Introduction to
Management Accountingand Managerial Control
(*Planning and Control*)

Session 1
7 March 2019

Introduction

Giuseppe TOSCANO

- I was born in Milan on April 20, 1963
- I'm married and I have two daughters
- Graduated in *Business Administration* at the Bocconi University in Milan
- I've been teaching, for ten years (1989-1999), *Cost Analysis and Decision Making* at the Bocconi University and *Management Control Systems* at the SDA Bocconi School of Management.
- Since 1991 I'm professor at the LIUC Cattaneo University, teaching *Planning and Management Control* and *Pricing and Costing*.
- My research activity concerns:
  - costing systems and target costing,
  - management control systems,
  - pricing systems,
  - performance measurement systems,
  - food management and retail business

The lesson schedule

10,30 I will arrive in the classroom

10,45 Beginning of the lesson (first part)

12,00 Stop the lesson - Coffee break

12,15 Beginning of the lesson (second part)

13,15 End of the lesson

Course Overview - Objectives

- Become familiar with what management accounting information is typically used within the firm.
- Develop an understanding of how management accounting information is used by managers in the decision making process.
- Consider how management accounting information can be used to motivate members of the firm or as a mechanism to control their behavior.

Course Overview - Learning Objectives

This course aims to prepare students to effectively and efficiently manage the activities that take place during the Planning and Managerial Control Process.

At the end of the course students will be able to:

- project and implement management accounting and related analytical methodologies for decision making and control in profit-oriented organizations
- manage product costing, budgetary control activities, and performance evaluation systems for planning, coordinating, and monitoring the performance of a business.
- determine principles of measurement and develops framework for assessing behavioral dimensions of control systems, impact of different managerial styles on motivation and performance in an organization.

Course Overview - Topics

Topics

- Introduction to Managerial Accounting and Managerial Control Systems
- Costs and Revenues Behavior
- Cost Allocation
- Contribution Margin Analysis and Break-Even Analysis
- Absorption Costs Systems
- Standard Costs and Variance Analysis
- Rensponsibility Accounting and Behavioral Accounting
- Activity-based Costing and Target Costing
- Managerial Planning and Control Systems
- Budgets and Budgeting
- Performance Measurement and Reporting Systems
- Balanced Scorecard Systems

Course Overview
Who should take this class

Are you going to be a manager?

Are you going to be a consultant?

Are you going to be an entrepreneur?

Course Overview - Requirements

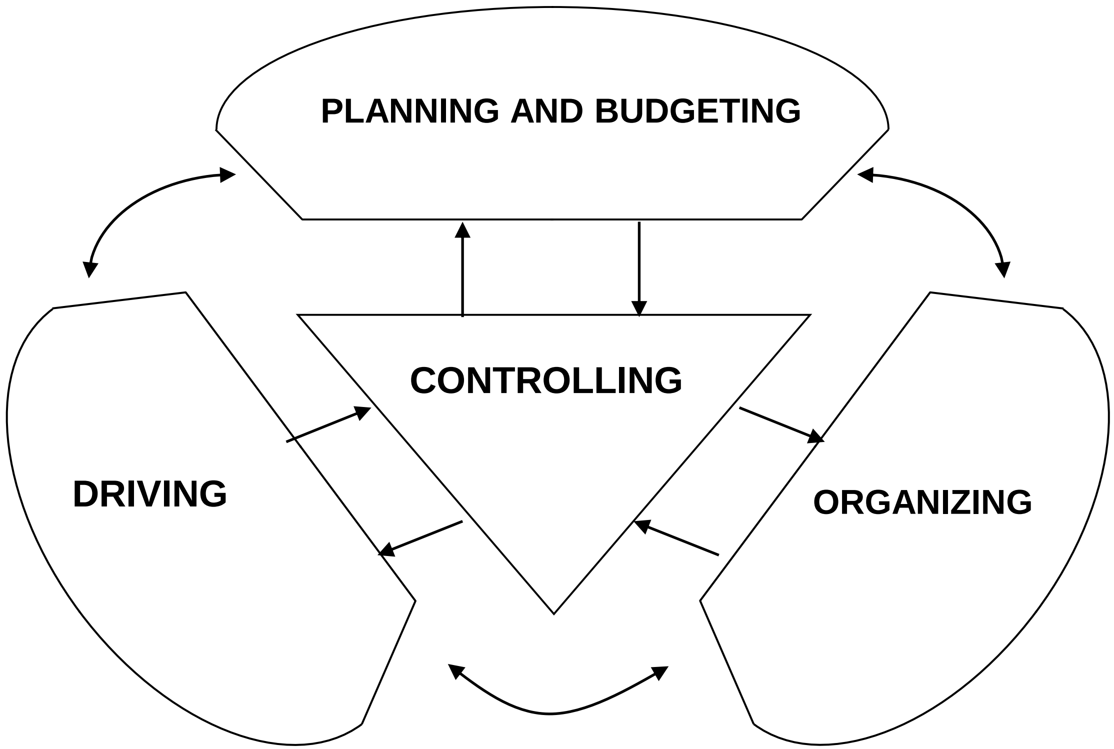
This class is designed to allow you to develop an understanding of the concepts by applying the material covered to real life problems and cases. I have designed the grading system for this class to meet this objective.

