On the Usefulness of Managerial Accounting for Setting up Business Planning and Control of the Management

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I. Nature of Managerial Accounting.

1. Definitions and Objectives

As the terms themselves imply, managerial (or management) accounting is an accounting technique used for managerial purposes; that is, for manageria decision-making. A rather precise definition is offered by the Committee on Management Accounting, referring managerial accounting to as "the application of appropriate techniques and concept in processing the historical and projected economic data of an entity to assist management in establishing a plan for reasonable economic objectives and in the making of rational decisions with a view toward achieving these objectives."[1]

As contrasted with financial accounting the primary objective of it is to furnish financial information to outsiders, such as stockholders, creditors, governmental agencies, etc., according to 'generally accepted accounting standards,' that of managerial accounting is to be helpful to insiders, the management personnel, through "the activity--and its result--of collecting financial information which has any usefulness other than the satisfaction of curiosity."[2]

Stated somewhat differently, managerial accounting has as its objective being useful in fulfilling the need of management both to plan and to control. First, the need to plan is shown in the development of long and short-term budgets and forecasts. Other objectives of performance, such as cost standards, inventory

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1) Committee on Mangement Accounting, "Report of the Committee on Management Accounting," Accounting Review, April, 1959, P. 210

2) Frank A. Singer, "Management Accounting," Accounting Review, January, 1961, P. 112

turnover, product profit margins, return on investment, etc., also fit the planning needs of managament. Second, the need to control is recognized in the reporting of performance against these plans or objectives.

2. Financial versus managerial accounting

A distinctive difference between financial and managerial accounting is that, since the primary objective of the former is to furnish information to outsiders, the information it provides has to be prepared according to definitions and principles clearly understandable by those having interests in the business; otherwise information would be of no use in its purposes for which it is prepared. The latter, however, does not concern itself with any of such external conformations or frames, but can be employed in whatever way management "finds most useful for its own needs, without worrying whether (this) conforms to some outside standard."[3]

Any rule applied in financial accounting, therefore, is not by all means a controlling factor in managerial accounting. Of course, it should be noted that a certain set of information gathered through managerial accounting is also used as a part of financial accounting for financial reports. Management may, for example, want to know the amount of sales orders received, even though it is not included in financial accounting for it does not yet represent a revenue. Management may also be interested in knowing estimates of future costs away from historical costs. The number of hours worked by employees, the amount of scraps occurred, or the other information of nonmonetary nature may interest management strictly outside the 'debit and credit structure.' In the application of any accounting information in managerial accounting process, therefore, a heavy emphasis is placed upon its usefulness for managerial needs, not if it conforms to generally accepted accounting standards.

Time factor is another distinctive feature in managerial accounting. while mere periodical or historical accumulation of financial data is sufficient for financial statements in financial accounting, up-to-date information gathered through quick procedures is essential in managerial accounting for proper managerial decision-

3) Robert N. Anthony, Management Accounting, Richard D. Irwin, Inc., Homewood, Illinois, 1960, P.315

making. Furthermore, the precise nature of information in financial accounting can be disregarded in managerial accounting that suffices approximate figures are just as useful as precise.

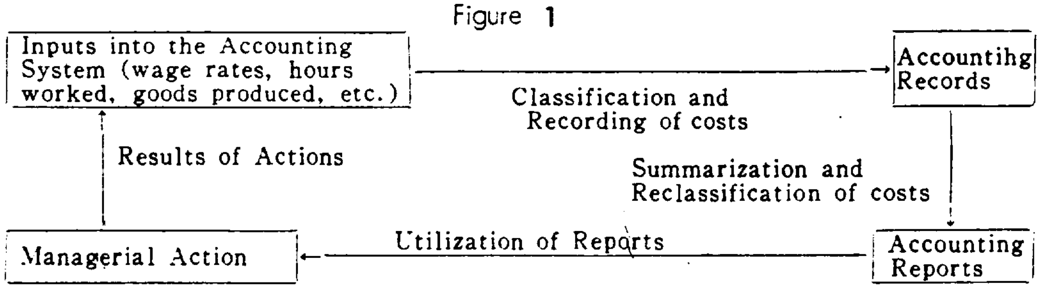
Compulsory nature in financial accounting is still another difference from managerial accounting. Financial accounting must be done, reporting on the overall status and performance of the business, but managerial accounting is optional. "Enough effort must be expended to collect financial accounting data in acceptable form, but any piece of management information is justified only if its value exceeds the effort required to collect it."[4]

Managerial accounting, therefore, is concerned primarily with the internal needs of the business. It is oriented toward the development of estimates of the future and the evaluation of performance against these estimates.

