

Theoretical Lesson 1
Introduction and Main Concepts

MANAGEMENT ACCOUNTING I

Management

2014-2015

Luís Pimentel

2014/2015 – 2nd semester

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Objectives of the Lesson [1/2]

- i. Define management accounting
- ii. Explain the objectives of management accounting
- iii. Express the difference between management accounting and financial accounting
- iv. Differentiate business functions from management functions

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Objectives of the Lesson [2/2]

- v. Describe the activity diagram of distribution (merchandising) and manufacturing companies
- vi. Define the components of the manufacturing cost
- vii. Ascertain the manufacturing costs of the products
- viii. Define the total and non-manufacturing costs of the products

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Main bibliography

- Horngren, C. *et al.* (2012), Cost Accounting: A Managerial Emphasis, 14th edition, Prentice Hall, ISBN-10:0-273-75387-8.
- Drury, C. (2009), Management Accounting for Business, 4th Edition, South-Western / Cengage Learning.

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Objective 1

i. Define management accounting

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Concept of Accounting

Accounting is an information system whose objective is ...

recognise, ...

measure, and ...

report ...

economic and financial facts of an organisation
to its interested users

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Financial Accounting *versus* Management Accounting

Financial Accounting...

... subsystem of information of an organisation which recognises, measures and reports economic and financial information so that **external users** make decisions.

Examples: stock market, credit financial institutions

Management Accounting...

... subsystem of information of an organisation which recognises, measures and reports economic and financial information so that **internal users** make decisions

Examples: Board of directors, business units managers

Management Accounting

More exactly, management accounting is...
a **subsystem of information** which...
recognises,
measures and **reports** economic and financial
information, ...
to help the managers and other
internal users to make a decision.

Costs Accounting

- ↘ Costs accounting is a subsystem of management accounting which provides economic and financial information to management accounting and to financial accounting.
- ↘ Costs accounting recognises, measures and reports economic and financial information related to the acquisition and to the consumption of the resources used by an organisation

ii. Objectives of management accounting

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Objectives of management accounting

- ↘ Ascertain the **expenses, revenues and incomes (profits)** of the business functions, particularly the manufacturing function.
- ↘ Provide **information** to support **financial statements**
- ↘ Provide **information** to help **the management functions**, particularly planning and control
- ↘ Provide **information** to managers **to support decision-making**.

iii. Differentiate between financial accounting and management accounting

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Characteristics of financial accounting

- a) Focus on financial information to external users
- b) Preparation of financial statements for **more or less long periods of time**
- c) **Information concerning general purposes**, referring to the global activity of the organisation and, highly consolidated
- d) Information collected and provided according to **international (legal) norms of accounting**.
- e) Information **subject to external audit**

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Characteristics of management accounting

- a) Focus on financial information to **internal users**
- b) Drawing up financial reports **when needed for decision-making.**
- c) **Information regarding specific purposes**, encompasses sub-units of the organisation. It is detailed and relevant to decision-making.
- d) Information is collected according to **methods and techniques generally accepted and not legal**
- e) Information **not subject to external audit**

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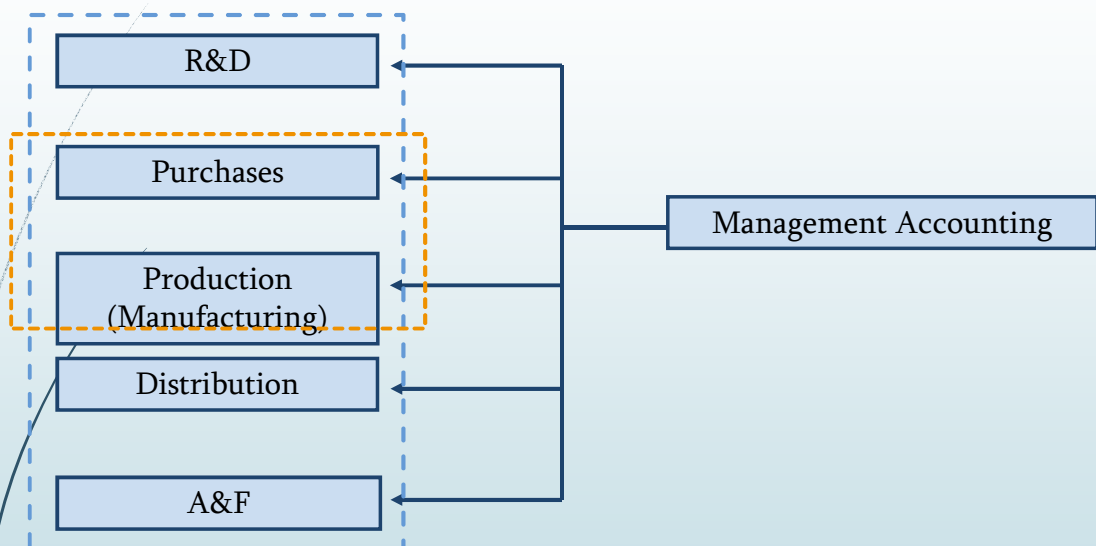
iv. Differentiate business functions from management functions

