational responses and management accounting responses to changes in the business environment;

12 after studying the appendix, describe how the focus of management accounting has evolved; and

13 after studying the appendix, discuss the professional qualifications that are relevant to becoming an accountant, and the ethical standards to which accountants must adhere.

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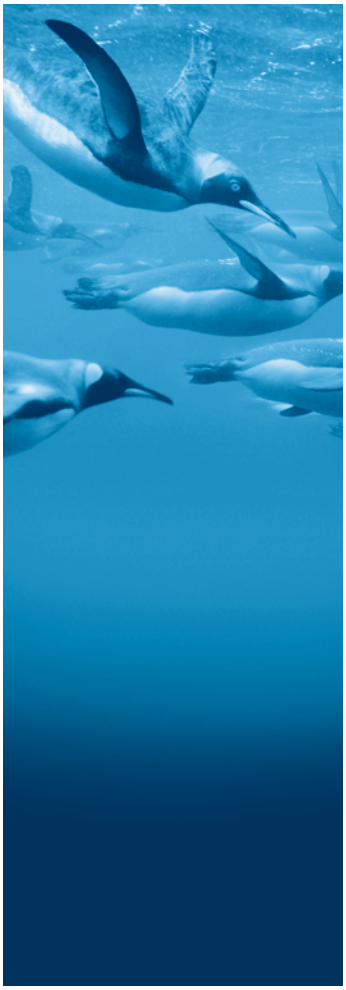
INTRODUCTION 1



We all deal with many different types of organisations as part of our daily lives. Manufacturers, retailers, service providers, not-for-profit organisations[1] and government enterprises provide us with a vast array of goods and services. These organisations seem very different, but they have three things in common. First, every organisation should have a stated purpose and objectives. For example, a police department may state that its purpose is to make the community a safer place in which to live. The specific objectives of an organisation flow from its purpose. In the case of the police department, the objectives may be to reduce the crime rate by 50 per cent and decrease the number of road fatalities by 30 per cent within the next five years. The objectives of organisations generally focus on adding value from the perspective of major stakeholders—in particular, owners and customers.

Second, in pursuing objectives managers need to make many decisions, and for this they need information. The information needs of managers extend across financial, production, marketing, legal and environmental areas. Generally, the larger the organisation, the more complex are its operations, and the greater is management's need for information. In the police department, senior officers will need information to assess progress towards objectives. Relevant information could include crime statistics for each quarter of the year, explanations of why crime rates may be meeting or exceeding targets, and details of the strategies put into place to reduce crime.

Last, to help achieve the organisation's objectives, managers need to manage their resources effectively and efficiently. Resource management can involve using resources more effectively (i.e. achieving better outcomes) and using resources more efficiently (i.e. using fewer resources to achieve an objective). In the police department, management will need to know the cost of new crime-reduction programs that have been put in place.

Management accounting information helps to satisfy the information needs of managers so that they can manage resources effectively and efficiently and add value for customers and the organisation as a whole.

Throughout this book we use case studies based on real businesses to bring management accounting principles and concepts to life. This chapter is based on the story of Australia's well-known speciality ice-cream retailer, Wendy's; but before we move to the Wendy's story, let's explore the business environment in which management accounting has evolved and operates.

AUSTRALIAN ORGANISATIONS IN THE TWENTY-FIRST CENTURY

1 LEARNING OBJECTIVE

Throughout the 1990s, many Australian organisations became exposed to global competition for the first time. Australian companies could no longer ignore the activities of companies operating in Asia, Europe and the United States (US). From the early 1990s, import tariffs, quotas and bounties were gradually reduced or eliminated. Many overseas companies became direct competitors for Australian businesses. For example, the steadily decreasing tariffs affected Australian car manufacturers, such as Holden, Ford, Toyota and Mitsubishi, as well as their local suppliers. High-quality motor vehicles manufactured overseas were imported into the domestic markets at competitive prices, to compete directly with locally produced cars. Australian automotive component suppliers were also competing directly with overseas suppliers, as Australian

1 In New Zealand, not-for-profit organisations (NFPs) are known as public benefit organisations reflecting the fact that they are generally organised for socially beneficial purposes.

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car manufacturers began to source their supplies globally. For example, in 2004 Mitsubishi announced that, as part of a major global restructure, its South Australian engine plant would be closed from October 2005, with engines required for its Australian operations being imported from Japan. Also, in 2000, Virgin Blue, set up by the Unitd Kingdom (UK) based Virgin Group, emerged to challenge the two dominant domestic airlines, Qantas and Ansett. By 2001, Ansett had failed and Virgin Blue flourished. In 2004 Qantas introduced its own low-cost provider, Jetstar and in 2007 Singapore's Tiger Airways entered the Australian market.

Changes in the regulatory environment have affected many industries. Deregulation of the telecommunications industry in the 1990s saw a variety of companies, such as Optus, enter the market as direct competitors to Telstra, a business that once held a monopoly in the telecommunications market in Australia. And in 2001 Optus was taken over by Singapore Telecommunications. During this period, many other public utilities and government bodies were commercialised, or corporatised. These bodies also found themselves competing directly with private enterprise. The process of corporatisation and privatisation of the public sector has continued into the new century. For example, we have seen the privatisation of electricity bodies, jails, major roads and public transport. Many public hospitals and local government councils now operate as commercial businesses. There have also been major changes in the regulation of labour markets—for example, the move towards enterprise agreements, negotiated within the workplace, which have significant implications for the competitiveness of businesses.

Over the past few decades we have seen a shift in Australia from primary producer and exporter of mineral resources to manufacturer. More recently, mineral resources have played an increasingly important role in the Australian economy, driven by strong demand, particularly from the Asian region, although in terms of overall economic activity Australia is now primarily a service-based economy. Growth areas in the service sector include tourism, education and 'knowledge-based' industries, such as software programming and consulting.

Australian businesses, in common with their overseas counterparts, operate in an environment that is subject to rapid and unpredictable change. Customers make increasingly strong demands on businesses for specific product requirements. The rise of the Internet and e-commerce has challenged the traditional modes of business operation; the increase in outsourcing and a greater reliance on various forms of business networks and relationships has led to the emergence of virtual organisations; and, now, organisations are grappling with increasingly important sustainability issues, such as the implications of climate change, which involves managing carbon dioxide (CO_2) emissions and scarce water resources.

The changing business environment has provided both opportunities and threats for Australian organisations. Organisations have had to evolve and adapt to find better ways to compete. New organisational structures, strategies and management philosophies have been adopted to enable organisations to be more responsive to customer needs and better able to make quick and informed decisions within global markets. It is little wonder that the practice of managing businesses effectively in the twenty-first century is very different to that of even 10 years ago. In addition, the focus of management accounting has had to keep pace with the information needs of contemporary organisations. In the appendix to this chapter there is a detailed account of the changing focus of management accounting over the past few decades.

WENDY'S: AN AUSTRALIAN SUCCESS STORY[2]

Wendy's, the retail franchise group,[3] is an incredible Australian success story, with more than 300 stores selling speciality ice-cream products to 750 000 customers per week. Wendy's was

2 The Wendy's case study is based on a number of sources including interviews with Shane Radbone, former CEO of Wendy's and Retail Brands Group; Davis, 2004; Retail Brands Group, 2004; Walker, 2004; the Wendy's web site; and BIS Schrapnel, 2001. Some material in this case has been simplified and changes have been made to protect Wendy's competitive stance. We would like to thank Shane Radbone for his invaluable assistance with this case.

3 A franchise is the granting of a licence by one person (the franchisor) to another (the franchisee) for a fee, which entitles the franchisee to sell the product under the trade name of the franchisor. The franchisor usually retains control over the nature of the product being sold, including the way the product is marketed.

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the brainchild of Geoff Davis and three other entrepreneurs who, in the late 1970s, developed an innovative and exciting product range that focused on unique 'Supa Sundaes' served in giant champagne glasses.

Wendy's opened in Adelaide in 1979 and was an overnight success. In its first week the store's sales revenue was $10 000, which even by today's standards would be considered a really good week! Over the next two years Wendy's developed into a franchising operation, and since then its franchising and retail operations have continued to grow and develop. During the 1990s the company also moved into manufacturing with the acquisition of its own product development and ice-cream manufacturing plant in Victoria. The Wendy's story is one of growth driven by energy, enthusiasm and commitment. By 2007, sales were $105 million through 300 stores across Australia and New Zealand.

While Australia has always been its primary market, Wendy's has not escaped the influences of globalisation, described earlier. During the early 1990s a number of stores were established in Singapore, Malaysia and Indonesia under the name 'Fundaes', although eventually they proved unsuccessful. In contrast, Wendy's also entered the New Zealand market in the 1990s, and by 2007 there were 28 New Zealand stores.

In 2001, Wendy's merged its operations into a holding company called the Retail Brands Group (RBG). With Geoff Davis at the helm, RBG pursued growth and profitability strategies, leveraging off Wendy's position in the retail ice-cream industry, as well as diversifying into other activities. The Board and leadership team searched globally for another food franchise that offered growth and excitement. Market research indicated that Australian consumers bought more sandwiches than burgers, chicken and pizza combined, with annual consumption of 422 million sandwiches, approximately 49 million of which were 'subs' (based on bread rolls similar to baguettes). And so the choice was made: RBG decided to enter the sandwich market with its new franchise, Quiznos Subs.

Wendy's and RBG provide a rich setting to explore the information needs of managers and the nature of management accounting.[4]

WHAT IS MANAGEMENT ACCOUNTING?

2 LEARNING OBJECTIVE

management accounting the processes and techniques that focus on the effective use of organisational resources, to support managers in their tasks of enhancing both customer value and shareholder value

customer value the value that a customer places on particular features of a product

shareholder value the value that shareholders, or owners, place on a business

Management accounting refers to the processes and techniques that focus on the effective and efficient use of organisational resources, to support managers in their tasks of enhancing both customer value and shareholder value.[5] Let's look more closely at this definition.

Value creation is a central focus for contemporary managers and can refer to both customer value and shareholder value. Customers have always been a key concern for organisations. However, it is only in recent years that managers have come to recognise explicitly that understanding **customer value**—the value that a customer places on particular features of a product[6]—and satisfying customers is critical to achieving increased sales and market share, and therefore to achieving shareholder value. Geoff Davis and the team at Wendy's created 'Supa Sundaes', an innovative taste experience that they believed customers would value—and they were right. But customer tastes and sources of customer value can and do change. As Wendy's recognises, 'Today's "great treat experience" is very different from 1979, and tomorrow will be very different from today'.[7]

Shareholder value is also a key focus for managers and involves improving the worth of the business from the shareholders', or owners', perspective.[8] So what is important to

4 RBG's decision to launch Quiznos Subs is particularly interesting, given the subsequent demise of Quiznos towards the end of 2006. Also Wendy's was acquired by senior management and a private equity investor in November 2006.
5 Adapted from International Federation of Accountants (IFAC) 2002.
6 Throughout this book, the term 'product' includes goods and services.
7 www.wendys.com.au/our_history.shtml.
8 The concept of shareholder value applies not only to the shareholders of listed companies; it applies to all types of business owners. These other owners also seek profits and capital growth.

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shareholders? Shareholders are usually interested in increased profitability, increased share price, and dividends, and management is charged with the responsibility of delivering this.

However, increasing customer value comes at a cost and, at times, managers may need to make trade-offs between undertaking actions that increase customer value, and actions that increase shareholder value. For example, more seating at Wendy's outlets may enhance customer value, and by increasing sales also enhance shareholder value. On the other hand, the push towards bigger sites with seating comes at a cost—which may have a detrimental effect on the potential to grow shareholder value. Where there is a conflict between increasing customer value and increasing shareholder value, shareholder value is likely to be given priority as this is the key strategic objective for most organisations. (Alternative objectives and priorities can be expected in not-for-profit organisations.) Resolving this conflict is not always straightforward. For example, increasing customer value may decrease shareholder value in the short run as costs also increase, but may increase shareholder value in the longer run, as market share increases.

To enhance customer value or shareholder value, managers need to understand what drives value. That is, they need to understand and make decisions about the activities or aspects of their business that lead to improvements in customer value or shareholder value. How important is seating: do most Wendy's customers want to 'eat in' or 'take away' their ice-creams? Later in this book we will learn about management accounting processes and techniques that may be used to assist managers to identify and manage those drivers, and to make decisions. Important decisions for managers include which products to produce, what prices should be set, what equipment should be purchased, and so on.

