AVCE Business
Unit 10 Management Accounting (E1)

Introduction
Jones' Compact cars, is a small family run business in rural Southgate. The business was established 40 years ago by old Mr. Jones and during that time, a Jones Compact car has become a well-known manufacture of classic remote control cars, its start product being the flame red MG.
Old Mr. Jones has recently has taken his nephew, young Ken, into the business, in the hope that he will carry on the firm in the family tradition when he himself retires.

Young Ken is a business graduate of Durham University, is excited at the prospects of taking over Jones' Compact car, but realises that the firm is not functioning particularly efficiently and that there is much room for improvement.

One of the main objectives for Jones' Compact cars is of meeting a target of increasing profits by at least 10% per year over the next five years.

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What is Management Accounting?
Management accounting is those areas of accounting concerned with financial planning, principally through the interpretation and use of financial data for important management of the business. The role of accounting is to provide relevant information, which will assist management with decision-making, planning economic performance, controlling costs and improving profitability. However, note that the information generated by the management accounting function is just one component part of the decision-making process. It is not the 'be all and end all'; it must be used in conjunction with other data.

The aim of management accounting is to provide management with information, which will help them to:

- Achieve their objectives/goals.
- Formulate policy.
- Monitor and assess performance.
- Appreciate the financial implications of changes in the internal and external environment in which the organization operates.
- Plan for the future.
- Make comparisons between alternative scenarios.
- Manage more efficiently the scarce resources, which are at their disposal.
- Control the day-to-day operations.
- Focus their attention on specific issues, which really need their consideration.
- Solve a variety of problems, e.g. investment decisions.
- Take account of behavioral factors.

Differing from financial accounting, the focus of management accounting is usually on the information at a more details level, on results for any products and on costs for particular productive operations. Understanding the role of management accounting requires an appreciation of what is involved in management and the kinds of decision that management is faced with.

The objective of the management accounting system is to provide the best information for assessments of the amounts, timing and uncertainty of cash flows to the business from each alternative course of action available to the business.

The purpose of management accounting involves identifying the types of decision needed in management accounting in order to provide useful information for managers.
The main types of decision include:

- Output decision-These are decisions on what types of goods or services should be supplied, at what prices and in what quantities.
- Input decision-These are decisions on how the outputs should be produced, i.e. the allocation of quantities used in raw materials, labour etc.

I think that these two types of decisions are inter-connected, because the cost of resources to produce goods and provide services is relevant to decisions on the best production output and best pricing strategy required.

Management Accounting is internal accounts, which do not have to be published, as they stay private within the business.

In conclusion, management accounting ensures the transformation process from inputs, through the production process to output is viable, and it plays a principal role in Business decision-making. Management accounting is the process of identifying; measuring, accumulating, analyzing, preparing, interpreting and communicating information that helps managers fulfill organization objectives. Accounting responds to the need for quantitative financial information. It is interpreted as a language of economic activity. The purpose of accounting is ultimately to assist someone to make decisions by the accumulation of all accounting information. The information to be provided by the accounting system depends on who is making the decisions and for what purpose

<u>What is financial Accounting?</u>

Financial accounts are concerned with classifying, measuring and recording the transactions of a business, at the end of a period (typically a year)

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Financial accounts are geared towards external users of accounting information. To answer their needs, financial accountants draw up the profit and loss account, balance sheet and cash flow forecasts.

Every UK Company registered under the Companies Act is required to prepare a set of accounts that give a true and fair view of its profit or loss for the year and of its state of affairs at the year-end. Annual accounts for Companies Act purposes generally include:
- A directors' report
- An audit report
- A profit and loss account
- A balance sheet
- A statement of total recognised gains and losses
- A cash flow statement
- Notes to the accounts

Types of Costs

There are three types of costs Jones Compact Cars have within their business. These are Variable costs, fixed costs and semi-variable costs.

A Variable cost is costs, which, rise as output rises. These could be raw material as the more the output Jones Compact Cars produce, the more raw materials will be required. Also direct labour can also be variable costs, for example during Christmas there are high demands for products such as compact cars and so direct labour may need to be employed to keep up with demand.