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Business functions



Management accounting is related to all business functions with the aim of ascertaining, namely, its expenses

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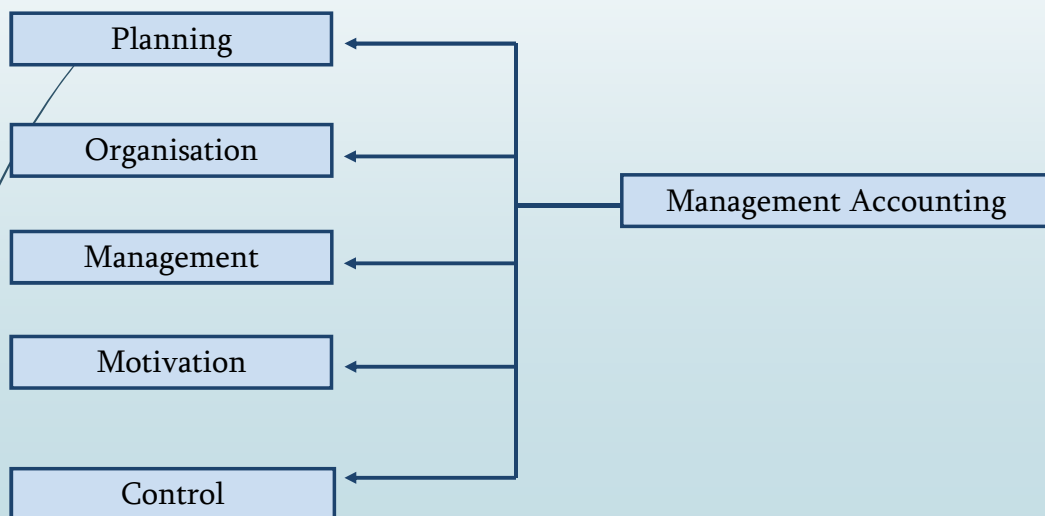
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A special emphasis will be placed on the relation between management accounting and the function of purchases and of production (manufacturing)

Management functions

- The organisational structure defines what the business functions are and the activities that they include
- As a rule, the management functions are the following ones:



**v. Describe the activity diagram of
distribution and manufacturing
companies**

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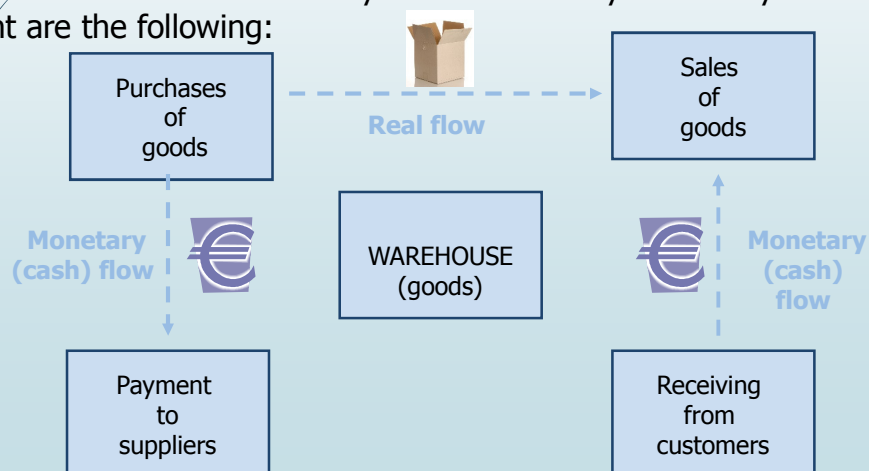
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Distribution companies