The effective and efficient use of resources is essential to creating both customer and shareholder value, and management accounting provides information to assist managers to perform this role. Effectiveness focuses managers on the successful achievement of an objective, whereas efficiency focuses managers on achieving the objective with the least possible consumption of resources. Resources can be defined broadly to include not only the financial resources of the organisation, but also non-financial resources such as information, work processes, employees, committed customers and suppliers. Non-financial resources determine the capabilities and competencies of the organisation, which allow it to survive and prosper in an increasingly turbulent global environment. According to Wendy's, 'our vision is "passionate people delivering a great treat experience . . . we value the people that make up our team . . ."'[9]

We will see in later chapters that a variety of management accounting techniques and skills can be used to manage resources to achieve increased customer and shareholder value.

MANAGEMENT ACCOUNTING SYSTEMS

A **management accounting system** is an information system that produces the information required by managers to create value and manage resources. It forms part of an organisation's wider management information systems. Management accounting information can be provided on a regular basis and can include estimates of the costs of producing goods and services, information for planning and controlling operations, and information for measuring performance. Management accounting systems also provide information on an *ad hoc* basis, to satisfy the short-term and long-term decision-making needs of management. The management accounting system may not be able to provide all of the information to satisfy managers' decision-making needs; sometimes information also needs to be obtained from other sources, including those outside the organisation. For example, the costing system at Wendy's ice-cream factory provides regular reports on the cost of ice-cream produced. However, from time to time Wendy's managers may need information about the prices from other ice-cream manufacturers, which are both competitors to the Wendy's ice-cream factory and potential suppliers to franchisees. Indeed, as Australian franchising law requires the

management accounting system
an information system that produces the information required by managers to manage resources and to create value

9 www.wendys.com.au/about_us.shtml.

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franchise system to ensure fair trading, Wendy's management need to be sure that the price of Wendy's own ice-cream is competitive in the market.

MANAGEMENT ACCOUNTING INFORMATION

The focus of management accounting is on the needs of managers within the organisation. Because accounting standards apply only to external financial reports, there is great flexibility in deciding the type of information that should be generated for managers. As managers' information needs vary, and as the nature of the resources that they manage varies, the type of management accounting information required will also vary. Other factors that cause management accounting systems to differ include differences in production or service technologies, organisational structure and organisational size, the external environment in which the organisation competes, and the levels of sophistication of computer systems. These aspects can affect managers' needs for, and the supply of, information, and will be an important influence on the design of a management accounting system. For example, when Geoff Davis set up the first Wendy's store in 1979, the cash register provided daily sales information, and recording payments to his small staff and purchases was straightforward. Now, with 300 stores located across Australia and New Zealand and its own ice-cream factory, the information needs of Wendy's managers across the organisation are far more complex. Stores still collect daily sales information, but now this information can be analysed in the Adelaide head office, in real time, to produce a wide range of reports about sales by store, region and product line.

Finally, it should be noted that management accounting information is relevant to managers from the top of the organisation through to managers in operational areas of a business. Senior managers need information that provides them with an overview of the entire organisation, whereas middle managers require more detailed information about their areas of responsibility. And operational managers will need information to help them manage their specific operations on a day-to-day basis, to help ensure that their performance targets are met. (**Operational managers** are managers who have responsibility for activities in the manufacturing areas of manufacturing firms, or for the areas that directly provide services to customers in service firms.)

operational managers managers who have responsibility for manufacturing activities in manufacturing firms, or for service delivery areas in service firms

Wendy's has identified people, innovation and growth as key drivers of business success, and its management accounting information reports on these drivers. Different reports are prepared for different levels of management. The business has an extensive field team that works directly with franchisees on daily and weekly individual store reports. One critical measure of franchisees' performance is the rent-to-sales ratio. As well as informing store managers, this information and other forms of business intelligence are reported at head office, where trends in products, revenue, costs and the broader business model are tracked. Business analysts also collect and monitor a range of workforce and new product development indicators, as well as stock and distribution information. These reports are tailored to meet the needs of particular managers. For example, workforce reports are developed for the human resources manager, supply and distribution reports go to the logistics manager, and so on. Top management at head office receives a monthly scorecard on the performance of the overall group that includes information about the workforce (including employee development), incremental income from innovation, trends in unit sales and average transactions, and so on, thus providing an overview of performance in Wendy's key areas of people, innovation and growth.

DIFFERENCES BETWEEN MANAGEMENT ACCOUNTING AND FINANCIAL ACCOUNTING INFORMATION

3 LEARNING OBJECTIVE

It should be clear from the above discussions that the orientation of management accounting is quite different to the external reporting focus of financial accounting. Exhibit 1.1 contrasts management accounting and financial accounting information.

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Exhibit 1.1

Management accounting versus financial accounting

	Management accounting	Financial accounting
Users of information	■ Internal: managers and employees at all levels	■ External: shareholders, creditors, banks, stock exchange, trade unions and government agencies
Regulations	■ No accounting standards or external rules are imposed. Information is generated to satisfy managers' information needs	■ Accounting standards and corporations law regulate the content of external financial reports
Source of data	■ Both financial and non-financial data drawn from many sources— the core accounting system; physical and operational data from production systems; and market, customer and economic data from databases external to the organisation	■ Financial data almost exclusively drawn from the organisation's core transaction-based accounting system
Nature of the information	■ Past, current and future-oriented; subjective; relevant; timely; and supplied at various levels of detail to suit managers' specific needs	■ Past; reliable; verifiable; not timely; not always relevant; and highly aggregated

financial accounting the practice of preparing and reporting accounting information for parties outside the organisation

Financial accounting is concerned with preparing and reporting accounting information for parties outside the organisation. The balance sheets and income statements[10] within the annual reports distributed by Amcor and BHP Billiton to their shareholders are examples of the output from a financial accounting system. Users of financial accounting information include current and prospective shareholders, lenders, investment analysts, unions, consumer groups and government agencies. In contrast, management accounting focuses on satisfying the needs of internal users (i.e. managers).

Financial accounting reports are based on past information that emphasises reliability and verifiability. Management accounting information and reporting are not constrained by accounting standards or regulations, so the content and design of management accounting information is determined by managers' needs. The nature of management accounting information is current and future oriented. Relevance and timeliness are considered more important than verifiability.

There is clearly some overlap between management accounting information and financial accounting information, because both draw data from an organisation's transaction-based accounting system. However, to manage the wider resources of the organisation, management accounting also draws on data from many other sources, both internal and external to the organisation. These may include data from operations (production) systems, personnel systems and customer information systems, as well as market share data and competitor costs from external bureaus. Also, the level of detail and the frequency of reporting of management accounting information is greater than for financial accounting.

10 In this book we use the terms 'balance sheet' (instead of 'statement of financial position') and 'income statement' (instead of 'statement of financial performance' or 'profit and loss statement'); or we use the term 'profit report' where a more detailed analysis of profit is presented for internal reporting purposes.

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costing system (or **cost accounting system**) a system that estimates the cost of goods and services, as well as the cost of organisational units, such as departments

One part of a firm's accounting system that is common to both financial accounting and management accounting is the costing system. The **costing system** (or **cost accounting system**) estimates the cost of goods and services, as well as the cost of organisational units, such as departments. Managers may need information about product costs for a range of strategic and operational purposes including setting prices, controlling operations and making decisions about the continuation of a particular product. These are management accounting uses. However, product cost data are also used to value inventory on a manufacturer's balance sheet and cost of goods sold on the income statement, which are financial accounting uses.

Management accounting is broader than just the preparation and reporting of financial information. Management accounting also includes analyses of non-financial resources, including manufacturing and sales performance data, and a range of techniques for managing costs and other organisational resources. Exhibit 1.2, which is drawn from a number of job advertisements, illustrates the diverse role of the management accountant and highlights the broad range of information provided to managers.

MANAGEMENT ACCOUNTANTS WITHIN ORGANISATIONS

4 LEARNING OBJECTIVE

To appreciate the management accountant's role in an organisation, we need to understand how organisations are structured and where the accounting staff may be located. However, the structures of organisations vary considerably and frequently change. Many large Australian businesses are structured with a corporate head office and a series of operating divisions. These divisions may relate to different geographical locations of the company—for example, the South Australian State Emergency Service has nine regional divisions. Alternatively, they may focus on different product markets—the Coles Group has separate divisions for its supermarket business and its discount stores. Organisational structures often identify significant functions, especially at the corporate level. For example, the organisational structure of the Commonwealth Bank includes units for Group Credit Policy and Control, Group Strategic Planning, Finance and Accounting, and Personnel. The structures within divisions may also be organised in any of these ways.

THE ACCOUNTING FUNCTION

Most large Australian organisations have a 'finance function', which is the group of staff who undertake a variety of accounting activities. Within the finance function the senior accountant may have a variety of titles, including financial controller, finance manager, financial analyst, business analyst, general manager of accounting and group accountant. (Indeed, the 'Real life' on page 12 indicates more creative titles such as strategic resource manager and e-commerce strategist!) The financial controller is usually responsible for both management accounting and financial accounting activities. As the organisation's most senior management accountant, the controller acts as an advisor to managers. Moreover, most financial controllers influence resource management decisions across all management levels and functional areas of the enterprise. In the twenty-first century, financial controllers are usually important members of the senior management team. In recent years, former accountants have served as chief executives in companies such as BTR Nylex, Coca-Cola Amatil and Foster's.

In some businesses accounting staff may be found in each operating division, as well as at the corporate level. Accounting staff are increasingly being located close to the operations of the business. For example, at Mitsubishi, which manufactured motor vehicles in Adelaide, some accountants were located within the factory. This allowed them to work more closely with operations managers and other employees.

In some organisations, accountants are clearly designated as either management accountants or financial accountants. In other businesses the distinction may be blurred, with many accountants being responsible for both functions. However, it should also be noted that the

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Exhibit 1.2

The diverse role of the management accountant

Management Accountant

- **Career path assured**
- **Exposure to global business**

THE FIRM
Our client - an International leader in the provision of mining, manufacturing, industrial and technical services employ over 39,000 people over 130 countries. Recent unprecedented growth and acquisitions have meant enormous growth and the need for Management Accountants based in their Asia Pacific head office.

THE ROLE
Reporting to a Business Manager who will be an excellent mentor, this role provides general strategic planning, forecasting and budgeting advice and commercial support to a number of divisional managers.

Specifically this will entail:

- Assisting with and developing pricing models
- Developing and reviewing costing models
- Contributing to the forecasting and budgeting process
- KPI reporting
- Variance, project and ad hoc analysis

THE PERSON
The successful applicant will be professionally qualified (CA/CPA) and possess a minimum 3 years experience (at least 2 in a commercial environment) and demonstrate an ability to "see beyond the numbers". In return you will receive mentoring from an experienced Manager, exposure to an international business and outstanding career prospects.

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Management Accountant

The Company

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The Role

Working in a team of 10, this role reports to the General Manager of Finance and is responsible for the commercial support to this business unit. This role's principal responsibilities are budgeting, forecasting, commercial analysis, business case scenario analysis, expenditure analysis and working with the business to influence change.

Your Profile

You will be CA or CPA qualified and will have a background in commercial accounting with good experience in management accounting. You will have strong analytical skills and be able to communicate at all levels of the organisation.

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To apply please send your resume to geoff.baxter@roberthalf.com.au. If you have any questions then please do not hesitate to contact Geoff Baxter on 02 9240 0608.

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Working with the Financial Controller you will be involved in strategic and business planning across their business; financial and management reporting; as well as developing models and with both financial reporting and management accounting functions, including cashflow, forecasts, budgeting and ad hoc analysis. Because you love working with the business and liaising with internal clients - you will develop strong relationships and provide financial information to key stakeholders.

Ideally you will have strong ambitions to work with likeminded individuals in a professional and dynamic team. You will be a fully qualified accountant with previous commercial experience. You will have at least five years experience in a general accounting role, be pro-active, thrive with challenges, excellent communication and a motivated team player.

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- **FMCG Leader**
- **Fantastic Opportunity**

Join the Supply Chain team at Kelso as the **Plant Accountant** and provide appropriate financial and cost control systems to assist in the development and achievement of planned objectives. Reporting to the Plant Manager your key responsibilities will include:

- Providing effective, accurate, timely reporting and analysis of factory operational costs and production performance
- Based on the analysis of cost performance, participate in developing strategies for improving performance
- Liaise with Corporate accountants and the leadership team to develop sound business plans
- Provide leadership to a team including accounts payable, payroll and site accounting
- Coordinating the preparation of the factory operational budget
- Managing the maintenance of the standard costing system to ensure a high degree of accuracy on a continuous basis
- Managing the development and application of effective systems that enable the control, collation and reporting of manufacturing data plan, and evaluate and verify capital expenditure proposals

You will be tertiary qualified in business, accounting or related disciple, have sound experience in management and cost accounting in manufacturing and demonstrate well developed leadership, business, communication, organisational and time management skills. Knowledge and experience with integrated systems is preferred. Excel and ERP system skills are essential.
Please apply on line.

