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Accounting

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Preface

THIS book is designed for a one-semester management accounting course for both accounting and non-accounting majors, to follow the first year of elementary accounting. It is offered in the conviction that, with the increasing use of accounting data in managerial decisions, all students in business administration curricula can benefit from a course in management accounting. Many colleges and universities have responded to this need by adding a third semester of accounting to the business curriculum, usually in the field of management accounting.

The order and presentation of topics are intended to supply an introduction to the accounting-management relationship. The student, whose year of elementary accounting has left him versed in the fundamentals of entries, closings, and statements—and perhaps costs as well—is still a beginner in management accounting. The thirteen chapters of the text, regarded as weekly teaching units, are designed to carry him through a one-semester course, with additional time for review and summary. What management accounting is, how it operates, and what its background is in a control system, form an introductory section of three chapters. A succeeding section of three chapters discusses primarily the responsibility of accounting in the several existing types of external reporting. A third section of four chapters is concerned with the functions that accounting discharges within management—budgeting, cost analysis, and service to the principal managerial tasks of sales and production. The final three chapters include those on data processing and decision making, and also one that considers various areas of compensation, including incentives, profit sharing, and pension plans in which the accountant often has administrative responsibility. In entirety, the four sections of the text are intended to provide a semester of instruction that will adequately inform and alert the student to accounting's primary role—namely, functional participation in management.

MARY E. MURPHY

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section one

Status and Functions

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The Nature of Management Accounting

THE most important function of accounting records and procedures is to facilitate managerial policy. Accountants, however, have tended to minimize the management aspect of their work. This situation reflects the long preoccupation of accounting with external financial relationships that, in turn, has resulted in a tendency of accounting techniques to become increasingly specialized and professionalized. Thus, accounting frequently has tended to evolve as a field of activity quite apart from management.

The gap has been at least partly bridged over the years as internal control problems have increased with the size of business, and accountants and engineers have shared in the developments of such useful devices as standard costs and flexible budgets. These items have been made into management tools. However, only in the past ten years has the emphasis in accounting changed from the historical to the control and planning aspects of its activities. Accounting is now accepted in a dual role as (a) the intelligence arm of management and (b) in itself a part of management. [1]

[1] It is clear, for example, that transactions may be recorded, entered in the books, and summarized by recognized bookkeeping processes without particularly involving, except on a nuisance basis, anyone in the company other than the accountant. This is especially true if all that is expected is that an annual statement (for officers, creditors, and public authorities, if required) will be prepared, along with a tax return. Nor will the contents of the statement, except the profit figures and some balance sheet values and ratios, be of general interest. The situation will differ markedly when accounting data, broadly construed to include estimated or adjusted figures, as well as those in the accounts proper,

Management Accounting

As early as 1950, the Management Accounting Team that came to the United States under the auspices of the Anglo-American Council on Productivity defined management accounting as "the presentation of accounting information in such a way as to assist management in the creation of policy and in the day-to-day operation of an undertaking." This statement was supplemented by the following reasoning: "The technique of accounting is of extreme importance because it works in the most nearly universal medium available for the expression of facts, so that facts of great diversity can be represented in the same picture. It is not the production of these pictures that is a function of management but the use of them."

The tasks of the management accountant are many. At the Seventh International Congress of Accountants, held in Amsterdam in 1957, the following facets of management accounting were emphasized:

1. *Cost accounting,* including standard costs.
2. *Material control,* not limited to inventories but extending to material usage during manufacturing.
3. *Budgetary control,* embracing the preparation of fixed or flexible operating budgets and their use as standards of performance for interim periods.
4. *Interim reporting,* including monthly or quarterly profit and loss accounts, together with significant data as of the end of these periods; for example, statements of current assets and liabilities, orders on hand, etc.
5. *Determination of the most efficient and economical accounting system* applicable to the particular business, including the best use of mechanical and electronic devices.
6. *Special cost and economic studies,* such as the study of capital costs and potential profits if output is increased or additional lines are produced. This requires study of cost-volume-profit relationships, mathematics of the break-even chart, etc.
7. *Assisting management in the interpretation of financial data* and rendering advice in connection with pending decisions which can properly be made on the basis of such information.

Requirements of Management Accounting It has been asserted that the quickest way to the board of directors of a company is through the accounting department. This statement correlates with the present strong demand for accountants to fill positions on all levels

are expected to provide ready information for the company's view of the immediate and far future, its assessment of performance, and its response to calls for "spot" decisions.

of management. The qualities an accountant should bring to these opportunities have been outlined by one accountant as including:

1. A personality acceptable to all types of individuals that may make up the management group in a company.
2. The ability to receive the views of management with comprehension and to appreciate the type of information management requires.
3. An understanding of how to fill the role of a specialist and adviser.
4. A knowledge of theory as well as practice of management.
5. A balanced outlook on the functioning of business.
6. The capacity to think and confer with top management about matters central to the profitability and progress of the company.

Logical as it is for accountants to develop these characteristics and to enlarge their area of service, the results desired require a new attitude. In the past, accountants have not been trained for management. In public practice, they have ensured that annual financial statements are not misleading to investors and the public; in private (company) practice, they have concentrated upon the maintenance rather than the interpretation of accounts. General and functional management have made their own decisions. Today, however, accounts are more and more frequently designed for management's purposes. The annual balance sheet and income statement, previously emphasized, have received less emphasis, while ever greater stress has been laid on information issued both within the company and within the period for the sole purpose of providing data on which to manage.