3. Cycle of operations of managerial accounting

Observing the cycle of operations of managerial accounting would make the picture on the nature of managerial accounting clearer to understand. The cycle with its focus on cost control and the uses of cost information may be illustrated as follows (see Figure 1):[5] Accounting information, such as wage rates, hours worked, goods produced, etc., is fed into the accounting system where various costs are computed, classified, and recorded into accounting records. Here, the information or costs are again summarized and reclassified in intelligible form into respective acccounting reports that, in turn, are utilized by management for managerial action or decision-making. Following the managerial action taken, new accounting data along with the old are reshaped and put into the accounting system, which starts its whole cycle of operations all over again until new managerial actions take place.

Figure 1



4) Robert N. Anthony, Ibid. P.316

5) Harold Bierman, Jr., Managerial Accounting, The Macmillan Company, New York, 1960, P.251

II. Techniques and Uses of Managerial Accounting for Business Planning and Control

It has been stated previously that the purposes for which management uses accounting imformation for managerial accounting are twofold, for planning and for control. Each of these two areas will be discussed in the sections that follow with regard to its techniqes and uses for managerial actions.

1. Planning for Decision-making

a. Nature of Planning

"Planning is the process of deciding what action should be taken in the future. Usually the planning process consists of considering several alternative courses of action and deciding which of these is best."[6] As an example, a decision as to whether or not a product line should be dropped is a plan.

Managerial planning includes establishing objectives or targets and considering how these objectives can be achieved. Planning by an individual business is dependent upon forecasts on its market conditions and internal operations. The basic foundations for proper planning, budgeting, and forecasting consist of the primary data gathered in the accounts of the business; therefore, the data of such nature should be gathered and recorded in a form conducive to such use. Various alternatives are usually encountered in planning decisions, in which case the governing or fundermental factor would often be accounting-based data, Alternative decisions concerning such matters as manufacturing or purchasing, advertising, pricing, capital additions, and other problems lie basically in the economics of each of the alternatives being considered. It is the accounting-based data that come in and weigh the merits or demerits of each of the alternatives. Such decisions are frequently based mainly on accounting estimates rather than historical data.

For an effective use of accounting information, planning is further broken down into period planning or budgeting and project planning.

b. Period Planning

"Period planning involves a projection of the activity of the enterprise,

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6) Robert N. Anthony, Ibid. P.3

in terms of expenses, revenues, assets, and equities, over a specified period of time in the future, usually one year."[7] Its objective is "to fit together the seperate plans made for various segments of the enterprise so as to assure that these plans harmonize with one another and that the aggregate effect of all of them on the whole enterprise is satisfactory;"[8] that is, to develop various sets of plans and to convert them into a single overall plan in order to direct and coordinate each of the seperate activities and to assure that their summation is an acceptable whole. Usually, period planning, as a part of which project planning is ordinarily carried out, becomes an overall budget, involving a build-up of estimated future costs by areas of responsibility and functions which must be performed if major policies and previously adopted plans are to be followed, and also provides for on overall evaluation by top-level management of a major plan prepared in accordance with major policies and restrictions previously imposed by it.

Usual budgets included in period planning are as follows:[9]

1. Operating budget showing planned operations for the forthcoming period. This budget consists of two parts:

a. Program budget describing the major 'programs' the company plans to undertake.

b. Responsibility budget setting forth plans in terms of the persons responsible for carring them out.