Apply now

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REAL LIFE

THE NEW GENERATION OF ACCOUNTANTS

A survey at the beginning of this decade by international consultant Robert Half International of 1400 chief financial officers (CFOs) highlighted the sweeping changes that have taken place in the accounting and finance profession and in the necessary skills and competencies of accountants within organisations. For example, 82 per cent of CFOs indicated that their accounting departments had become more involved with their company's technology initiatives in the past five years, and 49 per cent had become involved in e-commerce projects in the past three years.

This survey also revealed the many different job titles for senior accounting positions, such as financial manager, financial analyst, financial specialist, strategic resource manager, consultant, e-commerce strategist, asset manager and assurance services provider.

A more recent report by the Institute of Chartered Accountants in Australia and KPMG Australia, which surveyed CFOs in 1998, 2001, 2004 and 2007, also noted that CFOs' roles have changed over time. From the late 1990s Australian CFOs had become increasingly involved in the strategic development of their business. However, there was a swing towards regulatory compliance and corporate governance following the collapses of Enron and HIH and the introduction of the international financial reporting standards (IFRS). By 2007 a balance had been re-established with CFOs focusing on both stewardship and strategy development.

Although these two sources provide quite different perspectives regarding the emerging roles for accountants, they share some common views on the skills that accountants require. Not surprisingly Robert Half International identified technical skills as important, in particular an understanding of new applications and software, including wireless technologies. However, both sources emphasised the importance of a range of 'soft skills', including:

- *Communication*. Strong written and verbal skills, including the ability to explain financial information in non-financial terms, and to present in a compelling and commercially effective manner.
- *Interpersonal*. Persuasion, diplomacy, and coaching, to enable accountants to relate to colleagues from many different backgrounds and professions. High-level negotiating skills are particularly important.
- *Managerial*. Expertise in the areas of management, marketing and operations, to allow accountants to understand the areas and function of the business. Strong leadership and team building skills are important. Chief financial officers need to be able to manage difficult people and have the resolve to decline or challenge proposals, where appropriate, and withstand pressure.

Source: Williams (2001); Institute of Chartered Accountants in Australia (ICAA) & KPMG (2007)

various processes and techniques that we describe as 'management accounting' increasingly involve managers in other areas of a business, and are not solely the domain of the accountants. For example, the design and operation of performance measurement systems, an important aspect of management accounting, may involve managers in the human resource management area. A new costing system may be designed, and perhaps even initiated, by production engineers. Clearly, management accountants have an important role to play in coordinating many aspects of the management accounting system, and as a part of the management team. However, we should not necessarily assume that they are the sole custodians of management accounting information across every organisation. In the appendix to this chapter you may

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read about the changes that have taken place in the positioning of management accounting in organisations over the past few decades.

The 'Real life' on page 12 outlines some of the changing skills and roles of accountants in organisations.

MANAGEMENT ACCOUNTING PROCESSES AND TECHNIQUES

5 LEARNING OBJECTIVE

So far in this chapter we have explained that management accounting is focused on the effective and efficient management of resources to support managers in their quest for improved customer value and shareholder value. But what are the processes and techniques that management accounting uses to achieve this?

Management accounting:

- supports the organisation's formulation and implementation of strategy;
- contributes to improving the organisation's competitive advantage in terms of quality, delivery, time, flexibility, innovation and cost, through modern process improvement and cost management techniques;
- provides information to help manage resources, through systems for planning (such as budgets) and control (such as performance measures); and
- provides estimates of the costs of the organisation's output (goods and services), to support both the strategic and operational decision needs of managers.

Let's look at examples of each of these areas.

MANAGEMENT ACCOUNTING AND STRATEGY

6 LEARNING OBJECTIVE

In many organisations in the twenty-first century, management accountants play an important strategic role by contributing to the organisation's *formulation and implementation of strategy* and by helping managers *improve the organisation's competitive advantage*.

To make sense of this role we introduce some basic strategy concepts:

- vision;
- mission statement;
- objectives; and
- strategies.

Let's define each of these terms.

Many organisations prepare a **vision**, which describes the desired future state or aspiration of the organisation (Johnson & Scholes, 1999). Wendy's vision is 'Passionate people delivering a great treat experience', whereas the vision of Wendy's former parent company, Retail Brands Group (RBG), was to be the 'Preferred franchise choice in quick service retail food' (Retail Brands Group, 2004, page 8). The vision is often used by senior management to focus the attention and energies of staff throughout the organisation. While Wendy's vision focuses the attention of franchisees and their staff, as well as the corporate team, on how to deliver the entire 'treat experience', the RBG vision focused on its core business of developing franchising opportunities.

vision the desired future state or aspiration of an organisation

A **mission statement** defines the purpose and boundaries of the organisation (Johnson & Scholes, 1999; Viljoen & Dann, 2000). Mission statements tend to change very infrequently.

mission statement a statement that defines the purpose and boundaries of the organisation

Wendy's does not have a specific mission statement, but RBG's mission statement was:

> *Creating Profitable Business Opportunities for Passionate People through:*
>
> - *Living our Values*
> - *Delivering the Best Retail Experience*

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- *Recruiting and Developing the Best People*
- *Commitment to the Success of all Stakeholders*
- *World Class Business Innovation*
- *Contributing to the Community*.

objectives (or **goals**) specific statements of what the organisation aims to achieve, often quantified and relating to a specific period of time

While not all organisations specify a vision and a mission statement, they all have some form of objectives. **Objectives** (or **goals**) are specific statements of what the organisation aims to achieve, often quantified and relating to a specific period of time. Many organisations focus their objectives around some of the following:

- profitability;
- growth;
- cost minimisation;
- product leadership;
- innovation;
- product quality;
- quality of service;
- community service;
- employee welfare; and
- environmental responsibility.

The objectives of RBG centred on:

- *Innovation, world class business innovation*
- *Brand image, build great profitable brands*
- *Retail excellence, delivering the best retail experience*
- *Community, be part of the community in which we operate*
- *Inspire, live our values, recruit and develop the best people*.

You will notice that these objectives reiterated key themes included in RBG's mission statement, described earlier. They were quite broad, and were neither quantified nor related to a specific period of time. They did, however, provide the framework for Wendy's and Quiznos' strategic objectives, which were based on the same five themes, adapted slightly to reflect their own particular business environment (Retail Brands Group, 2004, page 11 and page 24).

ORGANISATIONAL STRATEGIES

strategies the direction that the organisation intends to take over the long term, to meet its mission and achieve its objectives

The **strategies** of an organisation specify the direction that the organisation intends to take over the long term, to meet its mission and achieve its objectives (based on Johnson & Scholes, 1999). The strategies will focus on ways to manage the organisation's resources to create value for customers and shareholders.

In *formulating an organisation's strategies*, major decisions are based on the following questions:

- In what business will we operate?
- How should we compete in that business?
- What systems and structures should we have in place to support our strategies?

corporate strategy decisions about the types of businesses in which to operate, which businesses to acquire and divest, and how best to structure and finance the organisation

The first decision involves formulating corporate strategy. **Corporate strategy** involves making choices about the types of businesses in which the organisation as a whole will operate. This includes decisions about what businesses to divest or acquire, and how best to structure and finance the company. In publicly listed companies, the choice of corporate strategy is heavily influenced by expectations of major shareholders and the securities market.

The decision by RBG, in 2001, to diversify business activities by becoming the master franchisee for Quiznos, the US submarine sandwich chain, is an example of a change in corporate strategy. Quiznos had 3500 outlets in 17 countries and RBG planned to open 20 stores by Christmas 2004 and more than 200 stores in Australia within five years.

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The second type of decision involves business strategy. **Business** (or **competitive**) **strategy** is concerned with the way that a business competes within its chosen market. For example, RBG knew that the major competitor for Quiznos would be the established global submarine sandwich chain, Subway, which at the time had 15 000 outlets worldwide and more than 580 outlets in Australia. Subway held 90 per cent of the Australian market for subs. Despite this strong foothold, the RBG leadership team decided that the market was big enough for two players. Their aim was to be 'a good number 2', competing on product appeal rather than price, with Quiznos prices intended to be 5 to 10 per cent higher than Subway's.

business (or **competitive**) **strategy** the way a business competes within its chosen market

If an organisation consists of several different business units, each with its own distinct market, then there will be a competitive strategy developed for each unit.

The third question is concerned with **strategy implementation**, which involves planning and managing the implementation of strategies. This can include introducing new structures and systems, such as setting up new business units, implementing new production processes, implementing new software packages, developing new marketing approaches, and introducing innovative human resource management policies.

strategy implementation putting plans into place to implement and support a chosen business strategy

Exhibit 1.3 (overleaf) includes examples from four Australian businesses of their approaches to formulating strategy. While elements of vision, mission statements, objectives and strategies are present you will notice differences in how businesses approach strategy formulation.

In implementing its strategies, RBG recognised the importance of getting the Quiznos experience right, and by October 2004 had sold only 58 franchises in response to more than 2000 expressions of interest. According to the RBG chief executive officer (CEO), 'Selection of the first batch of franchisees is critical to the success of the brand. We know that from our Wendy's experience' (Walker, 2004). By this time the company had spent millions of dollars on developing the infrastructure to ensure effective establishment and support of Quiznos franchisees.

A CLOSER LOOK AT BUSINESS STRATEGY

To create shareholder value a business must develop and manage its sources of competitive advantage. A well-known model for thinking about competitive advantage was developed by Michael Porter of Harvard University. **Competitive advantage** refers to advantages that a business may have over another, which are difficult to imitate. Porter suggests that a firm can gain a sustainable competitive advantage through adopting a business strategy of cost leadership or product differentiation.

competitive advantage the advantages that a business may have over another, which are difficult to imitate

When a firm is a low-cost producer, this allows the business to sell its goods or services at a lower price than competitors (**cost leadership**). Alternatively, firms may derive competitive advantage by offering goods or services that have characteristics that are different from those offered by competitors (**product differentiation**). Forms of product differentiation include superior quality, customer service, delivery performance and product features such as innovation. Within the one industry there may be successful cost leaders and successful differentiators. Many firms will develop a business strategy that emphasises both cost leadership and some form of differentiation. However, a firm may choose to place greater emphasis on either type of competitive strategy.

cost leadership a business strategy where a firm is a low-cost producer that allows the business to sell its goods or services at a lower price than competitors

product differentiation a business strategy whereby a firm derives competitive advantage from offering goods or services that have characteristics different from those offered by competitors

Businesses that choose to place a greater emphasis on cost leadership may achieve this in several ways, such as through economies of scale in production, superior process technology, tight cost control and cost minimisation in areas such as marketing, production, research and development, and customer service.

In Australia, examples of businesses that compete primarily on the basis of cost include The Reject Shop, Bi-Lo, Kmart and STA Travel. In these businesses some attention is also paid to aspects of differentiation, such as customer service and quality. However, it is the firm's cost performance that provides the basis for competitive advantage.

When a differentiation strategy is followed, the emphasis is on creating some characteristic of the good or service that is perceived by customers as unique. Successful differentiators

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Exhibit 1.3

Vision, mission and strategies

Advocates for survivors of child abuse	BHP Billiton charter
Vision A world without child abuse. **Mission statement** To support and enable survivors to overcome the effects of child abuse. **Objectives** To achieve our mission, ASCA will provide: ■ support services, ■ therapeutic services, ■ education, and ■ advocacy *Source:* http://www.asca.org.au/about/about_mission.html	Our purpose is to create long-term value through the discovery, development and conversion of natural resources, and the provision of innovative customer and market-focused solutions. To prosper and achieve real growth, we must: ■ actively manage and build our portfolio of high quality assets and services; ■ continue the drive towards a high performance organisation in which every individual accepts responsibility and is rewarded for results; and ■ earn the trust of employees, customers, suppliers, communities and shareholders by being forthright in our communications and consistently delivering on commitments *Source:* www.bhpbilliton.com/bb/aboutUs/charter.jsp
Coopers Brewery	**ACT Nursing and Midwifery Board**
Mission statement To provide natural beverages and food ingredients which satisfy tastes and nutritional needs, and create enjoyment. **Competitive advantages** ■ Strong branding, ■ focused on market niches, ■ focused on unique products—Ales and Stouts—that is, differentiation strategy based on uniqueness of product offering, ■ premium segment of the market, and ■ family involvement and leadership *Source:* http://www.coopers.com.au/students.php	**Vision** Integrity in nursing and midwifery. **Mission** Protecting the community through leadership and regulation of the nursing and midwifery professions in accordance with ACT legislation. **Strategic priorities** ■ Protection of the public through administration of the legislative framework, ■ promote development of the professions, ■ demonstrate excellence in business and professional practice, and ■ support the development of a national regulatory framework *Source:* www.actnmb.act.gov.au/board_mis_state.html

are able to set selling prices that more than offset the cost of the added product features that are valued by customers. Differentiation may be on the basis of a number of characteristics such as high quality products (Mercedes Benz), strong brand image (Coca-Cola and Rayban), superior customer service (Commonwealth Bank) and product innovation (Nokia and Motorola). Many firms pursue a combination of differentiation strategies (e.g. the David Jones department stores focus on high quality and superior customer service).