- Distribution companies are those that buy assets (goods) and sell them in the same form (shape) as they acquire them without any type of conversion (processing)

Example: a company that buys and sells cars)

The actual flows and the monetary flows which may be or may not be coincident are the following:

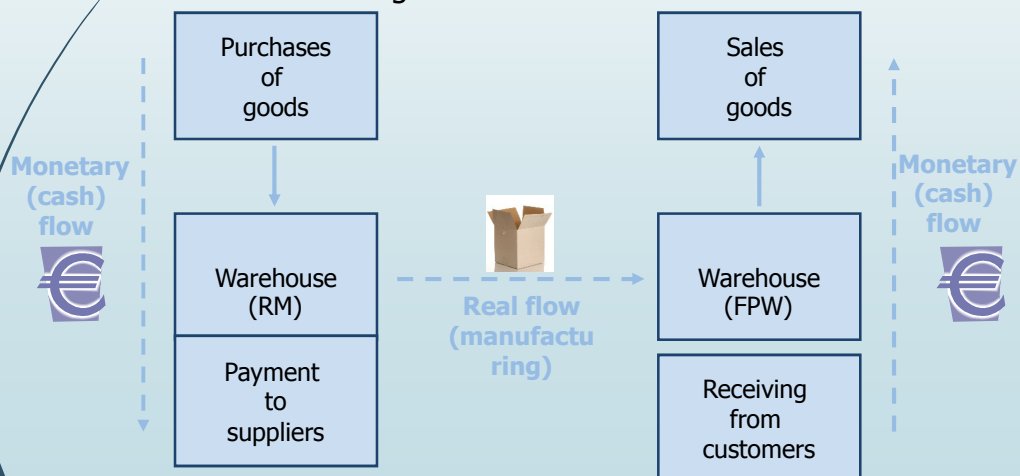


Manufacturing companies

- Manufacturing companies are those that buy the raw materials (or materials), convert them during the manufacturing process and sell the products obtained

Example: a company that buys components to produce (manufacture) and sell cars

- The actual flows and the monetary flows which may be or may not be coincident are the following :



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Types of stocks in manufacturing companies

- **Raw materials (RM) or direct Materials (DM):** are assets items which are not for sale and are incorporated in the products. They represent a significant part of the products cost.
- **Other (secondary) materials (OM(SM)):** are asset items which are not for sale and they may be or may not be incorporated in the products. They do not represent a significant part of the products cost.
- **Finished products (FP):** are the products obtained at the end of the manufacturing process.
Example: cars
- **Intermediate products (IP):** are the products obtained at an intermediate stage of the manufacturing process.
Example: the chassis of cars
- **Products in progress (PiP):** are the products which are at an intermediate stage of the manufacturing process.
Example: a car at an intermediate stage of painting

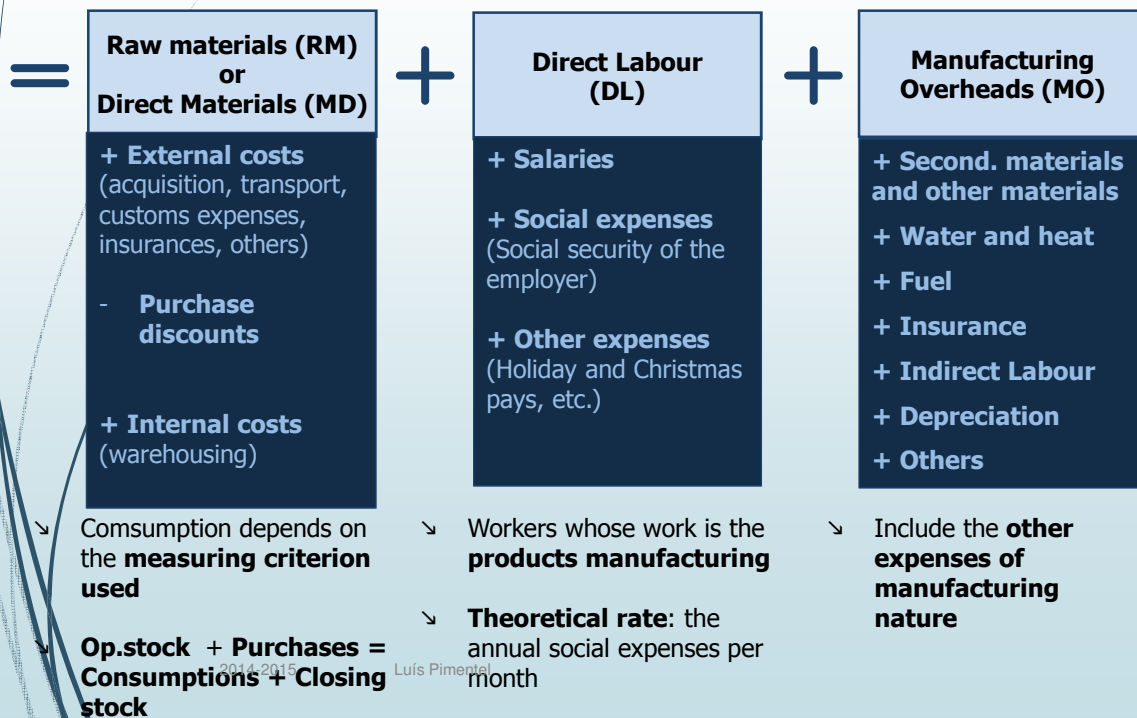
vi. Define the components of the manufacturing cost