Your grade will be computed as follows:

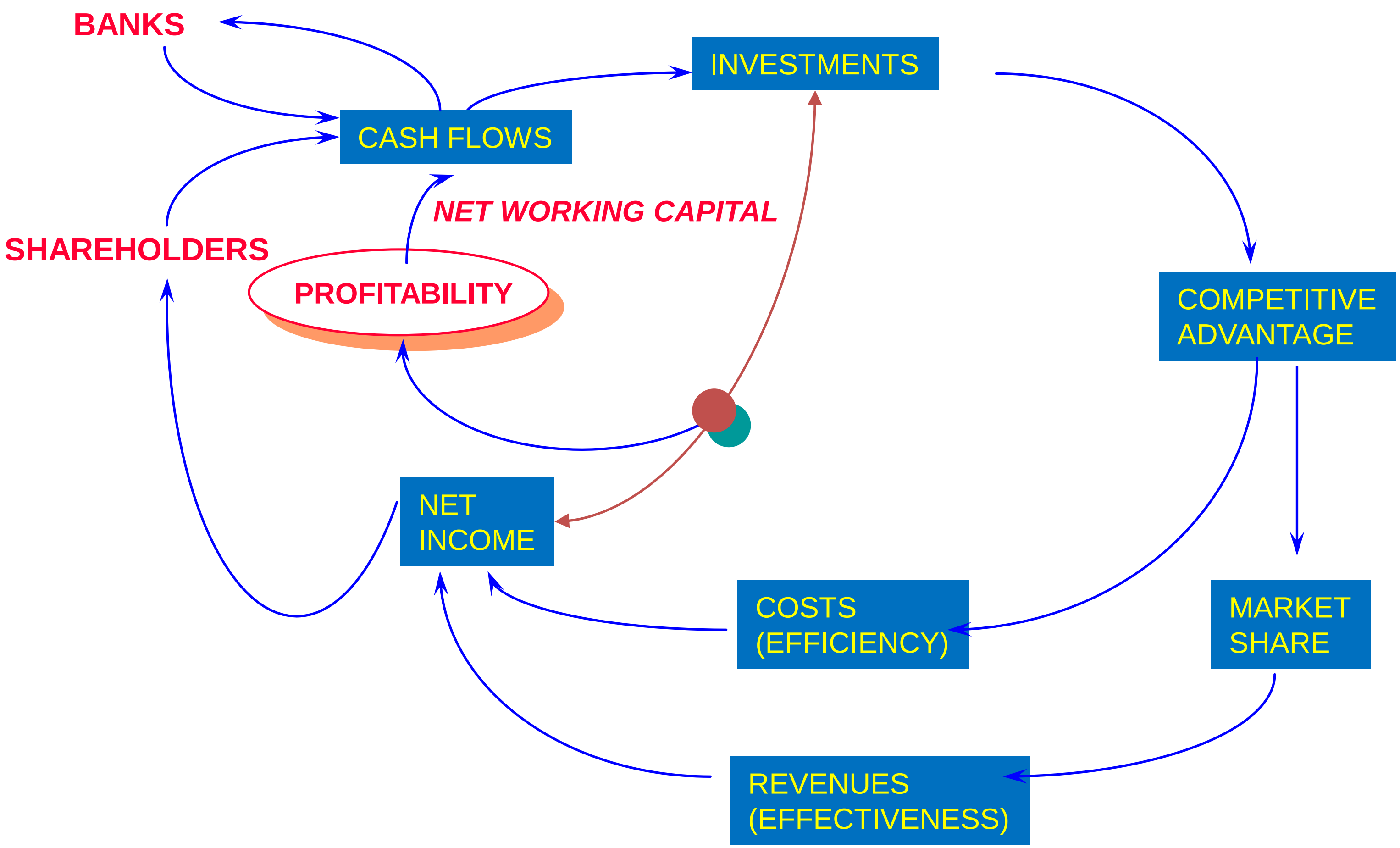
Discussion cases, exercises, case studies (individual or team)	40%
Final written examitation	60%