The emphasis at Wendy's is on innovative ice-cream experiences and customer service in a fun environment, rather than on price. The overall experience is the key. To achieve each of the five strategic objectives, described earlier, Wendy's identified more specific organisational strategies. For example, strategies for innovation (Retail Brands Group, 2004, page 25) include:

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- *Develop new products as part of a consumer driven product research plan*
- *Create a dedicated innovation team*
- *Build a company owned Concept Store Model to showcase innovation in product and retailing for the future*
- *Develop and implement new channels to market*.[11]

MANAGEMENT ACCOUNTING: CONTRIBUTING TO STRATEGY

Management accountants should tailor information to support the formulation and implementation of their organisation's strategies.

Strategic planning

Strategic planning is the term given to long-term planning, usually undertaken by senior managers, with a three- to five-year timeframe. Strategic planning involves making *corporate strategy* decisions about the types of businesses and markets in which the organisation operates, and *business* (or *competitive*) *strategy* decisions about how the business is to compete within its particular markets. Strategic planning draws on a wide range of management accounting information from the costing, budgeting and performance measurement systems, as well as information from special studies internal and external to the organisation.

strategic planning long-term planning to achieve the organisation's objectives, usually undertaken by senior managers

Implementing strategies

Once strategies have been formulated, managers at all levels of the organisation share the responsibility for implementing them. Management accountants can play an important role in this process using the planning and control systems described below. Long-term plans need to be linked to the budgeting system, to produce annual budgets that support the organisation's strategies. Likewise, performance measurement systems can be used to compare actual outcomes to budgets and other targets that focus on the organisation's strategic objectives.

MANAGEMENT ACCOUNTING: CONTRIBUTING TO COMPETITIVE ADVANTAGE

7 LEARNING OBJECTIVE

Well-managed organisations focus their objectives and strategies on building and maintaining sources of competitive advantage. To be an effective contributor to strategy, the management accounting information should be shaped around the organisation's sources of competitive advantage. If a firm competes primarily on the basis of low cost, its management accounting information should focus on product costs and tight cost control. If a firm follows a differentiation strategy, the focus should be on performance around the sources of differentiation such as quality, delivery, time, flexibility and innovation. For example, the management accounting reports at Wendy's monitor costs but they also provide a lot of information about product and process innovation, and about people—a key driver of customer service (and ultimately of quality and innovation).

With an increasing emphasis on strategy in organisations, several such strategic management accounting techniques have evolved since the 1990s. These include performance measurement systems that focus directly on aspects of business strategy, and techniques for improving the organisation's competitive advantage through modern process improvement and cost management, with an emphasis on reducing costs while also enhancing customer value.

PLANNING AND CONTROL

8 LEARNING OBJECTIVE

Planning and control systems are a vital element of management accounting. As part of strategy implementation, organisations need to put in place plans to set the direction of the

11 Retail Brands Group, 2004, page 25.

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organisation, and control systems to ensure that operations are proceeding according to plan. Planning and control systems provide the framework for effective resource management to generate customer and shareholder value.

PLANNING

planning a broad concept that is concerned with formulating the direction for future operations

budget a detailed plan summarising the financial consequences of an organisation's operating activities for a specified future time period

Planning is a broad concept that is concerned with formulating the direction for future operations. Plans are necessary so an organisation can consider and specify all of the resources that will be needed in the future—whether financial or non-financial. Planning activities occur at many levels within an organisation. As described above, many organisations develop strategic plans that normally involve a three- to five-year timeframe. However, most organisations also prepare short-term or operational plans, called budgets. A **budget** is an example of a plan that summarises the financial consequences of an organisation's operating activities for a specified future time period, usually one year.

To examine the nature of planning, let's consider the planning processes at Wendy's during the mid- to late 1990s, when the leadership team decided to reposition the business completely. McDonald's had begun setting up 'Express' stores in shopping centres across Australia, and in 1994 it launched the 30 cent soft serve cone. At the time, Wendy's product range focused primarily on soft serve ice-cream, offering a range of creative face cones such as 'Winky Dink', 'Wacky Witch' and 'Snowman', priced from $1.80 upwards. Although the Wendy's soft serve experience was very different to that of McDonald's, it seemed that consumers could not swallow the significant price differential. The effect on a Wendy's business when a McDonald's store was located nearby was catastrophic, with an average decline in store sales of 20 per cent and an even greater impact on profit (because the cost of ingredients and customer service was lower for cones than for other Wendy's products). Wendy's leadership team knew they faced a crisis when competitor intelligence indicated that the 30 cent cone was a key element of the longer-term marketing strategy of McDonald's rather than a short-term promotional campaign. According to Geoff Davis, this was Wendy's 'worst nightmare … one that caused … [the leadership] team to reconstruct the company, from the ground up over the next 3 years' (Davis 2004, page 79).

Wendy's spent $1 million responding to this challenge. The first step involved extensive market research to get a better understanding of customer value. Wendy's major market was shopping malls, and their research showed that 70 per cent of customers in shopping malls were adult females aged between 20 and 40 years. Although Wendy's had begun life targeting the adult market with its indulgent 'Supa Sundaes', over time it had moved more and more towards families, and in particular children, with the success of its face cones. Now, the company's market research indicated that it needed to develop a more adult position in the market. Armed with this information, Wendy's leadership team began a systematic planning and implementation process to reposition the business.

The strategic repositioning was based on a new family image concept, which was trialled with six stores in Wollongong in 1996. Its success gave the Wendy's team the courage to roll out the new concept across the nation under the name of 'BITES' (best ice-cream treat experience) from early 1997, and then 'Family Image' by the end of that year. The new concept involved new store designs and a new logo. It also meant new products that appealed to adults, especially females. As described earlier, Wendy's had bought its own manufacturing facility to develop and manufacture an innovative range of ice-creams. 'Chocollo', a low fat soft serve, is a classic example of a new product developed at this time. According to Wendy's CEO, Chocollo was intended to 'give women permission to buy Wendy's ice-cream, not just for their kids, but for themselves'. Other innovative products included smoothies, a sophisticated range of low fat scoop and yoghurt ice-creams, and low fat hot dogs, aptly named 'Skinny Dogs'. In 2004, Wendy's leadership team did more work on the family image concept with the launch of Operation Yum, a project focusing on store image, with new colours and a new feel—another step towards the family positioning with a real focus on females.

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Although stunned at the time, Wendy's leadership team now believes that the move of McDonald's into the soft serve market served them well, as it forced them to develop a much better understanding of their customers and sources of customer value. Without this shock they might never have developed their family image concept and captured the broader adult market.

The repositioning of Wendy's was a huge undertaking. It required detailed planning, supported by extensive information. The leadership group needed estimates of the resources required to develop and produce new products, new store designs, new marketing campaigns, and so on. Planning for such an operation entails more than formulating resource budgets: it also includes formulating detailed schedules and time-lines for its implementation, and selecting performance measures and targets to assess its success. Much of this information was future-oriented and financial in nature, and management accounting assisted in providing and analysing this data. This future orientation is a particular characteristic of management accounting information that distinguishes it from financial accounting information. Non-financial information was also important in formulating and evaluating these plans, and the inclusion of non-financial information is another distinguishing feature of management accounting information.

IMPLEMENTING PLANS: INFORMATION FOR DECISIONS

Almost every organisation has some sort of plans, whether detailed budgets or something less formal, and managers are responsible for implementing these plans (and sometimes for adapting them to take account of unplanned circumstances). Planning, implementing plans and controlling requires managers to make many decisions; and to make decisions, managers need information.

Many decisions made by managers occur frequently, so information to support these decisions, such as budgets, performance reports and product costs, is prepared on a regular basis. However, management accounting information is also needed to support non-routine decisions. For example, in making decisions about the development and implementation of their family image project, Wendy's leadership team relied on information drawn from regular management accounting reports, such as sales performance and product and store costs. However, the project also required a lot of additional information that was not available from routine management accounting reports, such as estimates of the costs of new store designs, costs of new product lines, estimated uptake of new ideas by franchisees and so on.

Management accounting systems are designed to produce frequently required information (often for control purposes), but need to be flexible enough to generate some of the information that is needed for decisions that occur very infrequently, or only once.

CONTROLLING

Effective resource management must also include systems for control. **Control** involves putting in place mechanisms to ensure that operations proceed according to plan and that objectives are achieved. There is sometimes confusion between the terms 'planning' and 'control', probably because of their interdependence. Plans will not be effective unless there is some way of ensuring that they are achieved. This is the role of control and control systems. **Control systems** are the systems and procedures that provide regular information to assist with control.

Exhibit 1.4 (overleaf) describes the various components of planning and control, and how they relate. In providing information for control, an aim of management accounting systems is to motivate employees to act in the interests of the organisation. This can be achieved by setting targets and then measuring the performance of managers and business units against those targets.

control putting mechanisms in place to ensure that operations proceed according to plan and that objectives are achieved

control systems the systems and procedures that provide regular information to assist in control

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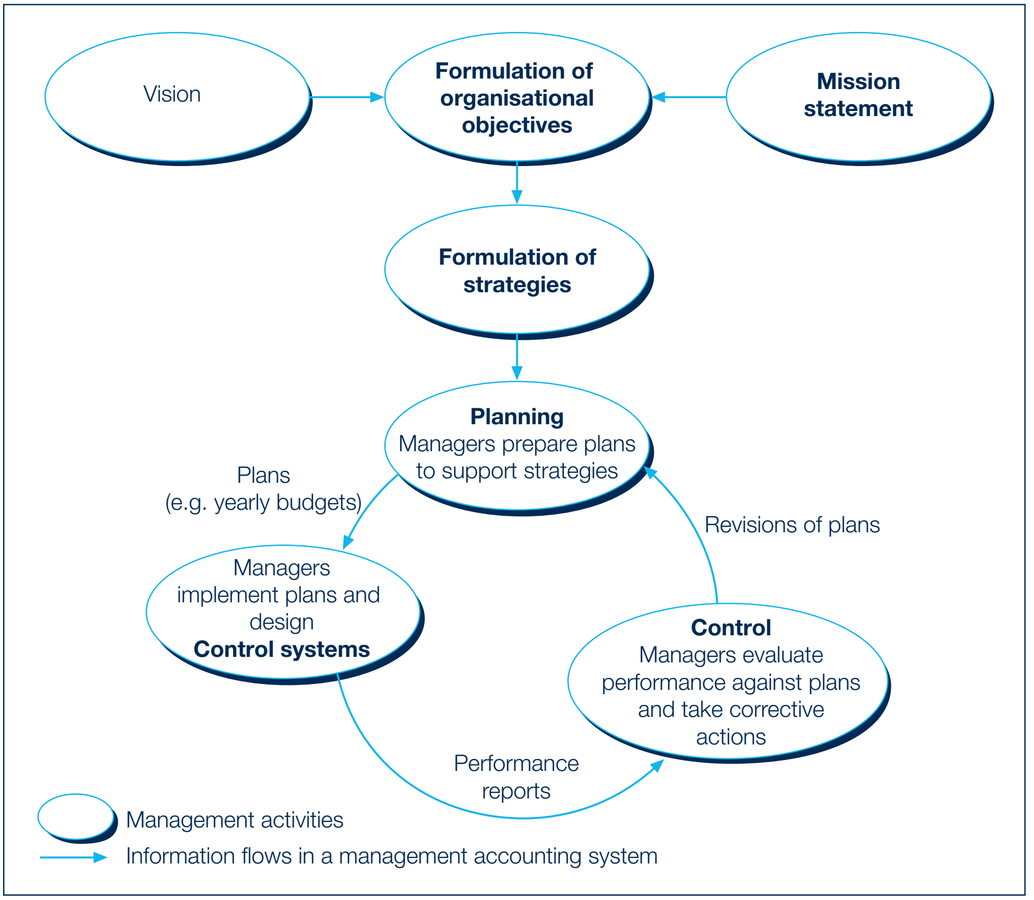
Exhibit 1.4

Planning and control systems



Thus, the control function is an important aspect of management accounting, as it directly assists in managing the use of resources in order to achieve plans for creating value.

