Victoria university of Bangladesh

Mid Exam

Sub: MANAGEMENT ACCOUNTING

Sub. Code: ACT 217

Program: BTHM

Semester: SUMMER 2023

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Question no 01

Define management accounting. Discuss the objectives of management accounting.

Answer to the question no 01

The process of creating organization goals by identifying, measuring, analyzing, interpreting and communicating information to managers is call management or managerial accounting.

Management accounting also is known as managerial accounting and can be defined as a process of providing financial information and resources to the managers in decision making. Management accounting is only used by the internal team of the organization, and this is the only thing which makes it different from financial accounting. In this process, financial information and reports such as invoice, financial balance statement is shared by finance administration with the management team of the company. Objective of management accounting is to use this statistical data and take a better and accurate decision, controlling the enterprise, business activities, and development.

The basic function of management accounting is to help the management make decisions. There is no fixed structure or format for it.

The only need for management accounting is that the data should serve its purpose, which is helping the management take important business decisions.

Types of Managerial Accounting

1. Product Costing and Valuation

2. Cash Flow Analysis

3. Inventory Turnover Analysis

4. Constraint Analysis

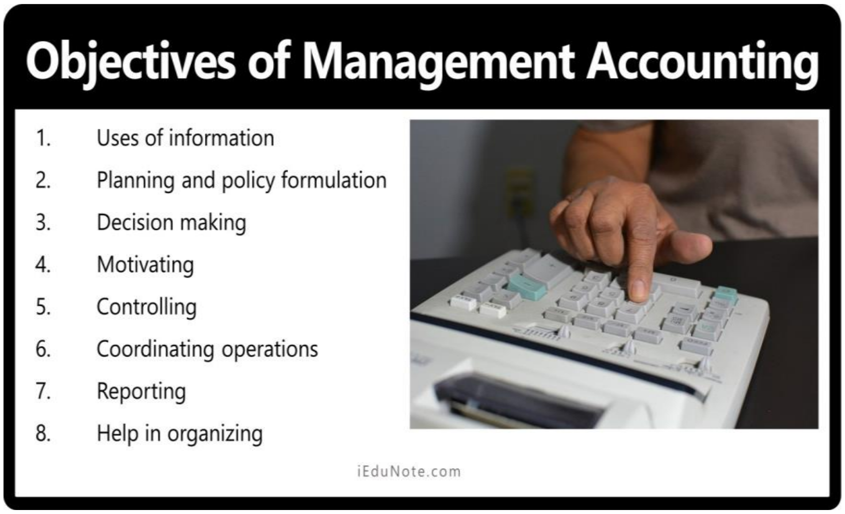
5. Financial Leverage Metrics

6. Accounts Receivable (AR) Management

7. Budgeting, Trend Analysis, and Forecasting

Objectives of Management Accounting

The primary objective of Management Accounting is to enable the management to maximize profits or minimize losses.



The fundamental objective of management accounting provides information to the managers for use in planning, controlling operations, and decision making.

Main purpose and objectives of management accounting may be summarized as under:

Uses of Information

The primary functions of management are the uses of information. It presents accounting information in a form that enables the management, investors, and creditors to analyze the financial statements.

Planning and Policy Formulation

Planning is deciding in advance what is to be done. It helps the management of ineffective planning. It provides costing and statistical data to be utilized in setting goals and formulating future policies.

Decision Making

All management work is accomplished by decision making.

Decision making is defined as the selection of a course of action from among alternatives. It helps the management in decision-making. It uses accounting data to solve various management problems.

Management accounting techniques like cost-volume-profit analysis, standard costing, budgetary control, capital budgeting, funds flow analysis, etc. Assist the management in arriving at the correct decision.

Motivating

Motivation means individuals need, desires, and concepts that cause him or her to act in a particular manner. Delegation serves as a motivation device because it increases the job satisfaction of employees and encourages them to look forward.

By setting goals, planning the best and economic courses of action, and also by measuring the performances of the employees, it tries to increase their efficiency and, ultimately, motivate the organization as a whole.

Controlling

Management accounting helps management in controlling the performance of the organization. Actual performance is compared with operating plans, standards, and budgets, and deviations are reported to the management so that corrective measures may be taken.

Coordinating Operations

It helps the management in controlling the performance of the organization.

Actual performance is compared with operating plans, standards, and budgets, and deviations are reported to the management so that corrective measures may be taken.

Reporting

One of the primary objectives of management accounting is to keep the management fully informed about the latest positions of the concern. The facilitates management to take proper and timely decisions. The object of management accounting is to provide data. It presents the different alternative plans before the management in a comparative manner. The performance of various departments is also regularly communicated to the top management.