Central Place of Services within Management Management accounting includes financial accounting and covers the supervision of all related processes—maintenance of the necessary books of account, compliance with legal requirements as to accounts and financial statements, and the operation of such subsidiary accounting functions as accounts receivable and payable. Management accounting includes also the establishment and operation of internal controls. These controls are primarily matters of providing historical information to satisfy the requirements of the company's relationships with outsiders and to make sure that it is developed accurately and with integrity.

Important as these responsibilities have been and continue to be, the area of greatest progress in managerial accounting has been the application of accounting to internal transactions, and the shaping, timing, and circulation of resulting information. Management accounting extends to the operation of systems of cost accounts, budgetary control, and statistical data. It embraces many informational materials that progressive management now customarily expects to be serviced with, and other materials that are not as generally provided but are well-established in many companies. Such information relates to cost and inventory control, short- and long-term planning decisions that must be made immediately and policies that may be developed over time.

The management accounting function is more susceptible of practical fulfillment today than at any other point of progress. One reason is the better and more general education of accountants and their resulting greater ability and prestige. Along with this, there has been improvement in data processing equipment and in analytical and problem-solving techniques, such as individual statistical tools and also operations research.

The Management Accountant

In a large company, management accounting duties are usually divided, but someone—a financial vice-president, controller, or chief accountant—must co-ordinate them and, in fact, symbolize them as a whole. In short, the management accounting function must have a head (that is, the management accountant) who does much more than the industrial accountant whose function he is charged with developing beyond traditional bounds.

A word on this basic function of management accounting is necessary. Industrial accounting is a central departmental responsibility within management accounting, if the company is large enough to separate the financial, industrial, and over-all executive accounting function into units. If financial and industrial accounting comprise a combined subordinate function, the industrial accountant is responsible for the department to which all financial and cost information is sent from its origin in transactions, and responsible also for the preparation of financial statements and for the issuance of cost control statements on predetermined lines. He maintains the flow of accounting information, works on a timetable, and handles staff.

The Field of Action Frequently, the management accountant is the product of his own competent exercise of the industrial accounting function. However, the specific additional functions that characterize him should be particularized because they are the "growing edge" of his work and account for his management viewpoint and participation. He designs the framework of the financial and cost control reports that provide each managerial level with the most useful data at the most appropriate time. He educates executives in the need for control information and in ways of using it. He works closely with top management on long-range programs and policies. He must combine his training and experience in both management and accounting.

For the management accountant to function properly, *two* things are essential—namely, direct contact with general management and freedom from detail. He frequently reports directly to the president as a senior staff officer; his most likely title is controller. He could not possibly measure up to this status if he is immersed in accounting routine or is a "slave" to the operation of balancing. His goal is to channel for use in the management process data that will have a vital influence on company policy. He offers figures as facts having managerial significance. If, as in a certain chemical plant, insufficient attention is paid to inventory control, there may be overstatement of profits because of unacknowledged losses, especially in interim statements not substantiated by a physical inventory. More efficient inventory control made the accounts more accurate in this instance. In addition, the closer relationship of inventory accounts to detail made it possible to keep the inventory both well-proportioned and at a lower figure.

In no case should financial and cost accounting be separated. It is precisely because the form of financial accounts has been primarily influenced by legal and tax requirements, and often limited to meeting these essentially incidental needs, that the accounts have proved to be, over the years, of only minor use to management. Costing, a part of the accounting process, produces information from what is or should be a single over-all set of company accounts. There should be no need for reconciliation between cost and other accounts. The accounts must be integrated philosophically as well as technically, for it is apparent that providing management with information can be successfully undertaken only by someone thinking in general management terms, someone with a practical knowledge of the problems, plans, and objectives that management is concerned with. This is a task for the management accountant and a staff imbued by the same viewpoint.

What Managing Means The management accountant always remains aware of the ingredients of management itself. The sequence of events in managing a company follows this general pattern:

1. Formulating a plan.
2. Allocating responsibilities for implementing the plan.
3. Organizing procedures to assist in the plan's execution.
4. Controlling performance.

5. Appraising results.
6. Continuing to plan.

The roll of accounting in the preceding process may be stated as follows:

1. To provide management with data designed to assist in the formulation of a plan covering all business functions.
2. To express the plan in dollars and by responsibilities at all managerial levels.
3. To exercise informed judgment as to the effectiveness of the organization and methods used to carry out the plan, and to be ready to point out shortcomings or incipient trouble spots.
4. To devise or adapt workable standards of performance acceptable to the responsibilities measured, to compare performance with those standards at set intervals, and to analyze variations in order to aid management to control performance.
5. To report to management on the extent to which the plan has been carried out, as a preliminary to the formulation of a fresh plan.
6. To bring the most pertinent aspects of company experience to bear on evaluations required to solve specific problems.

Emphases of Management Accounting

Managerial accounting stresses the future and prepares to appraise this future as it becomes the present. The use of budgets exemplifies this point of view. Accounting data here are utilized to project future operations. The data are valuable not only in translating management's plans into dollar figures but also in interpreting the costs as they are incurred. Budgets are a type of standard for this purpose and are often based on engineered standard costs, a related principal tool of managerial accounting used in accomplishing control and exercising planning. Well-designed standards can be converted into prospective costs with relative ease as changes in prices, efficiency factors, and other circumstances appear.

Managerial accounting therefore is selective in character. On the financial side, it is inclusive and discriminating in its portrayals; on its primarily managerial side, it is concerned, while still discriminating, with giving emphasis to relevant facts that have been gathered out of the mass to aid in the solution of the problem at hand. Costs useful in short-term decision-making are illustrative of this.

When the question arises, for example, as to whether a part should be purchased instead of being manufactured in one of the company's plants, the accounting information pertinent is limited to costs that

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