Let's return to Wendy's implementation of the family image concept to illustrate the nature of control. During the planning stage, targets were set for the number of stores converting to the new image, as well as for store growth (measured in sales dollars), customer counts and average transaction value. Targets were also set to monitor the development of new products and various 'people skills', as well as movements in product mix expected with the new concept. For example, with the shift to a more adult positioning, soft serve sales were expected to become less important—and, indeed, soft serve sales did move from about 40 per cent of the business in 1996 to 8 per cent in 2004. The management accounting system at Wendy's produced reports that compared these targets (and many others) with actual performance. When actual performance moved away from the targets, the reasons were investigated and actions were taken to correct any problems. In this way, management were able to exercise a degree of *control* over the operations underlying the implementation of their new concept.

COSTING GOODS AND SERVICES

9 LEARNING OBJECTIVE

Estimates of the cost of producing goods and services are often needed to support a range of operational and strategic decisions that confront managers. In manufacturing firms, and in some service firms, routine systems are established to estimate the cost of goods and services. Sometimes this forms a part of the financial accounting system. However, sometimes costs that are estimated for management decisions are produced outside of the financial accounting framework. Why is this so?

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Financial data within an organisation's primary accounting system are usually prepared for external reporting purposes. Thus, these are governed by traditional accounting conventions ('generally accepted accounting principles' or GAAP) including legally enforceable accounting standards. However, the costing information produced by the financial accounting system may not be adequate for managers' decisions. For example, let's consider decisions that require an estimate of the cost of producing a product. Products that are costed for financial reporting purposes, for example to value inventory or cost of goods sold, consist of manufacturing costs only. Many managers believe that for some decisions, such as whether or not to continue to produce a product, product costs should also include other product-related costs, such as marketing and customer support. Managers will also require information about the future revenues and costs of the product. However, future costs do not form part of the primary accounting systems of a business. (These issues will be discussed further in Chapter 4.)

Some managers also believe that the simplistic methods used to value products for external reporting purposes are too inaccurate to be used for managers' decisions. Thus, in the 1990s, some companies began to use activity-based costing (ABC) systems to provide more accurate estimates of product costs for use in managers' decision making. These costing systems are described in Chapter 8.

SOME IMPORTANT CONSIDERATIONS IN THE DESIGN OF MANAGEMENT ACCOUNTING SYSTEMS

10 LEARNING OBJECTIVE

Several important considerations influence the choice and design of management accounting systems. We will introduce these issues briefly here, and they will be considered further throughout the text.

BEHAVIOURAL ISSUES

When designing and implementing management accounting systems, we need to be conscious of the ways in which information impacts on individual behaviour. There may be expected and unexpected outcomes of management accounting systems. The reactions of both individuals and groups of individuals to management accounting information will significantly affect the activities and decisions within an organisation. For example, at Wendy's the accounting staff need to consider how franchisee sales staff might behave if made accountable for a very tight cost budget. Will they reduce customer satisfaction by reducing serve sizes? How much detail should be included in the reports to franchisees, and how often should they receive this information? If too much detail is provided, will they be overloaded with information and distracted from the main points? Understanding the behavioural implications of management accounting information is a real challenge for the Wendy's accounting team, given the potential impact on staff within the Wendy's corporate team, who are employees, and their franchisees, who are external to the business.

The 'Real life' overleaf describes the importance of considering the type and amount of information managers need in designing a management accounting system.

Motivating managers and other employees

We have seen that organisations have objectives or goals. However, organisations are made up of people who have goals of their own. The goals of individuals are diverse, and they do not always match those of the organisation. A key purpose of the management accounting system is to motivate managers and other employees to direct their efforts towards achieving the organisation's goals. One way of achieving this is through the design of tools such as budgeting and performance measurement. In management accounting, performance measurement systems are a key source of information for motivation. One means of motivating people to commit to the organisation's goals is to measure their performance in achieving performance

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REAL LIFE

WHAT INFORMATION SHOULD MANAGEMENT ACCOUNTANTS SUPPLY?

A survey of North American managers examined the type of information that managers used in their day-to-day activities and for performance evaluation. Accounting information was found useful for performance evaluation, but inadequate for the management and control of operational tasks. Many managers had given up using accounting reports and had developed their own systems. The authors recommended that:

1 *Management accountants should help in the provision of physical unit data to managers*. This includes daily information on physical measures for operational control, such as the number of units produced, number of units rejected, time lost to injuries, rescheduled shipments, quantity variances and units in inventory. Unlike financial measures, these are items that production managers can actually control.
2 *Management accountants should play a major role in ensuring effective interdepartmental communication between sales and production*. The information flows between sales and production are irregular and often undertaken on an informal basis.
3 *Management accountants should redefine their roles to include managing the development and implementation of information systems*. The traditional role of management accountants, as the primary providers of information within businesses, has slipped away. The scope of accounting information is regarded as too limited by many managers, and it often arrives too late to be of use for control or decision-making purposes.

Managers regarded relevance, accuracy and timeliness as important characteristics of information. However, much accounting information provided to managers did not rank highly on these criteria, because some management accountants were tied to financial models of reporting. To regain their role as primary information providers, management accountants need to become more directly involved in the operation of data-collection and reporting systems, and move closer to the managers they are serving.

The information above was gathered in the US, from managers, who are the *users* of management accounting information. It is interesting, therefore, to find that in Australia, the *preparers* of management accounting information have similar views. For example, the surveys of Australian CFOs, described in the 'Real life' on page 12, also identified the importance of communication skills and the ability to develop strong relationships with key stakeholders within the business.

Source: McKinnon & Bruns (1992, 1993); Williams (2001); Institute of Chartered Accountants (ICAA) & KPMG (2007)

targets. Such performance can be used as the basis for providing rewards. Rewards may include positive feedback (such as words of congratulation from the manager), promotions, bonuses and pay rises. For example, many large companies base the salaries of senior executives, in part, on achieving profit targets. In this way managers are encouraged to take actions that maximise the company's objectives. A growing trend in Australian companies is to involve employees at all levels of the business in employee share plans. Many Australian

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companies, such as Bendigo Bank, Woolworths and Boral, have employee share schemes in place. One reason for these schemes is to encourage all employees to identify more closely with their company and its goals.

Wendy's uses a sophisticated planning and control system that extends beyond financial budgets and performance measurement. For example, the performance of each member of the Wendy's leadership team is measured by a number of key performance indicators (KPIs), and their remuneration is linked to KPI achievement. Both short-term and long-term objectives are rewarded, with long-term incentives based on three-year plans. There are also franchisee reward programs, operating in an environment of continual performance reporting to the franchisee community.

COSTS AND BENEFITS OF INFORMATION

Information is a commodity, much like wheat or wool. Like other goods, information can be produced, purchased and consumed. It can be of high or low quality, timely or late, appropriate for its intended use or totally irrelevant. The generation and provision of information entails both costs and benefits. The costs of providing management accounting information to managers include the salary cost of accounting personnel, the cost of purchasing and operating computers, the cost of the time spent by managers to read, understand and use the information, and the cost of gathering, processing and storing information.

The benefits include improved decisions, more effective planning, greater efficiency of operations at lower costs, better control, and improved customer and shareholder value.

Thus, there are both costs and benefits that need to be assessed when considering whether to provide particular information. However, some accountants, eager to show that they have not overlooked anything, provide too much information. When managers receive more information than they can use effectively, information overload occurs. Struggling to process large amounts of information, managers may be unable to recognise the most important facts. In deciding how much and what type of information to provide, management accountants should consider human information-processing limitations.

The Alcoa case, in the 'Real life' overleaf, describes a situation in which the costs of information provided by the management accountant seemed to outweigh its benefits. And this is not an isolated example. A survey of 720 Australian organisations, from both private and public sectors, identified monthly reports of less than 10 pages as 'best practice' in management reporting. Yet 80 per cent of respondents exceeded this target, with 30 per cent producing reports of 30 pages or more each month. The report noted that a number of accountants seemed to:

> *… have a 'communicable' disease … [that] manifests itself in reports growing in the number of pages, print size becoming squint size and report formats not designed to aid the manager [to] locate key information … Busy executives want their reports to be concise. Best practice is to give them fast, brief reports that highlight the matters worthy of their attention and requiring action.*[12]

We will reinforce the need to trade off the costs and benefits of management accounting information throughout this text. Of course, a difficulty with this principle is that, while we can quantify the costs of providing information, the mainly intangible benefits of improved information cannot be determined with accuracy.

MANAGEMENT ACCOUNTING DESIGN: CONTINGENCY AND INSTITUTIONAL THEORIES

By now you will have discovered that that there is no single management accounting system. Rather the management accounting system is, or should be, tailored to the needs of the

12 Australian Society of CPAs, 1996.

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REAL LIFE

THE VALUE OF MANAGEMENT ACCOUNTING INFORMATION AT ALCOA

Alcoa is one of Australia's major aluminium producers. Interviews with a sample of managers selected across a range of refineries and mining sites in Western Australia found that senior managers were so swamped with information that the analysis of cost reports was delegated to subordinate managers.

The interviews unearthed several other problems with the management accounting information. For example, many managers, both senior and junior, considered the monthly reports of the differences between budgeted and actual results to be 'pointless' for control. Senior managers were aware of the inevitable fluctuations in production processes that occurred during the year, which undermined the value of the variance reports. Junior managers considered that the budgets were unrealistic and provided no constraint on their spending. Managers in the mine sites also viewed the routine management accounting reports as 'largely superfluous' for decision-making purposes. These managers regarded information from online systems, or the informal reports that the mine managers generated themselves, as much more valuable.

The evidence suggested a need for the Alcoa management accounting team to evaluate the costs and benefits of the information they provided to their managers. Indeed, the interviews were part of a total quality management program in the accounting function at Alcoa that addressed this issue.

Source: Smith (1994)

organisation or its managers. While there are many, many management accounting systems, researchers have invested considerable effort in understanding the general principles that influence the design of management accounting systems. Contingency and institutional theories provide two of the most widely accepted explanations for the design of management accounting systems.

contingency theory assumes that the design of an organisation's management accounting system may be influenced by (is *contingent* on) a range of factors including the external environment, technology, organisational structure, organisation size, strategy, and organisational and national culture

Researchers who follow **contingency theory** argue that the design of an organisation's management accounting system may be influenced by (i.e. is *contingent* upon) a range of factors that reflect the context within which the organisation operates, including the external environment, technology, organisational structure, organisation size, strategy, and organisational and national culture (Chenhall, 2003). This means that in designing the system, the management accountant will need to take account of the how large and complex the organisation is, what sort of market the organisation operates in, what management style exists within the organisation and so on.

Institutional theorists argue that a range of institutional forces also influence the design of organisational structures, including management accounting systems. According to

SAMPLE CHAPTER ONLY

institutional theory, management accounting practices become 'rationalised myths', and organisations may adopt these practices to achieve legitimacy both within and beyond their organisation. For example, organisations are dependent on support from a range of government institutions and on access to a wide range of resources such as labour, finance and technology. Achieving legitimacy through adopting 'accepted' accounting practices helps an organisation to access the support and resources that are critical to its continued operations and long-term survival. For example, an organisation may adopt enterprise-wide software such as SAP, or innovations such as the balanced scorecard, not as a rational response to the needs of managers, but to be seen as having the latest and same innovations as other leading companies. In contrast to contingency theory, which focuses on the cause of differences in management accounting system designs, institutional theory argues that similarities will be found in the management accounting systems of different organisations. The effects of education, staff movements amongst organisations and professionalisation enable firms to imitate the 'good' practices of other firms. In effect, firms may shape their management accounting systems based on accepted views of good practice as displayed in other organisations (Brignall and Modell, 2000; Baxter and Chua, 2003; Collier, 2006).

institutional theory states that the design of an organisation's management accounting system may be influenced by the need for legitimacy and the tendency for firms to imitate the 'good practice' from other organisations

MANAGEMENT ACCOUNTING RESPONSES TO THE CHANGING BUSINESS ENVIRONMENT

11 LEARNING OBJECTIVE

At the start of this chapter, we outlined some of the recent changes that have taken place in the business environment leading into the twenty-first century. Exhibit 1.5 (overleaf) provides a summary of key changes in the business environment, changes that have taken place within organisations to allow them to compete effectively, and new management accounting techniques that have been developed to support managers' changing needs.