2. Capital budget showing planned changes in fixed assets.

3. Financial budget showing the anticipated sources and uses of funds.

c. Project Planning

"Project planning inovlves a specific decision concerning one segment of the business."[10] It is "the analysis that is made in order to reach a decision on a specific project or proposal and involves a consideration of how future expenses and revenues will be affected over the whole life of the project.[11] Here, costs are a controlling factor in deciding whether a planned project will be undertaken in the future or not. They are "future costs which may be expressed as differential costs

7) Robert N. Anthony, Ibid. P.443
8) Robert N. Anthony, Ibid. P.4
9) Robert N. Anthony, Ibid. P.444
10) Robert N. Anthony, Ibid. P.4
11) Robert N. Anthony, Ibid. P.443

because evaluation is a comparative process requiring the determination of how total costs (and revenues) are likely to vary under different sets of future conditions."[12]

There are a number of differential costs of this nature as follows:[13] (1) Differential services to be acquired and fully consumed, the estimate of which is based on the expected future outlay of cash, or its equivalent, required for their acquisition; (2) those to be acquired and partially consumed, the estimate of which is based on the future outlay of cash, or its equivalent, required for their acquisition, less the estimated cash equivalent valuation of services remaining at the end of the period; (3) those on hand and fully consumed, the estimate of which is based on their cash equivalent valuation; and (4) those on hand and at the time of utilization; partially consumed, the estimate of which is on the same base as '(3), "except that if replacement of such services is considered, their valuation is estimated replacement cost, at the date of expected replacement, discounted to the time of utilization.

2. Control for Business Decision

a. Nature of control

Control is the process by which management assures itself, insofar as is feasible, that what the organization does conform to management's plans and policies.[14] It is an evaluation of performance against what the performance should have been according to plans and policies. Specifically, it consists of "seing that everything is being carried out in accordance with the plan which has been adopted, the orders which have been given, and the principles which have been laid down. Its object is to point out mistakes in order that they may be rectified and prevented from occurring again."[15] In other words, through observing, recording actual results, comparing the results with plans, objectives, and budgets, and taking corrective action, conformance with plans, objectives, and policies is maintained.

Although the importance of the aplications of historical data in control process

12) Committee on Cost Concepts and Standards, "Tentative Statement of Cost Concepts Underlying Reports for Management," Accounting Review, April, 1956, P. 185
13) Committee on Cost Concepts and Standards, Ibid. PP. 185—187
14) Robert N. Anthony, Ibid. PP. 2—3
15) E. F. Fitzmaurice. "The Essence of Control; What it is and Who does it," Controller, November, 1950, P. 493

is apparent, their usefulness would be limited if they are used alone, for there have to be some goals, standards, or objectives prior to control as a basis for control and from which to measure performance. Since they are only an expression of performance in the past, they should be compared with some standard or yardstick in order to evaluate the performance as favorable, indifferent, or unfavorable. Budgeting and standard costs are good examples against which relevant historical accounting data are compared and measured.

b. Usefulness of managerial accounting in control Process

Aside from measuring performance against objectives, managerial accounting in control process is useful "as a means of communicating information on what management wants and motivating the organization to act in ways most likely to attain the objectives of the business."[16]

Understanding among the organization personnel as to what has been planned is essential in carrying out the plan successfully. It is in this respect that through control process managerial accounting communicates plans to all personnel concerned; that is, for example, how many goods are to be produced, what methods of production are to be employed, what prices are to be offered to customers, etc.

Management being a system composed of people, they should be motivated if planned objectives are to be achieved. Managerial accounting control acts as a stimulus for this motivation, charging, for instance, those responsible for incurring certain costs.

c. Responsibility accounting for managerial control

In the use of accounting data for control, fixing responsibilities according to specific functions is an integral part for an effective managerial performance. Responsibility accounting is fitted into this requirement. It is "tying the accounting control system in with the organization and the responsibilities of department managers and supervisors."[17]

In this accounting approach, functions and responsibilities are clearly specified and stated in documents, so that there can be no misunderstanding as to the purposes or duties of each unit and its scope of activities. These documents, reflecting

16) Robert N. Anthony, Ibid. PP. 316—317
17) Harry B. Ailman, "Basic Organizational planning to Tie in with Responsibility Accounting," N.A.C.A. Bulletin, May, 1950, P. 1116

the horizontal setup or functionalization of the organization, would minimize, if not eliminate, the duplication of efforts. This type of documents or statements clarifying specific functions and responsibilities also deals with the administrative organizaton and sets forth the detailed accountable responsibilities, authorities, and relationships of the organization unit. These delegations are, in fact, guides for its manager and define for him his position in the line of the organization. He can tell from this document what actions he can or should not take and what actions he is free to take in achieving the objectives of his organization. In this way no confusions or complications would occur.