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Production Manufacturing Cost (PMC)



vii. Ascertain the products manufacturing costs

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Prime cost of the monthly production and of the finished production

- **Prime cost of the monthly production** (PCMP or PC) is the name given to the sum of the monthly consumption of raw materials with the direct labour:

$$\text{PC} = \text{RM} + \text{DL}$$

- **Prime cost of the finished production** (PCFP) is the name given to the PC considering the stocks variation of products in progress:

$$\text{PCFP} = \text{PC} + (\text{Opening stock PiP} - \text{Closing Stock PiP})$$

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Conversion cost of the monthly production and conversion cost of the finished production

- ↘ **Conversion cost of the monthly production** (CCMP or CC) is the name given to the sum of the expenses with the direct labour with the manufacturing overheads:

$$CC = DL + MO$$

- ↘ **Conversion cost of the finished production** (CCFP) is the name given to the CC considering the stocks variation of products in progress:

$$CCFP = CC + (\text{Opening Stock PiP} - \text{Closing Stock PiP})$$

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Manufacturing cost of the monthly production

- ↘ Manufacturing cost of the monthly production (MCMP) or only MCP is:

$$\text{MCP} = \text{RM} + \text{DL} + \text{MO}$$

OR

- ↘ The sum of the prime cost with the manufacturing overheads

$$\text{MCP} = \text{PC} + \text{MO}$$

- ↘ The sum of the consumption of raw materials with the conversion costs

$$\text{MCP} = \text{RM} + \text{CC}$$

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Manufacturing cost of the finished production

- ↘ **Manufacturing cost of the finished production** (MCFP) is the name given to the sum of the MCP with the stocks variation of products in progress:

$$\text{MCFP} = \text{MCP} + (\text{Opening Stocks PiP} - \text{Closing Stocks PiP})$$

Manufacturing cost of the products sold

- ✚ The **Manufacturing cost of the products sold** (MCPS) or sales Cost (SC) is equal to the sum of the manufacturing cost of the monthly finished production (MCFP) with the stocks variation of finished products :
- ✚ **MCPS (or SC) = MCFP + (Opening Stocks FP – Closing Stocks FP)**

viii. Ascertain the non-manufacturing cost and the total cost of the products

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Non-manufacturing cost

- The **non-manufacturing cost of the products in the broad sense of the word** (NMC) is equal to the sum of the distribution costs (or selling costs) (DC) with the administrative costs (AC) and with the financial costs (FC):

$$\text{NMC} = \text{DC} + \text{AC} + \text{FC}$$

- The allocation of these expenses to the different products presents some difficulties.

Total Cost

- ↘ The **total Cost** (TC) of the products is equal to the sum of the manufacturing cost of the products sold (MCPS) (or sales cost - SC), with the non-manufacturing cost (NMC) in the broad sense of the word:

$$\text{TC} = \text{MCPS (or SC)} + \text{NMC}$$

- ↘ A selling price of the product superior to the total cost causes a positive income (profit).

End of Theoretical Lesson 1

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