Help in Organizing

Organizing is the process of allocating and arranging human and nonhuman resources so that plans can be carried out successfully.

Question no 02

How management accounting helps financial managers to make decisions?

Answer to the question no 02

In the last couple of decades, technology has played a huge role in changing the business ecosystem. The use of computers and information management systems has made the processes faster and more accurate. This has led to changes in expectations from various professionals across the organizations. For instance, traditionally the accounting and the finance department was involved in maintaining the books of accounts and reporting it to the external stakeholder on a quarterly or yearly basis. With the advent in technology and information systems, a large number of information which could not be captured earlier is now being done easily and in real time. Further the time required for the traditional routine work has reduced drastically. This has led to a shifting in the focus of the roles in the accounts and financial profiles; they are now being involved in day-to-day decision making process thus making the Management Accounting more relevant than ever before.

Management accounting is the process of preparing reports and accounts which help in everyday decision making. The management accounting reports differ from the traditional financial accounting reports in **two major aspects**:

- **The frequency:** Financial accounting reporting is performed on a quarterly or annual basis, while the management accounting

reports are more frequent like daily, weekly or monthly

- **Target Audience:** Financial accounting reports are prepared for the external stakeholders while management accounting

reports are consumed internally by managers.

Management Accounting reports generally show the orders in hand, sales revenue, available cash, accounts receivable, raw material and inventory, accounts payable and outstanding debts. These reports further include variance analysis, and other statistics which will help managers in the decision making process.

How Managerial Accounting Helps in Decision Making:

Managerial accounting is very effective in highly competitive and fast-paced business environments where quick decisions need to be made. These decisions might have to do with a sales tactic, budgeting or cash flow management. Managerial accounting will use operational data to make sense of the situation quickly.

The goal is to use the budget to help make short-term operational decisions that will help increase the company's operational efficiency.

Let's say an internet company subscribes to cloud computing services. Monthly prices to rent out space in the cloud have been increased. The internet company's managers can use budgets to see if the price increases are costing too much and decide to reduce cost and increase operational efficiencies.

The company budgets $100 a week for access to the cloud services and the actual expenditure for the week is $200. Managers know there is a 100 percent variance between budgets and actual costs. A managerial accountant would advise to increase their expectations on prices in their budget or move to another provider to meet their budget cost.

Management accounting important for decision-making

The following features of management accounting helps in the decision-making process.

It helps to conduct relevant costs analysis

The most important job of the management accountant is analyzing the relevant costs for determining the present expenses and giving suggestions for future actions. Before taking action, managers need to consider all prospects and explore the best strategies to enhance the company's profit. Management accountants must analyze various sales channels, services, products, and marketing activities to analyze the most beneficial business models.

After the management accounting team has completed the costs analysis, managers can make informed and evidence-based decisions.

It facilitates in utilizing activity-based costing strategies

Customers are the top priority of marketers, and they must lay special focus on them. It is crucial for businesses; thus, companies need to build a buyer persona that includes the following features.

- Gender and age
- Income level
- Location
- Academic background
- Personal value
- Lifestyle

Management accountants must analyze the worth of every customer to generate profitable revenues and help the managers to make informed decisions regarding the time and resources required to have profit in a long-term scenario.

After determining the selling products in businesses, company's need to decide the prospective buyers of the product. The activity-based costing allows the management accountants to choose the activities needed to produce the product line. One important aspect of the process is determining the customers' worth and their profit to business owners.

It aids in deciding whether to buy and make your product

Though product production is a complex and expensive business task, choosing between purchase and production needs to suit the company's financial condition. The management accountants facilitate the decision to make your product or buy it from a third party.

They evaluate the actual cost of both solutions and determine whether purchasing it from manufacturers or making it in the company is a cost-effective and reliable process. It may appear to be a simple decision but is delicate and can boost or lower the businesses.

It helps to define the budget

The budgeting processes of businesses are not random, and a decision must align with the company's marketing database and sales history. Here, management accounting plays a role in analyzing previous business activities and defining the investments for future activities. They devise financial plans for every department, marketing campaign, project, new products, and other business tasks.

It supports controlling

Controlling is an essential aspect of management accounting and supports evaluating the functions of all company departments to make inferences on financial performance. It allows you to determine the causes of profits and losses generated in each department. In these situations, it is simple for senior managers to decrease operational costs.

The strategies to reduce the financial costs is to cut the salaries of floundering units or cut off the employees from the company. Conversely, they can increase the investments in high performing departments to increase the net profitability of the organization.

It assists in effective planning

Another essential aspect of management accounting is its ability to detect financial designs and foresee prospects. It allows the senior executive to remain updated with recent trends in the market that helps you react and implement strategies to stay ahead of your competitors.