To improve shareholder value, firms need to increase their competitiveness. By the 1990s, many firms realised that they needed to improve product or service quality, delivery responsiveness, cost performance, and ultimately market share and profits. This led to organisations adopting some of the new management structures, systems and practices listed in Exhibit 1.5. Throughout the following chapters we will refer to conventional and contemporary management accounting approaches. Conventional approaches include budgeting systems, costing systems and financial performance measurement systems. These systems have been in wide use for many decades. Contemporary approaches are more recent developments, and some of these newer techniques are identified in Exhibit 1.5. For example, activity-based costing, a more accurate method for determining the costs of goods, services, customers, projects and activities within organisations, as well as for budgeting, is described in Chapters 7 and 8, and revisited in Chapters 11, 15, 16, 18 and 19. Chapter 12 introduces economic value added, a measure of shareholder value. New approaches to measuring performance are explored in Chapter 14. Chapter 15 describes contemporary approaches to managing suppliers and customers, based on principles of supply chain management and contemporary approaches to managing inventory and time. Chapter 16 presents new methods of managing costs and quality. These include activity-based management, business process re-engineering, target costing and quality costing, and in Chapter 17 we explore recent developments in management accounting for sustainability and climate change. Of course, even in chapters that focus primarily on more traditional management accounting techniques, contemporary adaptations and developments are also described.

The 1990s have passed, and we are now well into the twenty-first century. However, introducing change in organisations can be a difficult and slow process. Some Australian organisations are yet to implement many of the organisational changes and new management accounting techniques, and many others are in the midst of implementing change.

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Exhibit 1.5

Key influences on management accounting systems

Changes in the business environment →	Organisational responses: structures, systems and practices →	Management accounting responses (chapter in which discussed)
■ Increased global competitiveness ■ Deregulation of the service sector—banks, communications, utilities ■ Privatisation/ commercialisation of public service providers ■ Reduced tariffs on imports ■ Growth of the service sector ■ Increasing awareness of sustainability issues ■ Emerging environmental issues associated with climate change	■ Flatter organisational structures ■ Employee empowerment ■ Team-based structures ■ Computerised production systems ■ ERP (enterprise resource planning) systems ■ E-commerce technologies ■ Real-time reporting systems ■ Supply chain management ■ Increased focus on key sources of customer value, such as quality, delivery and innovation ■ Increased focus on continuous improvement ■ Environmental management systems	■ Activity-based cost systems (Chapter 8, and revisited in 15, 16, 18 and 19) ■ Activity-based budgeting systems (Chapter 11) ■ Measures of shareholder value (Chapter 12) ■ Strategic performance measurement systems, such as balanced scorecards, and benchmarking (Chapter 14) ■ Supply chain management, supplier analysis, and customer profitability analysis (Chapter 15) ■ Inventory management (just-in-time) (Chapter 15) ■ Time management (Chapter 15) ■ Cost management systems: activity-based management, business process re-engineering, life cycle management, target costing and throughput accounting (Chapter 16) ■ Managing quality, and quality costing (Chapter 16) ■ Information to support sustainability, environmental management accounting and sustainable balanced scorecards (Chapter 17) ■ Measures of CO_2 emissions and other scarce resources such as water (Chapter 17)

SUMMARY 1

Management accounting refers to the processes and techniques that are focused on the effective and efficient use of organisational resources, to support managers in their tasks of enhancing both customer value and shareholder value. Key points include:

- **By the 1990s, Australian companies had been exposed to increased competitiveness and rapid and unpredictable change.**
- **Management accounting can be distinguished from financial accounting. Financial accounting focuses on preparing and reporting accounting information for external parties, deals with past information, is regulated by accounting standards, and emphasises reliability and verifiability. Management accounting draws data from wider sources than the transaction-based accounting system, is not subject to external regulations, considers current and future information, and emphasises relevance to managers.**

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- Management accountants in organisations may be located in accounting departments or closer to the aspects of the business that they support, such as the manufacturing operations areas. In some organisations, management accounting activities are also performed by managers from other functional areas of the business.
- The processes and techniques that are used by management accounting to improve value include:
  - systems to support the formulation and implementation of strategy,
  - process improvement and cost management techniques to help develop and manage the firm's competitive advantage,
  - information to help managers manage their resources through planning and control systems, and
  - estimates of the cost of products to support strategic and operational decisions.
- The objectives of an organisation flow from the vision and mission statement, and strategies are developed to achieve these objectives. Management accounting provides information to support the development and evaluation of strategies, and strategy implementation.
- Management accounting may contribute to activities that seek to improve the organisation's performance in terms of quality, delivery, time, flexibility, innovation and cost, through modern process improvement and cost management techniques.
- Planning and control systems are part of strategy implementation and assist in improving the management of resources. Planning systems set the direction of the organisation, while control systems help to ensure that operations are proceeding according to plan.
- Costing systems provide information about the costs of goods and services, which are important in a range of operational and strategic decisions.
- Some important considerations in the design of a management accounting system include an awareness of the behavioural implications of management accounting information, and of the costs and benefits of designing, producing and using management accounting information, as well as perspetives drawn from contingency and institutional theories.

A range of contemporary management accounting techniques have been developed in recent years to support the adoption of a range of new organisation structures, systems and practices, which are a response to changes in the business environment. As we move through the chapters of this book we will learn about both traditional and more contemporary management accounting techniques.

KEY TERMS

budget 18
business (or competitive) strategy 15
competitive advantage 15
contingency theory 24
control 19
control systems 19
corporate strategy 14
cost leadership 15
costing system (or cost accounting system) 10
customer value 6
financial accounting 9
institutional theory 25
management accounting 6
management accounting system 7
mission statement 13
objectives (or goals) 14
operational managers 8
planning 18
product differentiation 15
shareholder value 6
strategic planning 17
strategies 14
strategy implementation 15
vision 13

SAMPLE CHAPTER ONLY

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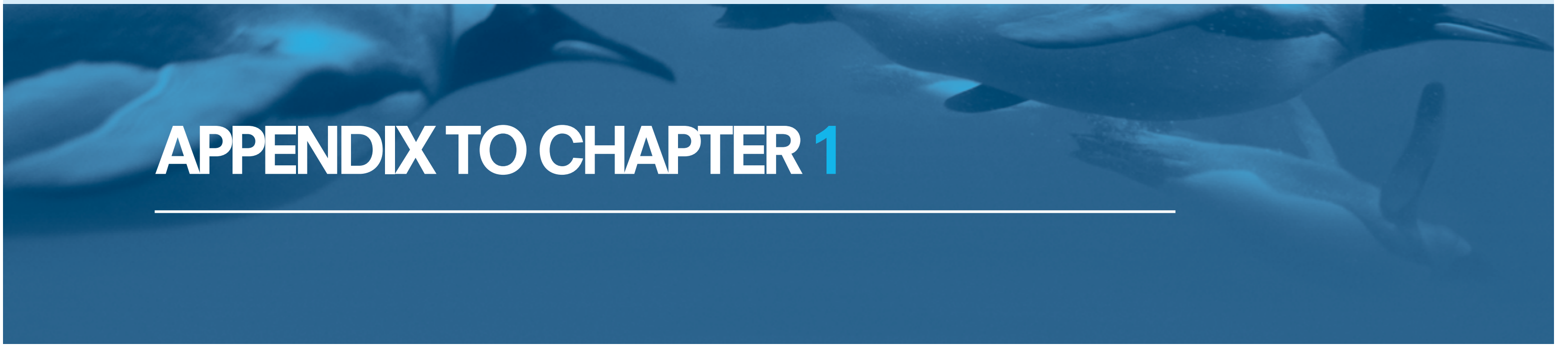
CYBERSEARCH 1

1 Find a web site that contains an organisation's mission statement and objectives.
   (a) Do these statements correspond with the definitions in this chapter? If not, explain why.
   (b) What type of management accounting information could be collected to help managers assess whether these objectives are being achieved?

2 Find the annual report of an Australian company on the Internet. Consider the financial information that is provided. Do you consider this information suitable for management decisions? Explain your answer.

For a list of useful web sites to help you with these exercises visit the Online Learning Centre at www.mhhe.com/au/langfield5e.

SAMPLE CHAPTER ONLY



APPENDIX TO CHAPTER 1

EVOLUTION AND CHANGE IN MANAGEMENT ACCOUNTING

12 LEARNING OBJECTIVE

The area of activity that we now call management accounting has developed over the past 50 years. Exhibit 1.6 (overleaf) summarises changes in the focus of management accounting since the 1950s. Prior to the 1950s the focus was on cost accounting, primarily for inventory valuation, and financial control, and the emphasis was on the management accountant as a scorekeeper for management. *Cost accounting*, rather than management accounting, was the name given to this area of accounting.

Between 1950 and 1965 the term *management accounting* began to be used, and referred to the provision of information to management for planning and control. This area of accounting now included investment appraisal, decision analysis and responsibility accounting, as well as the established techniques of budgeting, and planning and control. From the mid-1980s, the focus of management accounting moved to waste reduction, and new techniques involving process analysis and cost management were added to the existing range of management accounting techniques. From the mid-1990s, the focus of management accounting started to shift towards the broader techniques of resource management, and focused on the creation of customer value and shareholder value through the effective use of resources.

In the twenty-first century management accounting has not abandoned the concepts of cost accounting and financial control, nor the provision of information for planning and control. These objectives now form part of the broader function of resource management. Management accounting still involves many of the techniques that were developed in past decades, such as budgets and basic product costing principles, but these are now supplemented by modern technologies that better assist managers in value creation. (We wait to see what new developments will arise in the twenty-first century!) As you read this book, you will become familiar with many of the terms used in Exhibit 1.6.

Notice that in Exhibit 1.6, with each of the changes in focus, there was a repositioning of management accounting within organisations (IFAC, 2002). Prior to the 1950s, cost accounting was simply a technical activity. From the mid-1960s, management accounting emerged as a *staff function*, providing support to *line management*. **Staff management** are managers who support the activities of an organisation as a whole, and are only indirectly involved in the operations of a business. **Line management** are managers who are directly involved in the core activities of the business. In the 1980s, with the emergence of new process improvement technologies and waste reduction, management accounting often became a part of team-based activities. Management accountants played a role in decision-making teams and key aspects of management accounting came to be practised across the organisation.

staff management managers who support the activities of an organisation as a whole, and are only indirectly involved in the operations of a business

line management managers who are directly involved in the core activities of the business

SAMPLE CHAPTER ONLY

Exhibit 1.6

The changing focus of management accounting

	The focus of management accounting	Management accounting technologies	The positioning of management accounting within organisations
Prior to 1950	**Cost** Cost determination and financial control	Budgeting and cost accounting	Technical activity
1965 ⇒	**Profitability** Provision of information for planning and control	Decision analysis and responsibility accounting	A staff function, reporting to management
1985 ⇒	**Waste reduction** Reduction of waste through strategic cost management	Process analysis and contemporary cost management	Team-based activity
1995 ⇒	**Resource management and value creation** Creation of value through strategic resource management—the effective and efficient use of all resources	Analysis of drivers of customer value, shareholder value and organisational innovation	Part of the management process
2000s	?	?	?

Source: International Federation of Accountants (*IFAC) (2002)*

From the mid-1990s, the domain of management accounting started to become a dimension of the management process. While in many organisations the management accounting responsibilities were clearly the responsibility of the accounting specialists, in other organisations a broader range of managers, such as marketing managers and engineers, became more involved in the production and analysis of management accounting information.

By the early-2000s organisations were becoming aware of the increasing importance of environmental and social responsibility issues, in particular those associated with climate change. It is clear that businesses will place great emphasis on reducing CO_2 emissions and managing scarce resources, such as water, more efficiently. In addition, social responsibility is likely to become a more important consideration that will influence a range of business decisions and activities.

Given the major changes that have taken place in the business environment described earlier in this chapter, it is not surprising that there have been significant changes in the focus and positioning of management accounting. However, it is important to note that in some organisations management accounting may not yet be focused on resource management, and may rely on more traditional tools than some of the more contemporary technologies discussed above. In general, however, we can assume that as managers' information needs change, management accounting systems should continue to evolve to satisfy those needs better.