Another type of cost is Semi-Variable costs, which are costs, which consists of both fixed and variable elements.
This is because they are not entirely fixed or variable costs. Labour is a good example. If Jones Compact Cars employees a member of staff on a permanent basis, no matter what level of output, this is a fixed cost. If this member of staff is asked to work overtime at nights and weekends to cope with extra production levels, then the extra cost is variable. Such labour costs can be identified as Semi-Variable costs.
Another example could be the cost of telephone charges. This often consists of a fixed or "standing charge" plus an extra rate, which varies according to the number of calls.

Fixed costs are cost, which are fixed in the short run and don't vary according to output. Examples might be rent, insurance, heating bills, depreciation and business rates, as well as capital costs such as factories and machinery.
These costs remain the same whether Jones Compact Cars produces nothing or is working at full capacity. For example, Mr. Jones must pay rent even if his business is shut for 2 week holiday period and nothing is produced.

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Business Objectives

Having focused business objectives gives the business a clear idea of the direction they are heading towards. It should also help the business to judge how successful they have been meeting their objectives.

The most important business objective is making a profit. Profit is the difference between the total revenue of the business and its total cost. Failure to make a profit leads to a loss of confidence in the business. Employees start to worry about their jobs, people who have supplied the business with goods on credit worry if they will be paid back and the government may receive less tax from businesses in forms of corporation tax.

Smart Objectives

A business must have some way of telling if its strategies have been successful. This will provide important feedback, which may influence future decisions taken by the business. First a business needs to set strategic performance targets and indicators. No real understanding of the success, failure, viability or otherwise of any strategy can be achieved unless accurate, measurable and achievable performance targets are drawn up. Targets and indicators need to be specific, measurable, achievable, and realistic and time based, known as SMART objectives. All concerned must also easily understand them.

Jones Compact Cars has many business objectives to improve their business efficiency and competitiveness in the market of compact cars.

There are many objectives that Jones Compact Cars have set, such as:

- Increasing profits by at least 10% per year over the next 5 years
- To meet sales target of £490,000 in one year
- To break into the Taiwan market and to expand their market share
- To invest in new machinery, this will allow productivity to increase and costs to reduce
- Survival
- Profit maximization

The objectives above are all smart objective as they are, specific, measurable, achievable, realistic and time based.

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One of the most important objectives for Jones Compact Cars is to make a profit. If the business does not make profit then they will find it difficult to plough back money into research and development, it will find it difficult to invest in new technology, which already Jones Compact Cars face as their machinery is old fashioned and they need to buy new machinery in order to work more efficient.
In order for Jones Compact Cars to break even they need to sell 300 compact cars a month.
Also For Jones Compact Cars to make a profit they need to sell over 321 compact cars every month to increase their profits.
To help them profit maximize Jones Compact Cars should take special orders for their compact cars. This can increase the profits of the business and meet their objective.
Also Jones Compact Cars can increase their profits by lowering their fixed and variable costs.
Jones Compact Cars can lower their variable costs on materials by taking advantage of economies of scale and operating through activity.
This means that Jones Compact Cars should buy all their raw materials in bulk as they can get them at a cheaper discounted price.
Also Jones Compact Cars can reduce fixed costs by changing their premises from where they operate and moving to cheaper premises.
By reducing their costs Jones Compact cars will be reducing their production costs, which can mean they will have increased profits and by reducing costs Jones Compact Cars can also reduce their prices of compact cars, which may increase sales leading to increased profits.
Also reducing their costs would mean that Jones Compact Cars could become more competitive in the compact cars market.

Another objective for Jones Compact Cars is to survive in the compact cars market in which they operate.
In order for them to survive I think they should introduce a new line of products through diversification.
Diversification is a strategy for growth that involves developing products or business areas that are outside the organizations markets. For example, Jones Compact cars currently manufacture compact cars and they could decide to introduce new products and services such as, credit cars, new games, or even clothes.
Jones Compact cars need to operate a policy of diversification by trying to identify the most attractive and rapidly developing industries to engage in order in survive.
I think the best business strategy to survive, which would guarantee success is to enter attractive and emerging industries, rather than staying in static and slow developing ones.

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