Finance - managerial accounting

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Managerial Accounting Introduction Managerial accounting is the branch of accounting that deals with the use of accounting information for assisting managers in making sound business decisions. It is mainly related to costs and not expenses. The Institute of Management Accountants has defined managerial accounting as " the process of identification, measurement, accumulation, analysis, preparation, interpretation, and communication of financial information used by management to plan, evaluate, and control within an organization and to assure appropriate use of and accountability for its resources" (qtd in Davis & Davis, 3). Hence, managers can influence organizations' cost behavior to a great extent. This paper will discuss capacity costs, committed fixed costs, and discretionary fixed costs in detail with reference to their current and future impact on business or society. Capacity costs Capacity costs can be simply referred to the fixed costs required for achieving predetermined level of production or meeting desired level of customer satisfaction without compromising product quality. Generally companies infrequently make strategic or capacity decisions because this process is highly complex and time consuming. Furthermore, an incorrect capacity decision may raise potential challenges to an organization's market competitiveness. However, some well established corporation like Starbuck make capacity decision more frequently as part of their international expansion strategy. Janeba suggests that firms with long term demand variations must be more vigilant while setting their capacity costs as it is not easy to frequently alter the capacity cost structure. In times of unforeseen contingencies like economic downturns, there would be a significant fall in demand and therefore companies may struggle to recover fixed capacity costs fully. It must be noted that a capacity decision can have

great influence on employees’ ethical commitment. A sound capital cost structure would assist an organization to keep its employment policy stable and thereby avoid employee terminations unless there are huge fluctuations in demand. In addition, an effective capital cost decision may also benefit a corporation to keep itself away from reputation damaging activities including business downsizing. Committed fixed costs Sometimes, an organization may incur some additional costs even though it has taken measures to trim down fixed capacity costs. Such costs are called committed fixed costs. “ Possession of facilities, equipment, and a basic organizational structure” contributes to committed fixed costs (given file). According to Baxendale, these costs may include long term interest payments, insurance property taxes, and mortgage and lease payments. While closely analyzing a business organization, it is clear that elimination of committed fixed costs would be an impossible task. However, a mounting committed fixed cost may raise serious threats to the company’s operational efficiency and thereby profitability; this situation would probably weaken the company’s chances of long term survival. Hence, managers have to adopt strategies for minimizing the organization’s committed fixed costs. In order to minimize these costs, it is necessary for managers to make notable changes in the organizational structure or scope of operations. However, it must be emphasized that a thoughtless change in the scope and scale of organizational activities would have an adverse effect on the company’s competitiveness. In short, an organization’s capacity decisions may greatly influence its level of committed fixed costs. Discretionary fixed costs Managers consider discretionary fixed costs as a tool to meet the organization’s goals and hence these costs are subject to some levels of fluctuations. Discretionary fixed

costs do not have any direct relationship with the levels of activities or organizational productivity. In the view of Cooper and Kaplan, these costs include research and development costs, advertising and promotion costs, public relations, social responsibility costs, purchase of management consulting services, and employee training costs. Discretionary fixed costs are set during periodic planning process and the cost level remains the same until the next planning period. Managers have complete control over these costs and therefore they can alter the costs up or down frequently. Flexibility of discretionary fixed costs is high as compared to committed fixed costs. To illustrate, managers may completely eliminate discretionary costs during times of financial dullness whereas they cannot alter the structure of committed fixed costs. Even though discretionary fixed costs are necessary to achieve the organization's long term objectives, managers are permitted to vary spending levels for the purpose of accomplishing some short term goals. In short, setting discretionary fixed costs is an integral part of strategic management and hence this decision may affect the organization's profitability and ultimately sustainability performance. Conclusions From the above discussion, it is clear that management accounting areas related to capacity costs, committed fixed costs, and discretionary fixed costs can have great influence on the organization's profitability and thereby sustainability. Capacity costs and committed fixed costs are required to meet the organization's short term objectives whereas discretionary fixed costs are aimed at the long term organizational goals. Works Cited Baxendale, Sidney, J. " Outsourcing opportunities for small businesses: A quantitative analysis". Business Horizons. 47/1 (January-February 2004). 51-58. Cooper, Robin and Kaplan, Robert S. " How Cost Accounting Distorts Product Costs".

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