Management accountants play an important role in many enterprises. As a member of the management team, they need to be in touch with the heartbeat of the organisation. In most businesses, management accountants interact frequently with sales personnel, finance specialists, production people, and managers at all levels. To perform their duties effectively,

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management accountants must be knowledgeable, not only in accounting but in other major business disciplines. Strong oral and written communication skills are also becoming increasingly important for success as a management accountant.

PROFESSIONAL ACCOUNTING ORGANISATIONS

13 LEARNING OBJECTIVE

In Australia, many management accountants belong to CPA Australia or the Institute of Chartered Accountants in Australia (ICAA). Some Australian management accountants are also members of the US or UK management accounting bodies. These are the Institute of Management Accountants (IMA) and the Certified Institute of Management Accountants (CIMA).

CPA Australia is the largest Australian professional accounting body (and one of the largest in the world) with more than 117 000 members. Of those members, about 49 per cent work in commercial, industrial and private companies, 18 per cent work in public practice and about 10 per cent work in government enterprises. Many of these accountants work in the management accounting field. Members of CPA Australia must have completed a three-year accredited degree. To obtain the CPA qualification (certified practising accountant), members must complete several segments of the CPA program, complete three years of practical experience mentored by a trained mentor, and make a commitment to undertake 120 hours of continuing professional development each triennium (three-year period). The CPA qualification is designed for all types of accountants, whether they are corporate treasurers, auditors, financial accountants or management accountants.[13]

There are also specialist qualifications that may be completed by CPAs in eight different areas, one of which is management accounting. To qualify as a management accounting specialist, a CPA will have extensive management accounting experience in a responsible position or will complete an accredited postgraduate course in management accounting, as well as have experience in the area.

The Institute of Chartered Accountants in Australia has about 46 000 members. In the past, most members of this body were employed in public practice. However, less than 50 per cent of members now work in public practice, with the remainder in commerce, government and academia, and many in the management accounting area. Accounting graduates who wish to become members of the ICAA must hold an accredited degree, complete the CA program, and have three years' practical experience mentored by a CA in public practice or industry. The CA program consists of several modules, including 'Management Accounting and Analysis'. Like CPAs, CAs are required to complete at least 120 hours of continuing professional development each triennium.[14]

ADVANTAGES OF PROFESSIONAL MEMBERSHIP

The qualifications offered by the professional bodies provide employers with a level of assurance of the competence and skills of the accountant. Membership of a professional accounting body allows accountants to keep up to date with developments in their field. They can participate in conferences, seminars and specialist discussion groups, and gain valuable contact with other management accountants working in various organisations.

PROFESSIONAL ETHICS

The professional accounting associations offer support to members troubled by ethical issues. As professionals, management accountants have an obligation to themselves, their colleagues, their organisation and the public interest to adhere to high standards of ethical conduct. In recognition of this obligation, both CPAs and CAs are required to comply with the

13 www.cpaaustralia.com.au.
14 www.icaa.org.au.

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Code of Ethics for Professional Accountants The Code of ethics with which CPAs and CAs are required to comply, issued by Accounting Professional and Ethical Standards Board (APESBA)

Code of Ethics for Professional Accountants, issued by the Accounting Professional and Ethical Standards Board (APESB),[15] which is an independent board set up in 2006 by CPA Australia and the ICAA. These professional bodies are members of the International Federation of Accountants (IFAC) and the code is based on the IFAC code of the same name. The fundamental principles of the Code are:

- *Integrity.* Members must be straightforward and honest in professional and business relationships. Integrity also implies fair dealing and truthfulness.
- *Objectivity.* Members must not compromise their professional or business judgement because of bias, conflict of interest or the undue influence of others.
- *Independence.* Members must be and should be seen to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity.
- *Professional competence and due care.* Members must maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service, and act diligently in accordance with applicable technical and professional standards when providing their services.
- *Confidentiality.* Members must not disclose outside the firm or employing organisation confidential information acquired as a result of professional and business relationships without specific authority from the client or employer unless there is a legal duty to do so. Members must not use confidential information acquired as a result of professional and business relationships to their personal advantage or the advantage of third parties.
- *Professional behaviour.* Members must comply with relevant laws and regulations and avoid any action or omission that may bring discredit to the profession.

15 www.apesb.org.au.

KEY TERMS

QUESTIONS EXERCISES PROBLEMS CASES

QUESTIONS

1.1 Select an organisation with which you are familiar, and outline some of the main changes that have taken place in its business environment in recent years.

1.2 Examine the definition of management accounting provided in this chapter, and explain what is meant by *customer value* and *shareholder value*.

1.3 Consider two different products you are familiar with, and describe the aspects that you value as a customer.

1.4 What is meant by *resource management*? Why should management accounting be concerned with non-financial resources?

1.5 Briefly explain the key differences between financial accounting and management accounting.

1.6 Explain the key differences between cost accounting and management accounting.

1.7 'Some accounting information that is produced by the financial accounting system of a business is of limited use for management accounting purposes. This is because of the accounting procedures, or accounting standards, that are used in its preparation.' Provide an example to illustrate this issue.

1.8 Using the 'Real life' scenarios included in this chapter identify the skills that managers value in a management accountant.

SAMPLE CHAPTER ONLY

QUESTIONS
EXERCISES
PROBLEMS
CASES

1.9 'We don't have an accountant in our organisation but we do have a financial controller. His job is to control the finances.' Discuss.

1.10 Using 'Exhibit 1.3: Vision, Mission and Strategies' on page 16, explain the relationship between an organisation's vision, mission statement and strategies. Identify the similarities and differences amongst the four organisations.

1.11 Formulate a vision and mission statement for each of these organisations: The Red Cross, The Body Shop and Toyota.

1.12 For the three organisations listed in the previous question, formulate some objectives that each organisation might wish to achieve over the next 12 months.

1.13 Explain the differences between strategy formulation and strategy implementation and describe the role that management accounting can play in formulating and implementing strategy.

1.14 Give examples of how management accounting information could assist in managing resources in the Australian Taxation Office.

1.15 Explain why senior managers, middle managers and operations managers require different types of management accounting information.

1.16 What types of management accounting information might assist management in a business that followed a differentiation strategy based on innovation?

1.17 A large manufacturer of electronic equipment stated the following as one of its objectives: 'The company should become the low-cost producer in its industry.' How can management accounting help the company achieve this objective?

1.18 What types of information might a management accountant provide to assist management in a business that considered customer service to be of key strategic importance?

1.19 Do you think that a management accountant can play an important role in a not-for-profit organisation? Choose a specific not-for-profit organisation with which you are familiar to explain your answer.

1.20 Explain the relationships between strategies, planning systems and control systems.

1.21 How might managers' behavioural characteristics affect the way they use information? How can management accountants take this into account when designing management accounting systems?

1.22 Explain how specific aspects of management accounting systems may be used to motivate employees and managers.

1.23 Explain how costs and benefits are relevant to the design of management accounting systems.

1.24 Identify the factors that may influence management accounting system design according to contingency theory.

1.25 (appendix) Briefly describe changes in the focus of management accounting that have occurred since the 1950s.

1.26 (appendix) Explain what is meant by each of the following fundamental ethical principles for accountants: *integrity*, *objectivity*, *professional competence*, *confidentiality* and *professional behaviour*.

1.27 (appendix) Describe the role that the Accounting Professional and Ethical Standards Board plays and the relevance of its work for management accountants.

EXERCISES

E1.28 **The nature of management accounting systems**
Classify each of the following statements as true or false. In each case provide reasons to explain your answer.

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1 Management accounting systems provide managers with all the information they need to make decisions.
2 Management accounting systems need to be flexible enough to provide information for financial statements.
3 Management accounting systems may draw on data that are internal and external to the organisation.
4 Management accounting systems are concerned with the quality of products produced by the organisation.
5 Management accounting systems need to produce information that is objective and verifiable.

E1.29 Differences between management accounting and financial accounting

Which of the following roles:

(a) Management accounting?
(b) Financial accounting?
(c) Cost accounting?
(d) None of the above?

belongs to:

1 Preparing a balance sheet.
2 Preparing a profit forecast by product line.
3 Estimating the depreciation expense for a factory's equipment.
4 Monitoring the effects of a quality improvement program.
5 Estimating the cost of goods produced.
6 Estimating the cost of a prototype for a new product being developed.
7 Preparing a sales forecast.
8 Monitoring the effects of a waste reduction program.
9 Preparing a report on customer satisfaction.
10 Preparing an income statement.

E1.30 The role of the management accountant

Use the internet to find a job advertisement for a management accountant. Identify the key roles and the applicant's qualifications required for this position.

E1.31 Management accounting information

Give an example of management accounting information that could be used by a manager to make each of the following decisions. Remember to consider non-financial information where relevant.

1 The manager of a discount department store is deciding how many security personnel to employ to reduce shoplifting.
2 A local council is deciding whether to build an extension to the council library.
3 The manager of a rental car agency is deciding whether to add luxury cars to the rental car fleet.
4 The production manager in a car manufacturing plant is deciding whether to have routine maintenance performed on a machine weekly or every two weeks.

E1.32 Major influences on management accounting

Classify each of the following statements as true or false. In each case, provide reasons to explain your answer.

1 The growth of the service sector in Australia has led to the widespread development of new management accounting techniques.
2 As hierarchical organisational structures give way to team-based structures, management accountants need to learn how to provide their services to employees at all levels of the organisation.
3 Management accounting has only a limited role to play in developing measures of customer service.
4 Advances in information technology have changed the way that many businesses conduct their operations, and the way that management accountants supply information to managers.

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E1.33 Management accounting information

Identify management accounting information that could assist managers in making each of the following decisions. Remember to consider non-financial information where relevant.

1 A marketing manager is considering whether or not to launch a new product.
2 A travel company is considering whether it should increase its staff numbers by one-third.
3 A production team leader is considering whether an important customer order should be produced next week, or during overtime hours tonight.
4 A fruit picking company is considering purchasing a new cherry-picking machine.

E1.34 Management accounting system design

According to contingency theory, a number of factors may influence the design of management accounting systems.

1 Explain the implications of contingency theory for management accounting system design.
2 Identify two contingent factors and discuss why they might influence management accounting system design.

E1.35 (appendix) Evolution of management accounting

Complete each of the following statements by selecting the best answer.

1 The term 'management accounting' began to be used because:
   (a) costing systems became more sophisticated.
   (b) the role expanded to include information for planning and control.
   (c) accountants were moved into managerial roles.
   (d) the role focused on scorekeeping for management.
2 From the mid-1980s to the mid-1990s, management accountants:
   (a) became more interested in waste reduction because of the emphasis on the environment.
   (b) made detailed inventory valuation as their primary focus.
   (c) added process analysis and cost management to their techniques.
   (d) introduced the concept of responsibility accounting to their organisations.
3 From 1995 onwards, management accounting:
   (a) added a customer focus because managers were sick of hearing about costs.
   (b) added a shareholder perspective to ensure consistency with financial accounting reports.
   (c) introduced the concept of investment appraisal to satisfy investor concerns.
   (d) recognised the importance of both customer and shareholder value.
4 By the mid-2000s, management accountants were increasingly concerned about environmental issues because of:
   (a) the need to improve their organisation's reputation with environmental pressure groups.
   (b) the need to improve the organisation's reputation with customers.
   (c) efficient and effective management of environmental issues offered opportunities to enhance both customer and shareholder value.
   (d) the need to include environmental measures in the organisation's annual report.
5 Over time, the management accountant has increasingly become:
   (a) a technical advisor.
   (b) a staff role, supporting line managers.
   (c) a part of the management team, providing strategic advice.
   (d) an expert on financial accounting reports.

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PROBLEMS

P1.36 Designing a new management accounting system

You have just been appointed as the new management accountant to manage the transition of the existing Royal Adelaide Hospital to the proposed new Marjory Jackson Hospital site. The hospital has a number of separate departments responsible for direct patient care, such as Accident and Emergency, Intensive Care, Neurology, and Cardiology, as well as a number of support departments such as Radiology and Patient Records. You are a little uncertain as to what your role will be in this new hospital, as consultants have been engaged to design the new management accounting systems. You thought that as a management accountant you would be responsible for developing the new systems!

Required:

1 Write a report to senior management explaining how you, as the management accountant, may contribute to the design and operation of the new management accounting systems for the new hospital.
2 Outline the types of management accounting information that you believe senior managers may require on a regular basis (say, weekly and monthly) to manage the operations of the new hospital. Consider both financial and non-financial information.
3 The new hospital plans to invest in the latest computer technology to run various aspects of the organisation, including the management information systems. Discuss the opportunities that this may present for the way in which you supply weekly and monthly reports to managers.

