

FOURTH EDITION



Accounting for Managers

Interpreting Accounting Information
for Decision Making

Paul M. Collier

Accounting for Managers



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Interpreting Accounting Information for Decision Making

Fourth Edition

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Fourth Edition

For Loredana and Alexis

Preface to the Fourth Edition

Rationale for the book

My own education as an accountant many years ago was aimed at achieving professional recognition and emphasized an uncritical acceptance of the tools and techniques that I was taught. Teaching accounting hasn't changed much since then. However, it was only after moving from financial to general management positions in industry that I began to see the limitations and questionable assumptions that underlay accounting tools and techniques. When I returned to study later in my career, I was exposed for the first time to alternative perspectives on accounting that helped me to understand the assumptions and limitations of accounting that I had seen in practice. This book is therefore as much a result of my practical experience as a producer and user of accounting information as it is a result of my teaching and training experience.

The title of the book, *Accounting for Managers: Interpreting accounting information for decision making*, emphasizes the focus on accounting to meet the needs of managers. As accounting increasingly becomes decentred from the accounting department in organizations, line managers in all functional areas of business are expected to be able to prepare budgets, develop business cases for capital investment, calculate prices and exercise cost control to ensure that profit targets are achieved. Managers are also expected to be able to analyse and interpret accounting information so that marketing, operations and human resource decisions are made in the light of an understanding of the financial consequences of those decisions.

The material contained in the book stresses the interpretation of accounting information as well as a critical (rather than unthinking) acceptance of the underlying assumptions behind accounting. This book has been continually motivated by my experience in teaching accounting at postgraduate level (MBA and MSc) at Aston Business School in Birmingham (UK) and subsequently in the MBA and MPA at Monash University in Melbourne (Australia). It has also been used to support customized training programmes for non-financial managers in the use of financial tools and techniques in their own organizations. Hence the emphasis in this book is on *using* accounting, not *doing* accounting. Most accounting texts are a 'cut down' version of a text used to train accountants, but this book takes a *user*, not a *preparer*, focus. It has been written specifically focused on the needs of non-financial managers who need a solid grounding in accounting.

There is a focus in most accounting texts on manufacturing organizations, perhaps because many of those books have been issued as revised editions for many years and have not adequately reflected the changing nature of the economies in the developed world. The growth of service businesses and the knowledge

economy is not sufficiently explored in most accounting texts. This book uses examples, case studies and questions that are more equally balanced between the needs of organizations in manufacturing, retail and services. It also uses corporate examples, rather than small business examples that lack realism to practising managers. Most of the examples and illustrations in this book are simplified versions of real-life business problems, drawn from my experiences with various companies.

In most accounting books there is insufficient attention to theory, particularly for postgraduate students who should have a *wider theoretical underpinning* of the assumptions and limitations of accounting information. Theory should encourage the reader to enquire more deeply into the alternative theoretical positions underlying accounting as well as its social and behavioural consequences, both within their own organizations and in the wider society. This book introduces the reader to some of the journal literature that is either fundamental to the role of accounting or is 'ground breaking'. This book provides, through the ample references in each chapter, an accessible route for those who want to reach into the wider literature.

Accounting books are often inaccessible to those from non-English-speaking backgrounds, because of the complexity of the language used. Many of the examples and questions in accounting books rely on a strong knowledge of the nuances of the English language to interpret what the question is asking, before students can make any attempt to answer them. This book adopts a more plain English style that addresses the needs of European and Asian students.

Finally, the examples in most accounting books focus on the calculations that accountants perform, rather than on the *interpretive needs* of managers who use those reports. While some calculation questions are needed to ensure that readers understand how information is produced, the emphasis for the non-financial manager should be on *critical understanding and questioning* of the accounting numbers and of the underlying assumptions behind those numbers, and on the need to supplement accounting reports with non-financial performance measures and broader perspectives than satisfying shareholder wealth alone.

This fourth edition takes into account the author's experience in teaching accounting to non-financial managers. While it has not been possible to incorporate every suggestion made, this edition has benefited from feedback from many students and from a number of reviewers and academics who use the text in their teaching. There has been considerable updating of every chapter, and new and revised questions have been added. An important change has been to include illustrations, questions and solutions using multiple currency symbols: the £, € and \$. This should help the book to be seen as more relevant across national boundaries and reflects the internationalization of accounting tools and techniques.