Non-attending students are provided with a written examination supplemented by an oral examination

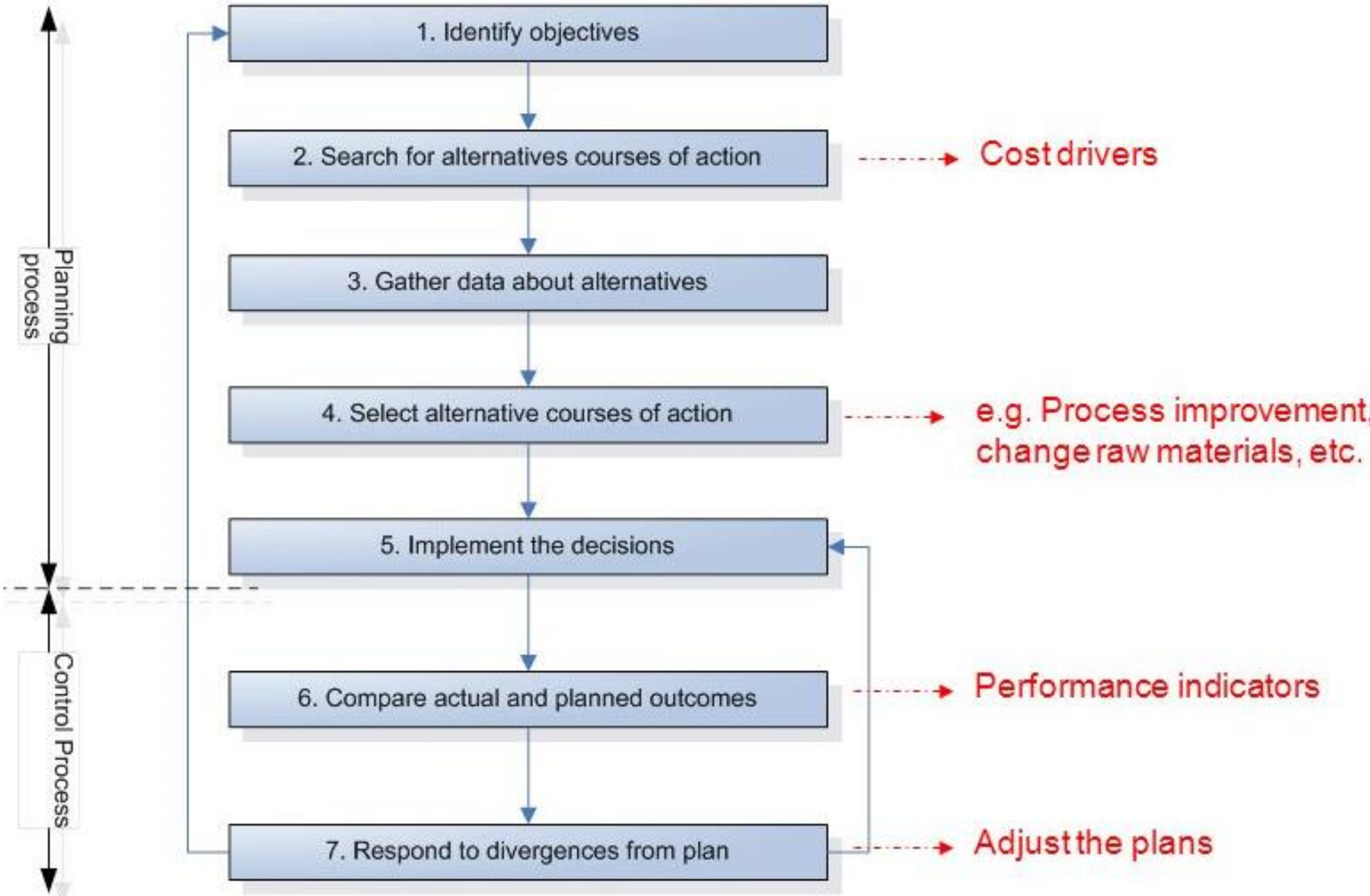
THE MANAGERIAL PROCESS



MANAGERIAL PROCESS & PROFITABILITY RESULTS



DECISION MAKING, PLANNING & CONTROL PROCESS



MANAGEMENT ACCOUNTING

	Financial Accounting	Management Accounting
Purpose	Communication of financial position	Decision making
Requirement	Mandatory	Optional
Primary Audience	External	Internal
	Investors, Regulators, Tax authorities, etc.	Management & decision makers
Regulation/guidelines	GAAP, IFRS, IAS	None
Frequency	Quarterly, Annual or per period	As needed and ongoing
External review	Auditors, Regulators	None
Focus	Past transaction	Information to aid decisions for the future
Scope	Company wide	Narrow per segment, product, etc. as needed.

Financial and Management Accounting: Basic Features

- Some key differences between financial and management accounting are as follows:
  - Audience
    - *Financial* – External (and Internal): Stockholders, creditors, banks, tax authorities….
    - *Management* – Internal: managers
  - Purpose
    - *Financial* – valuation and stewardship assessment.
    - *Management* – to make decisions, communicate strategy, evaluate performance, control/align behavior.

Financial and Management Accounting: Basic Features

- Some key differences between financial and management accounting are as follows:
  - Timeliness
    - *Financial* – historical or ex post; at regular intervals; relatively long reporting periods
    - *Management* – Current, and future oriented, but also historical for control reporting periods depend on need
  - Regulation
    - *Financial* – regulated; rules driven by generally accepted accounting principles and government authorities
    - *Management* – no regulations; systems and information determined by management to meet strategic and operational needs; not required by law

Financial and Management Accounting: Basic Features

- Some key differences between financial and management accounting are as follows:
  - Type of Information
    - *Financial* – financial measurements only
    - *Management* – financial plus operational and physical measurements on processes, technologies, suppliers, customers, and competitors
  - Qualitative Characteristics of Information
    - *Financial* – auditable, reliable
    - *Management* – not subject to audit, could be more subjective

Financial and Management Accounting: Basic Features

- Some key differences between financial and management accounting are as follows:
  - Scope
    - *Financial* – highly aggregated; report on entire organization
    - *Management* – not aggregated; informs local decisions and actions
  - Behavioral distortions
    - *Financial* – primarily reports economic events but also influences behavior because, e.g., manager's compensation is often based on reported financial results
    - *Management* – could distort the behavior of managers and other employees, because of link to performance evaluation and reward system

Managerial Accounting

- Managerial accounting is broad.
  - It straddles competitive strategy, organizational economics, finance, operations management and organizational behavior.
  - It also provides useful knowledge for all organizational settings:
    - for-profits,
    - non-profits,
    - government agencies,
    - etc.