The management accounting planning facilitates long-term policies for businesses and ensures that every department is working on the right path and mutually working to achieve business goals.

Question no 03

What is the different between a management accounting and financial accounting, and how do those two support each other.

Answer to the question no 03

Financial accounting is a branch of accounting concerned with the summary, analysis and reporting of financial transactions related to a business. This involves the preparation of financial statements available for public use. Stockholders, suppliers, banks, employees, government agencies, business owners, and other stakeholders are examples of people interested in receiving such information for decision making purposes.

Importance of Financial Accounting

- Financial accounting is important to track and analyze performances and transactions of a business over a period of time.
- The transparency and reliability of accounting is crucial in evaluating management policies and creating budgets.
- It is used to compare reports so that stakeholders and investors can decipher and use the data to make better decisions in the future.
- It provides clarity in internal and external communication regarding the sources and destinations of finances in the company.

Financial accounting and management accounting are closely inter-related since management accounting draws out a major part of the information form financial accounting and modifies the same for managerial use.

Financial accounting ensures that the assets and liabilities of a business are properly accounted for and provides shareholder investors, tax authority, creditors, etc.

On the other hand, management accounting provides information, especially for the use of managers who are responsible for making proper decisions within an organization.

Financial accounting is concerned with the recording of day-to-day transactions of the business. Though both financial and management accounting relies on the same financial data, there are some differences between financial and management accounting.

Distinctions between Management Accounting and Financial Accounting are the following:

Point of difference	Management Accounting	Financial Accounting
Users	Management accounting is especially for internal users. Management accounting reports are exclusively used by internal users viz. managers and employees.	Financial accounting is both for internal and external users. Financial accounting reports are primarily used by external users, such as shareholders, banks, and creditors.
Objective	The objective of management accounting is to assist internal management.	The objective of financial accounting is to assist both internal and external decision-makers.
Uses of GAAP	GAAP is not mandatory to follow in management accounting.	GAAP is mandatory to follow in financial accounting.
Events	It emphasizes decisions on future events.	It emphasizes decisions on past events.
Freedom of choices	No constraints are other than costs about the benefits of improved management decisions.	Constrained by generally accepted accounting principles (GAAP).
Type of Reports	Detailed reports: concern about details of parts of the entity, products, departments, territories, etc.	Summary reports concern primarily with the entity as a whole.
Behavioral implications	Concern about how measurements and reports will influence a manager's daily behavior.	Concern about how to measure and communicate economic phenomena.
Delineation of Activities	The field is less sharply defined—heavier use of economic, decision science, and behavioral sciences.	The field is more sharply defined—lighter use of related disciplines.
Timespan	Flexible, varying from hours to years	Less flexible; usually 1 month to 1 year.
Methodology	In management accounting, cost, and revenue are mostly reported by responsibility centers or profit centers.	Financial accounting records are maintaining in the form of revenue, income and expenditure, and property accounts.
Annual Reporting	Annual reporting of management accounting is not mandatory.	Annual reporting of financial accounting is mandatory.

Characteristics	It holds qualitative characteristics.	It holds quantitative characteristics.
Fundamental quality	Emphasizes relevance.	Emphasizes objectivity and verifiability.
Enhancing Quality	Emphasizes timeliness.	Emphasizes precision.
Rules	It has the managers' own rules.	It has no accountants' own rules.
External vs. Internal	Management accounting system produces information that is used within an organization, by managers and employees.	A financial accounting system produces information that is used by parties external to the organization, such as shareholders, banks, and creditors.
Segment reporting	May pertain to smaller business units or individual departments, in addition to the entire organization.	Pertains to the entire organization or materially significant business units.
Focus	Management accounting focuses on the future and present.	Financial accounting focuses on history.
Format	No specific format is designed for management accounting systems. (Formal and informal recordkeeping)	Financial accounts are supposed to be in accordance with a specific format so that financial accounts of different organizations can be easily compared. (Formal recordkeeping)
Planning and Control	Management accounting helps management to record, plan, and control activities to aid the decision-making process.	Financial accounting helps in making investment decisions and in credit rating.
Information	Quantitative and qualitative. Monetary and non-monetary.	Quantitative and monetary.
Reporting frequency and duration.	As needed – daily, weekly, monthly.	Well-defined – annually, semi-annually, quarterly. (Verifiable)
Optional	Preparing financial accounting reports is mandatory, especially for limited companies.	There are no legal requirements to prepare reports on management accounting.