II. Factors essential for proper use of managerial accounting in planning and control

To be effective, both of planning and control processes in managerial accounting must be founded on a number of factors: proper organizational structure, adequate personnel, and coordination.

The business organization of itself should be so set up that it provides for sound managerial planning and control, and within its various elements the same principle must be carried out; that is, each integral unit of the business should duplicate the top planning organization. This means that what has been applied to production also applies to sales, or any other department. A foreman, for instance, who operates a little section in the production department, the technical thinking is still along the same line, all closely geared to the thought processes of the management level closest to the last line. This requires that the objectives of the prduction department be translated into the planned pattern of the business. Through operating budget, the technical foctors of production planning and control are easily transmitted from the production deparment to the whole organization.

It is obvious that unless proper personnel is supplied nothing will be obtained from an organizational structure the purpose of which is to produce sound managerial planning and control. The translation of departmental objectives into a common plan and the ability to determine that all departmental objectives have been considered require the following:[18]

1. Adequate manpower to study departmental plans and coordinate them into an

overall master plan which is represented by the operating budget.

2. Technically qualified personnel that understands in broad terms the functional fields of the business such as marketing, engineering, accounting, finance, and economics.
3. Since plans must be subject to adjustment for changing conditions, analysts are essential to point out to management failures of actual performanne to measure up to the planned objectives.

Coordination is also an integral requirement for managerial planning and control. For example, production must be carried out in full capacity and must be able to maintain such level over a long period of time. The sales department, however, wants to fill every costomer order whenever it may arise; they will try to have production reduced when markets are not favorable and request for increased production when the demand increases. procurement department, again, may want to procure materials according to current market condition; that is, load up if a tight supply of materials is in prospect, or buy when prices drop. This may result in problems in financing the inventory. All of these different factors cause a big problem in managerial planning and control. Each department has its own plan of operations under varying sets of conditions, and it is natural that they conflict in many areas. To eliminate (or reduce) this conflict, some means should be set up so that a plan is established simultaneously by several departments, each taking into consideration its own plans and requirements. At this point, there should be some interdeparmental consultations since, for example, a production personnel cannot develop anything on new plant capacity unless he has some idea of the degree to which the sales personnel look to future plant requirements. In this way, coordination among all departments concerned can be maintained.

Ⅳ. Conclusion

This paper has concerned itself with pointing out what managerial accounting is and what its uses are, according to the basic managerial functions -- planning and control. Major emphasis has been placed upon the techniques and uses of managerial accounting in the processes of these functions.

18) John V. van Pelt, Ⅲ., "The place of the Controller in Management Planning and Control," Controller, October, 1952, PP. 473—474

The concepts of managerial accounting are important in that they deal with basic foundations of maximizing return on investments, an ultimate objective of a business organization. This is particularly true in marketing field, where the broad and comlex prolems of pricing, methods of distribution, marginal costing, and product mix must be met and solved. The isolation and elimination of loss items, of whatever type, is a primary analytical problem facing all business executives. The techni ques of managerial accounting, based on sound economic principles, should be applied generally, and particularly in the fields of production and distribution, to eliminate the the subsidization of loss activities and place importance on those phases of activities that result in contributions to return on investments. It should be noted, however, that one limiting factor in managerial accounting is that it is concerned more with quantitative analysis than with qualitative. Any qualitative data coming in the form of external influences, such as price trends in the industry, economic conditions, ect., should be analyzed in conjunction with quantitative data on hand.

As above, this paper has empasized on the usefulness of managerial accounting for setting up business planning and control of the management. So that an analysis of this problems is very important in accounting profession. It is nothing but a introductory research in managerial accounting theory, but it should be deeply worked in the field of accounting study.