Managerial Accounting

- Here are some topics we will cover.
- As they will illustrate, the demand for managerial accounting info stems from its use in:
  - Decision Making and Planning
  - Cost Management
  - Strategic Cost Management
  - Management Control

Decision Making and Planning

- Managers make decisions, and therefore need information. Some common decisions we will study are:
  - suppose your company makes medical probes.
    - In July, you receive a call from a company that is not a regular customer.
    - They would like to purchase 5000 probes this month only, and the price they offer is below your production cost.
    - Should you accept this one-time special order, and under what circumstances?
    - What information do you need to make this decision?
  - suppose each probe costs $10 to produce, and 70% of this cost is due to one part, a fibre optic wire, that you also manufacture.
    - Should you continue to make this costly part, or should you buy it from an outside vendor, and under what circumstances?
    - What information do you need?

Decision Making and Planning

- Managers make decisions, and therefore need information. Some common decisions we will study are:
  - suppose you manufacture five other types of medical devices.
    - Should you add another product line, or drop a line, and under what circumstances?
    - What information do you need?
  - suppose you are planning for the upcoming year, and you need to determine how many units to sell to breakeven, or to make a target profit figure.
    - What information do you need?

Decision Making and Planning

- In public policy debates, an example of a decision might be:
  - palliative care or not for cancer patients – what is the cost;
  - what is the objective, to minimize cost or something else?

Cost Management

- We used cost estimates to make the decisions illustrated above.
- But how are these costs determined or measured ?
  - Understanding cost measurement helps us manage costs.
  - Managing cost is especially important today because of:
    - global competition, that requires better knowledge of costs.
      - Some companies choose a low cost leadership strategy.
      - Measuring and managing costs is the lynchpin of this strategy;

Cost Management

- global competition also requires focus on quality.
  - Improved quality can result from process improvements made during the course of identifying cost drivers, since streamlined process generally improves quality;
  - It can also come from reduction of waste, which comes from better measurement of waste;

- some companies choose a product differentiation strategy, which requires analysis of costs from customers viewpoint.
  - What features are worthwhile to customers?
  - This requires looking at cost from customers' viewpoint, and eliminating costs that are not valued;

Cost Management

- Managing cost is especially important today because of:
  - shorter – 2 to 3 years – product life cycles, which require more accurate up-front projections about profitability of proposed investment, and leave less room for error in production planning and product costing;
  - increasing automation, which means that labor is no longer the only major overhead cost driver.
    - This requires more care in identifying, measuring and managing cost drivers.

Cost Management

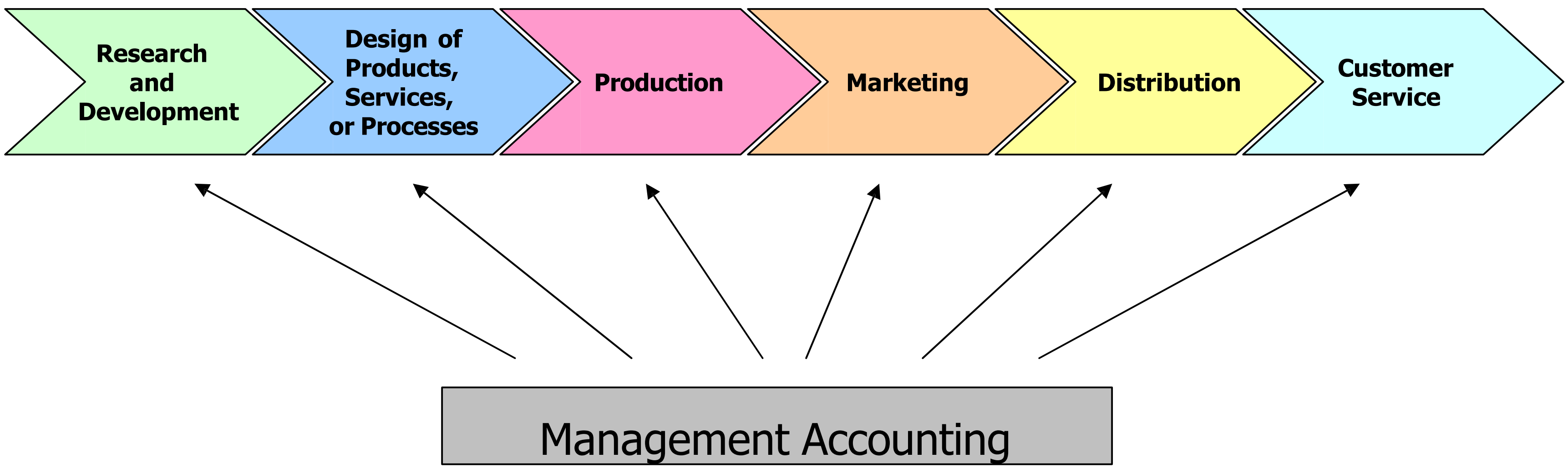
- In product costing, we will shed light on some of the following issues:
  - What is the true cost of a product?
    - This is not as straightforward as it seems.
    - For example, Roberts vs. GSA and cost of federal courts – why the half billion dollar discrepancy?
  - Reported cost is malleable, and can be exploited.
    - E.g., Stanford yacht.
    - Cost-plus contracts vulnerable, therefore carefully specify which costs qualify.
  - How can we refine cost estimates?
  - What is the cost of excess capacity?
    - How much is optimal?
    - Who should bear this cost?