(Source: CMA, adapted)

P1.37 Information for management

Joe Murphy retired a few years ago at the age of 48, having built up a substantial retirement portfolio through a range of entrepreneurial activities. He moved to the Snowy Mountains to follow his dream of a peaceful mountain life. However, after a few months, Murphy became restless and opened a ski equipment store. This single store soon grew into a chain of four outlets spread from the Snowy Mountains to the Victorian Alps. As Murphy put it, ‘I can’t believe how fast we’ve expanded. It’s basically been uncontrolled growth—growth that has occurred in spite of what we’ve done’.

Although business was profitable, the chain did have its share of problems. Sales tended to be seasonal, with a slowdown once the snow had disappeared. Murphy therefore added fishing and camping equipment to his product line. The need to finance required inventories seemed to be bulging and left cash balances at very low levels, occasionally giving rise to short-term bank loans.

Part of Murphy’s business focused on skiing trips, which were arranged through local ski lodges, and included ski hire, lessons and lift passes. Reports from the company’s financial accounting system seemed to indicate that this part of the business was losing money because of increasing costs, but Murphy could not be sure. ‘The traditional income statement is not too useful in assessing the problem’, he noted. ‘Also, my gut feeling is that we are not dealing with the best suppliers in terms of quality, delivery reliability and prices.’ Additional complications were caused by an increasingly competitive marketplace, with many former customers now buying equipment through the Internet.

Murphy was not sure what to do. The company’s accountant was very good at keeping the books and preparing the financial statements and tax return, but she did not understand the way the business really worked.

Required:

1 Describe the types of information that Murphy needs to run his business more effectively.

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2 Murphy approaches the accountant to seek her help in gathering and analysing this information, but she responds: 'You must be joking—I'm an accountant. My job is to look after the money side of the business!' Do you agree with this statement?
3 What actions would you recommend that Murphy takes?

P1.38 Vision, mission statement, objectives and strategy

1 Use the internet to find a vision and mission statement for an organisation.
2 Identify objectives and strategies for this organisation. (If this information is not included in the website, suggest some likely objectives and strategies for this organisation. Explain your suggestions.)

P1.39 Management accounting information for resource management

You have just been appointed as the management accountant for Close Up and Personal (CUP), a company that sells pottery items, jewellery and cool clothing, featuring personal digital photos. This company employs a team of 12 designers who design the pottery items, jewellery and clothing. These products are manufactured by independent companies. CUP then prints the customer ordered photos onto the products and sells them to customers through six sales outlets located in shopping malls.

Required:

1 Identify the specific types of management accounting information that may be needed by the following employees, on a monthly basis, to help them control operations:
   (a) Manager of each retail outlet.
   (b) Manager of the design team.
   (c) Marketing manager responsible for planning advertising campaigns and identifying customer needs.
   (d) Manager who manages and renegotiates contracts with the outside manufacturers.
2 The managing director of CUP is interested in developing more sophisticated planning systems, but has some doubts over the value of undertaking strategic planning. Prepare a report outlining the importance of planning systems. In your report, consider the interrelationships between the objectives of the company, its strategies and short-term planning systems. Explain how management accounting information may assist in improving the planning function of the company.

P1.40 (appendix) Behavioural issues; ethics

Janet Kaniva is the head of the sales department for a large book distributor. She manages a team of five salespeople, including her close friend, Ima Lyer. Each salesperson is responsible for particular product lines and is entitled to receive an annual salary bonus provided that he or she exceeds the profit forecast for his/her product group by more than 10 per cent. Profit for each product group is estimated by deducting from sales revenue the cost of the books sold, plus a charge for corporate overheads. Corporate overheads are charged as a percentage of sales revenue, using a complex formula based on different percentages of revenue for different product lines; and salespeople can never make any sense of their annual overhead charge.

As the year end approaches, Lyer, who sells religious and philosophical texts, learns from the accountant, Stanley Riteous, that she will not receive a bonus, as she will not achieve her annual profit forecast. She is feeling very frustrated, as she has heard that the rest of the sales team will come in more than 20 per cent above their forecast.

Lyer approaches Riteous suggesting that an accounting entry is made to move some of the overhead charges to the other salespeople, who, after all, will still earn their bonus. Riteous refuses on the grounds that he is a CPA, but he is subsequently instructed by Kaniva to make this journal entry.

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Required:

1 Explain how the bonus system is leading to unintended behavioural outcomes.
2 What relevance does Riteous' CPA status have to this situation?
3 How should Riteous respond to Kaniva's instruction to move overhead charges from Lyer to the other salespeople? Explain your answer.

CASES

C1.41 Objectives, strategy and management accounting systems

Cakes R Us operates a series of bakeries in Canberra that specialise in supplying a range of cakes to restaurants and coffee shops. Major products include lamingtons, scones, éclairs and custard tarts. Until last year, sales levels were fairly stable. However, sales have been decreasing for the last 18 months. Ralph Slick, the marketing manager of Cakes R Us, is worried, and has visited major customers to find out the reasons for their decreasing sales orders. The comments of the owner of one of the most popular Canberra coffee shops sum up the general response: 'Ralph, your style of cakes is old-fashioned. They are not what people want any more. Our customers prefer lighter, tastier food. They want variety, and are willing to pay more for high quality innovative creations'.

At a recent meeting, Slick stated that the company should expand its product offerings, or there may be no future for the company. Specifically he believes that there are untapped markets for gourmet pies. The managing director is uncertain; he states: 'I really don't think that we can afford to invest time and money into fads. We sell cakes, we are not a gourmet caterer!' Slick points out that it is these new items that customers are asking for, so it makes sense from a strategic point of view to develop these products. However, the managing director is still uncertain: 'I have no idea whether we are going to make a profit this year, and cash is always tight. We don't need strategies, I prefer to just sell good products'.

Slick understands why the managing director is resisting his plea to be more innovative with products—the bakery has been producing the same line of cakes for 30 years. Slick also knows that there has never been any formal planning undertaken within the company, or consideration of objectives or strategies.

Required:

1 Ralph Slick has asked for your help. As the new management accountant, prepare a report for the managing director outlining the advantages of implementing processes to determine organisational objectives, strategies and planning systems.
2 Consider the nature of the control system that you could design to report on monthly performance. What types of information do you think may be of interest to Slick and the managing director? Consider both financial and non-financial data.

C1.42 (appendix) Management accounting and ethical issues

Kai Hong lives in Wangaratta, and has recently joined the staff of his community hospital as the financial controller. He has lived in this town for most of his life, plays for the town's bowls club, attends church on a regular basis and is an active member of the Hospital Foundation. The Foundation runs a number of very successful fundraising events each year, such as charity auctions, trivia nights and an annual ball, a highlight of the Wangaratta social calendar. The hospital is funded primarily through the public health system, but also depends on funds raised by the Foundation. Kai is a very experienced accountant, approaching retirement age. Although the salary for this position is considerably lower than for his last job, he has become passionate about the value of this hospital and wants to 'give back' to his community.

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Hospitals operate in a high risk environment because of their responsibility for human life and the potential for litigation in the case of error. During his first three months in the new role Kai completes a risk management audit, identifying the likelihood of particular risks and assessing the systems for managing them. The audit reviews processes in the areas of quality, occupational health and safety, and financial management. It uncovers some potential problems in the quality area, particularly around the identification and recording processes for patient mismanagement. The major risks in the occupational health and safety area relate to back injuries for nursing staff handling patients, and the processes for disposing of hazardous wastes. He is relieved that a review by the hospital's senior accountant, Craig Stevens, finds no significant problems with the financial management system.

Amalie Lester, the daughter of one of Kai's closest friends at the bowls club, is the treasurer of the Foundation. At the Foundation's most recent annual ball Kai noticed that Amalie spent most of the evening in Craig's arms. According to Kai's wife, who is the local gossip, Craig had become involved with Amalie when he completed an internal audit of the Foundation's books. She is appalled by this behaviour, as Craig's mother, who is part of her crochet group, has no idea that this is happening, and Craig's wife is due to have their baby in just a few weeks. Amalie owns a small business, located on the edge of Wangaratta, that sells a range of funky clothes and accessories. The rumour around town is that Amalie's business is not doing well and that she owes a substantial amount to her landlord.

Although Wangaratta is a fairly close-knit community, until now Kai has always been very careful to keep his work and social interests separate. However, given his accounting experience, Kai wonders whether he may be able to help Amalie solve her business problems or at least exit from the business without any further losses. He is convinced that her remote business location is all wrong, as fashion businesses depend on a high volume of pedestrian traffic. However, her father tells Kai that there is no need to worry, as recently she seems to be doing much better. She has been able to pay all overdue rent and buy a 'new' car, a bright red Mini, which her father describes as a relic from the 1960s! Although very relieved, Amalie's father is unable to explain the cause of this dramatic turnaround, other than to attribute it to good luck combined with good management.

A couple of days later Kai has a chance to think over this conversation. From experience he knows that 'good luck' is rarely an underlying factor in business turnarounds. He becomes increasingly concerned as, over the last few months, the Foundation has been through a very successful period of fundraising, although Craig's recent internal audit and review of the hospital's financial management system had shown no cause for concern. 'Something is not right here', he laments to his wife over dinner that evening. A lively discussion follows and next morning Kai leaves for work very early.

It does not take long for Kai to discover that in her role as treasurer, Amalie has been stealing Foundation funds. When confronted, Craig initially denies any knowledge of this situation but later admits to his involvement. He appeals to Kai to show sympathy, if not for Amalie's sake, then to protect her father, one of Kai's closest friends. Craig reminds him that, in a place like Wangaratta, word will spread rapidly, ruining the lives of Amalie and her family as well as causing considerable distress to Craig's pregnant wife.

Required:

1 Review the accounting professional code of ethical conduct set out in the appendix to this chapter. Which parts are relevant to Craig Stevens' situation?
2 Which parts are relevant to Kai Hong?
3 What actions would you advise Kai to take, given the ethical code of conduct of the accounting profession?

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QUESTIONS EXERCISES PROBLEMS CASES

C1.43 (appendix) Disclosure of confidential information; ethics

Smart Worx Ltd, a developer and distributor of business applications software, has been in business for five years. The company's main products include programs used for sales management, billing and accounting for mail order shopping businesses. Smart Worx's sales have increased steadily to the current level of $15 million per year, and the company has 250 employees.

Erin McFail joined Smart Worx approximately one year ago as accounting manager. McFail's duties include supervision of the company's accounting operations and preparation of the company's financial statements. McFail has noticed that, in the past six months, Smart Worx's sales have ceased to rise and have actually declined in the two most recent months. This unexpected downturn has resulted in cash shortages. Compounding these problems, Smart Worx has had to postpone the introduction of a new product line because of delays in documentation preparation.

Smart Worx contracts most of its printing requirements to Web Graphics, a small company owned by Rob Rodent. Rodent has dedicated a major portion of his printing capacity to Smart Worx's requirements, because Smart Worx's contracts represent approximately 50 per cent of Web Graphics' business. Erin McFail has known Rodent for many years—as a matter of fact, she learned of Smart Worx's need for an accounting manager through Rodent.

While preparing Smart Worx's most recent financial statements, McFail became concerned about the company's ability to maintain steady payments to its suppliers. She estimated that payments to all suppliers, normally made within 30 days, could exceed 75 days. McFail is particularly concerned about payments to Web Graphics. She knows that Smart Worx has recently placed a large order with Web Graphics for printing the new product documentation, and that Web Graphics will soon be placing an order with its suppliers for the special paper needed for this new job. McFail is considering telling Rodent about Smart Worx's cash problems, although she is aware that a delay in the printing of the documentation would jeopardise Smart Worx's new product.

Required:

1 Describe Erin McFail's ethical responsibilities in this situation.

2 Independent of your answer to requirement 1, assume that Erin McFail learns that Rob Rodent of Web Graphics has decided to postpone the special paper order required for Smart Worx's printing job; McFail believes that Rodent must have heard rumours about Smart Worx's financial problems from some other source, because she has not talked to Rodent. Should Erin McFail tell Smart Worx managers that Rodent has postponed the paper order? Explain your answer.

3 Independent of your answers to the first two requirements, assume that Rob Rodent has decided to postpone the special paper order because he has learned of Smart Worx's financial problems from a source other than McFail. In addition, McFail realises that Jim Grason, Smart Worx's purchasing manager, knows of her friendship with Rob Rodent. Now McFail is concerned that Grason may suspect she told Rodent of Smart Worx's financial problems when Grason finds out Rodent has postponed the order. Describe the steps that Erin McFail should take to resolve this situation.

(Source: CMA, adapted)

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