Legal / Rules	Drafted according to management suitability.	Drafted according to GAAP – Generally Accepted Accounting Procedure.
Accounting Process	Cost accounts are not Reserved under Management Accounting. The data from financial statement and cost ledgers are analyzed.	Follows a full process of recording, classifying, and summarizing for analysis and interpretation of the financial information.

Management accounting and financial accounting support each other. Like, Management accounting occurs at regular intervals. So it helps provide some framework for the financial accounting that only occurs at year-end. Nowadays all accounting systems are automated, so the recorded and verified data does help financial accounting.

Question no 04

Explain the concept of cost. How can you categorize costs?

Answer to the question no 04

While running a business, companies need to employ cost accounting strategies to analyze their cost structure. Under this procedure, the cost is assigned to a company's product, services, and other company activities. Check out the following sections for a complete idea of the concept and techniques of cost accounting.

Cost accounting refers to the computation of a company's overall expenditure. This procedure includes an assessment of a company's variable and fixed costs involved in each step of production. Cost accounting helps in taking strategic decisions to manage a company's expenses.

Importance of cost accounting

Cost accounting is essential for a business and benefits the employees, clients, stakeholders, and even the government. Here are some of the best advantages of the cost accounting technique:

As cost accounting helps differentiate fixed and variable expenses, it helps the company make better financial decisions. Management can decide the product price as per the cost incurred in producing the item.
It helps efficient workers get recognition and incentives on time. This is because cost accounting help assesses the efficiency of every worker and keeps a competitive work spirit going on.

Cost accounting helps manage and control costs by determining the various costs incurred in running a company. With this technique, a company can reduce operational costs and enhance work efficiency, thereby benefiting the company and its client.

Categorize of costs

Direct Costs

Direct costs are related to producing a good or service. A direct cost includes raw materials, labor, and expense or distribution costs associated with producing a product. The cost can easily be traced to a product, department, or project.

For example, Ford Motor Company (F) manufactures cars and trucks. A plant worker spends eight hours building a car. The direct costs associated with the car are the wages paid to the worker and the cost of the parts used to build the car.

Indirect Costs

Indirect costs, on the other hand, are expenses unrelated to producing a good or service. An indirect cost cannot be easily traced to a product, department, activity, or project. For example, with Ford, the direct costs associated with each vehicle include tires and steel.

However, the electricity used to power the plant is considered an indirect cost because the electricity is used for all the products made in the plant. No one product can be traced back to the electric bill.

Fixed Costs

Fixed costs do not vary with the number of goods or services a company produces over the short term. For example, suppose a company leases a machine for production for two years. The company has to pay $2,000 per month to cover the cost of the lease, no matter how many products that machine is used to make. The lease payment is considered a fixed cost as it remains unchanged.

Variable Costs

Variable costs fluctuate as the level of production output changes, contrary to a fixed cost. This type of cost varies depending on the number of products a company produces. A variable cost increases as the production volume increases, and it falls as the production volume decreases.

For example, a toy manufacturer must package its toys before shipping products out to stores. This is considered a type of variable cost because, as the manufacturer produces more toys, its packaging costs increase, however, if the toy manufacturer's production level is decreasing, the variable cost associated with the packaging decreases.

Operating Costs

Operating costs are expenses associated with day-to-day business activities but are not traced back to one product. Operating costs can be variable or fixed. Examples of operating costs, which are more commonly called operating expenses, include rent and utilities for a manufacturing plant.

Operating costs are day-to-day expenses, but are classified separately from indirect costs – i.e., costs tied to actual production. Investors can calculate a company's operating expense ratio, which shows how efficient a company is in using its costs to generate sales.

Opportunity Costs

Opportunity cost is the benefits of an alternative given up when one decision is made over another. This cost is, therefore, most relevant for two mutually exclusive events. In investing, it's the difference in return between a chosen investment and one that is passed up. For companies, opportunity costs do not show up in the financial statements but are useful in planning by management.

For example, a company decides to buy a new piece of manufacturing equipment rather than lease it. The opportunity cost would be the difference between the cost of the cash outlay for the equipment and the improved productivity versus how much money could have been saved in interest expense had the money been used to pay down debt.

Sunk Costs

Sunk costs are historical costs that have already been incurred and will not make any difference in the current decisions by management. Sunk costs are those costs that a company has committed to and are unavoidable or unrecoverable costs. Sunk costs are excluded from future business decisions.

Controllable Costs

Controllable costs are expenses managers have control over and have the power to increase or decrease. Controllable costs are considered when the decision of taking on the cost is made by one individual. Common examples of controllable costs are office supplies, advertising expenses, employee bonuses, and charitable donations. Controllable costs are categorized as short-term costs as they can be adjusted quickly.