Chapter 1 Solutions

Solution 1.1

Distinguish between financial and management accounting and discuss the role both of them have in an organisation

Financial accounting is primarily a method of reporting the results and the financial position of a business. Financial Accounts are required by Company Law and accounting standards. Management accounting is an internal reporting system for the organisation's own management. It provides management with the information required to manage the business.

Key differences between Cost & Financial Accounting

Cost	**Financial**
• Internal - management reporting	• External - reports to outside world
• Not required by Law	• Must comply with the Company's Act
• Not required to follow SSAP/FRS requirements	• Required to follow SSAP/FRS requirements
• Looks at past, present and future	• Historical record
• Provides detailed analysis	• Provides overview

Financial accounting is the recording of actual monetary transactions of a business in accordance with the rules in the accounting standards and company law. The Profit and Loss Account, Balance Sheet and Funds Flow will be used to provide those external to the main running of the organisation with a summary of what has happened in the past accounting period. The role of financial accounting can be summarised as the recording of all actual business transactions that have happened, and the reporting to those both internal and external to the organisation a true and accurate picture of what has happened in the past accounting period.

Management accounting concerns detailed analysis of information for the internal management of the organisation. As it is mainly for internal use it is not necessary for the accountant to comply with the rules in the accounting standards and company law. The cost accountant will be concerned with; what was the cost of goods produced or services provided? what are future costs likely to be? how do actual costs compare with budget? what information is needed by management in decision making? The role of the cost accountant would be the analysis and presentation of information to assist in the internal running of the organisation, and the preparation of budgets and standards so that control can be achieved.

Solution 1.2

Briefly outline the role of management within an organisation

The role of management can be described as making decisions that are likely to ensure the viability of an organisation and to plan and control the implementation of these decisions. Ultimately, management is concerned with planning, decision-making and control.

Set business objectives The aims of a business are often couched in broad terms and may be set out in the form of a mission statement. This statement is usually brief and will generally articulate high standards or ideals for the business. The objectives of a business are usually quantifiable and more specific and should be consistent with the aims of the business. Examples could include; the kind of market it wishes to serve, the market share it wishes to achieve and the range of products and services to be offered.

Identify potential strategies This second stage involves the search for a range of strategies for the business to achieve its objectives. This task is undertaken by management and involves much data collection and analysis of both the external market and an internal analysis of the resources and expertise available to the business to pursue each option. Much of the external analysis focuses on the future, for example new markets, future demand, and the changing business environment. These decisions are referred to as long-run or strategic decisions and generally have a profound effect on a businesses future position. By comparing the environmental influences (opportunities and threats) and the resource limitations (strengths and weaknesses), a strategic plan can be put together setting the organisation on a course to follow in the hope of achieving specific goals.

Evaluate and select strategies When deciding on the most appropriate option(s) to choose, management must examine information relating to each option to see if that option fits with the objectives that have been set and assess whether or not it is feasible to provide the resources required. Management must consider the effects of pursuing each option on the future financial performance and position of the business. Projected financial statements play an invaluable role in the evaluation of the various options open to management.

Implement the strategies Once decisions have been made at stage three, they should be implemented as part of the normal budget process. A budget is a financial plan outlining the projected effects of the decisions management has made. They are prepared based on the differential costs and revenues associated with the particular course of action chosen and although these costs and revenues are estimates, generally management will apply probabilities to calculate a likely basis for the costs and revenues estimated. The planning process leads with an overall or strategic plan, which is divided into annual plans, which show in detail how the strategic plan is to be achieved.

Compare actual results with plan This is where progress on achieving the plan is monitored. This involves daily, weekly or monthly comparison of actual performance against budget. In particular, budgeted costs and revenues are compared to actual performance and any variances are identified.

Investigate variances and take corrective action The control process should provide management with relevant, reliable and timely information to help them decide on possible corrective action when variances between budgeted and actual costs and revenues occur. All significant variances must be investigated and this must be done quickly to ensure management have timely information to take corrective action. This process involves focusing on possible reasons for the variances and then deciding on the corrective type of action required. This corrective action can involve changing the plan slightly as it may have been too ambitious and unachievable or too easily achieved. Management must also be aware of the external factors that can influence actual performance and create variances.

Solution 1.3

Outline the role of accounting as a support tool for management

Accounting is often described as the language of business and is an essential support tool for business managers. Developments in the global economy have provided significant challenges for business managers. The accounting profession has had to develop and broaden its scope to provide relevant, timely, accurate and understandable financial information required in the modern economy of today. Managers use this information to develop efficiencies within their business, grow their business and ultimately gain competitive advantage over business rivals. From an accounting perspective, the role of management can be described as making decisions that are likely to ensure the viability of an organisation and to plan and control the implementation of these decisions.

The role of accounting as a management tool involves the analysis and presentation of information to assist in the internal running of an organisation, and the preparation of budgets and standards so that control can be achieved. It involves providing information for planning, controlling, decision making and the formulation of business policy and strategy. Across all business sectors, management accounting helps provide answers to the following questions; what are future costs likely to be?, how do actual costs compare with budget? and is the organisation achieving the objectives set by management?

Management accounting helps provide management with answers to the following typical questions that empower managers to plan, control and make decisions.

- Is the hotel operating at an optimum level – is occupancy level acceptable?
- How many customers does the restaurant require to break-even?
- What strategy will maximise profits?
- Is the organisation meeting customer expectations in terms of quality, reliability and price?
- What is the optimum price to charge per room or per seat?
- Should a particular tourism attraction shut-down in an off-season period?
- What is the effect of special offers and packaged deals?
- Is the mark-up on purchases sufficient to cover all costs and achieve a satisfactory profit?
- What is the cost of providing additional services for customers?
- Is each retail department performing adequately and contributing to the organisation?
- What product ranges are particularly successful?
- What is the effect of reducing the price of products during a sale?
- How does the organisations performance compare to other similar organisations?