Outline of the book

The book is arranged in four parts. The first part describes the context and role of accounting in business. The first two chapters are provided for those students who are coming to business studies for the first time, although even the experienced reader will find value in reading them. Chapter 3 provides a basic introduction to accounting, without the confusion that usually accompanies 'debits' and 'credits'.

Some theoretical frameworks are provided in Chapters 4 and 5. It is hoped that this will provide a foundation for readers' understanding that accounting is more than a technical subject but is grounded in competing theories and values. These theories and values are themselves rooted in historical, political,

economic and social causes. The theoretical framework should help to make the subject more meaningful to students and practitioners alike.

In Part II, Chapters 6 and 7 provide a comprehensive review of financial statements and ratio analysis from the perspective of a user of financial statements and reflect the latest practice under International Financial Reporting Standards (IFRS). Chapter 8, which looks at inventory valuation, provides an important link between Parts II and III of the book.

The third part of the book shows the reader how accounting information is used in decision making, planning and control. In this third part the accounting tools and techniques are explained and illustrated. Beginning with an introduction to accounting and information systems in Chapter 9, subsequent chapters review how accounting is integral to decisions about marketing (Chapter 10), operations (Chapter 11), and human resources (Chapter 12). The problem of overhead allocation is covered in Chapter 13, followed by capital expenditure decisions (Chapter 14), the evaluation of business unit performance (Chapter 15), budgeting (Chapter 16) and budgetary control (Chapter 17). Chapter 18 introduces a range of the more recent, strategic accounting approaches.

Theory is integrated with tools and techniques, and case studies, drawn mainly from real business examples, help draw out the concepts in each chapter. A critical approach to the assumptions underlying financial information is presented, building on the theoretical framework provided in Chapters 4 and 5. The questions at the end of each chapter rely on knowledge gained from reading that and preceding chapters. Consequently, there is a greater level of detail involved in questions in the later chapters. Attempting these questions will help the reader to understand how accountants produce information needed by non-accounting managers. The end-of-chapter case studies provide the reader with the opportunity to interpret and analyse financial information produced by an accountant for use by non-accounting managers in decision making.

Part IV provides a wealth of supporting material, including an extensive glossary of accounting terms. Four readings from the accounting literature cover a broad spectrum and support the most important theoretical concepts in the book. They present four different yet complementary perspectives on accounting in organizations. Each reading has several questions that the reader should think about and try to answer in order to help understand the concepts. The fourth part of the book also contains solutions to the end-of-chapter questions and case studies. The case study answers are indicative answers only, as different approaches to the same problem can highlight different aspects of the case and, as in real life, there is a range of possible approaches.

About the Author

Dr Paul M. Collier PhD (Warwick), BBus (NSWIT), MComm (NSW), Grad Dip Ed (UTS), CPA (Aust) is Professor of Accounting at Monash University in Melbourne, Australia. He was until 2006 a senior lecturer at Aston Business School in Aston University, Birmingham, UK. Paul has worked in senior financial and general management roles in the UK and Australia. He was chief financial officer and company secretary and subsequently general manager (operations) for a public listed company in Sydney before moving to the UK in 1993. He also worked in the public sector before completing his PhD and moving to academia.

Paul has been a board member and chair of the audit committee of a non-profit distributing housing association in the UK with assets of £200 million; and a board member, chair of the finance and resources committee and member of the audit committee of a health service in Australia with a budget of over \$350 million. He has been an examiner for the Chartered Institute of Management Accountants (CIMA) in the UK, and has written study material for both CIMA and CPA Australia.

This book uses material developed by the author based on his experience as a practitioner, in his teaching at Aston and Monash, and in delivering financial training to non-financial managers in diverse industries over many years. Paul's research interests are in the use of management accounting and non-financial performance information in decision making and the behavioural aspects of management accounting and management control systems. He has published many case studies of accounting in academic journals and as book chapters. He is also the author of *Fundamentals of Risk Management for Accountants and Managers*, published in 2009.

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