Strategic Cost Management

- This requires finding and eliminating non-value-added activities, structures, etc. in the business ecosystem, rather than just within the business itself.
  - It requires understanding of ecosystem, the value chain and supply chain.
  - The supply chain is the sequence activities that transform the raw materials into finished goods delivered to the consumer.
  - The value chain is the portion of the supply chain within the company.

Management Accountant's Role in Implementing Strategy

Different Parts of the Value Chain



Strategic Cost Management

- Strategic cost management requires going beyond providing information demanded by specific decisions, to proactively identifying, measuring and managing key cost drivers within the entire supply chain.
  - Examples of strategic cost management initiatives include measuring customer profitability, and working with suppliers to implement JIT.
  - Incorporate cost into product design: controlling parts proliferation; target costing

Management Control

- This refers to performance evaluation, incentive alignment and minimizing divergence of actual results from desired results.
  - In the discussion above, we assumed neutrality of information (i.e., freedom from bias).
  - Now we introduce bias, by recognizing the presence of agency issues.
    - These arise because the interests of the business owners are not perfectly aligned with the self interest of the owners' agents – firm managers and employees.
    - Decentralized organizations require the assignment of decision rights to points (people) further away from the owner.

Management Control

- To control, or minimize, agency issues requires measuring or evaluating performance and rewarding agents appropriately.
  - How do we measure both organizational and individual performance – which metrics should we use and what are their implications?
    - Measure should be ‘hard’ or verifiable. E.g., RAF bomber command.
    - Performance metrics determine rewards, and therefore behavior, which in turn influences profits.
    - Inappropriate metrics can have costly consequences. E.g., CMS uses timing of pneumonia-related antibiotic therapy as performance measure.

Management Control

- One of the concepts we will highlight is that using a piece of information for control impairs its use for decision making.
  - For example, getting projected sales from salespeople when preparing the budget.
    - This problem is especially salient in large, decentralized organizations, in organizations where specialized knowledge is required for decision making and where decision timeliness is critical.

Management Control

- We will study some of the following management contro tools and concepts:
  - (a) budgets (aid in control not just planning);
  - (b) transfer prices, or internal prices which aid in control of resource usage;
  - (c) the controllability principle and relative performance evaluation (RPE may be older than suspected – Hammurabi’s code)
  - (d) responsibility accounting and responsibility centers;
  - (e) variance analysis;
  - (f) multiple performance measures and non financial performance measures.

External Environment and Management Accounting

- Shocks in the external environment feed through and affect management accounting, e.g.,
  - manufacturers using just-in-time inventories

Summary

- The role of managerial accountants is
  - identification,
  - measurement, and
  - management
- of key operational and financial value drivers (Institute of Management Accountants, 1999).
- Managerial accountants are
  - problem solvers (e.g., providing information for decision making),
  - scorekeepers (e.g., measuring performance of individuals, groups and processes), and
  - attention directors (e.g., strategic cost management).