

# [Management accounting information and criteria](https://assignbuster.com/management-accounting-information-and-criteria/)

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Management accounting information should comply with a various number of criteria including verifiability, objectivity, timeliness, comparability, reliability, understandability and relevance if it is to be useful in planning, control and decision-making. Shall discuss the criteria to serve its natural purposes, which is for planning, control and decision- making.

The first criteria of management accounting information are verifiability . Verifiability means observable to outsiders, in the context of a model of information. It refers to the ability of accountants to ensure that accounting information is what it purports to be. It also means that the selected method of measurement has been used without error or bias. The outsiders cannot see them and so references to those variables in a contract between the two parties cannot be enforced by outside authorities. An example of verifiability is that of two accountants looking at the same information like inventory valuation and coming to similar conclusions.

Objectivity is also one of the criteria that useful in planning and making decision. Accountant reliance on verifiable evidence such as delivery notes, invoice, orders, physical counts or paper in the measurement of financial result. Objectivity makes it possible to compare financial statements of different firms with an assurance of reliability and uniformity. For instance, management accountant should not alter or change when provide the information to top level managers so that the manager can make the accurate decision without being influenced.

Besides that, timeliness is one of the important parts for management may need to balance the relative merits of timely reporting and the provision of reliable information. More accurate information may take longer to produce. Therefore, to provide information on a timely basis it may often be necessary to report before all aspects of ma transaction or other event are known thus impairing reliability. For example, a company may test-market a potential new product in a particular city. However, a long wait for the accurate marketing report may unduly delay management’s decision to launch the new product nationally and the information will be of no avail to the decision making process. Thus, the managerial accountant’s primary role in the decision-making process which is decide what information is relevant to each decision problem and provide accurate and timely data, keeping in mind the proper balance these often-conflicting criteria.

The next criteria will be comparability. Comparability helps to make compare the financial statements of an entity through time in order to identify trends in its financial position and performance. Besides that, it also helps to compare the financial statements of different entities in order to evaluate their relative financial position, performance and changes in financial position. Hence, the measurement and display of the financial effect of like transaction and other events must be carried out in a consistent way throughout an entity and over time for that entity and in a consistent way for different entities. By giving an example, management accountant prepare the accountant information is a consistent way for every year, it is much easier for company to make comparison with the past accounting information or related entities.

Next, reliability is the quality of information that allows those who use it to depend on it with confidence. The reliability of an item is the probability that the item will perform a specified function under specified operational and environmental conditions, at and throughout a specified time.  The best way to specify the reliability of an item depends upon how the item is expected to function. Here, our focus among the above four demand times is on the “ interval” and “ continuous” time demand cases. In the interval case, we are concerned with mission reliability or simply reliability. This is defined as the probability that an item will operate without failure throughout a specified interval. For example, where we are scheduling the next week’s production, the equipment reliability or probability that the equipment will operate throughout the week is our concern. However, if we want to evaluate the performance of a piece of equipment with a continuous demand, for instance, within the last two years, the focus should be on the expected mean time between the failures events that cause the equipment to go down. In this case we may also focus on the availability of the equipment, which can be defined as the fraction of time that the equipment was actually operating.

The next criterion is understandability. Understandability is assumed users to have a reasonable knowledge of business and economic activities and accounting and a willingness to know more the information with reasonable diligence. Information about complex matters that should be included in the financial statements because of its relevance to the economic decision making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand. For the example, management accountant should prepare the accounting information or summarize of the report and analysis that easily understood to the decision maker in order to let them easy to make final decision.

Lastly, relevance is also one of the important parts in planning, control and decision-making. To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decision of users by helping them evaluate past, present or future events or confirming, or correcting there past evaluations. Different decisions typically will require different data. The primary theme of this chapter is how to decide what information is relevant to various common decision problems. For example, an analysis on a project should not have any information on indirect costs because it is not relevant for making decision of the project and should include any prime cost because it is relevant cast for the decision-making.

## Give a brief explanation of how the criteria detailed in (a) might be conflict with each other, giving example to illustrate where such conflict might arise.

Each criteria of management accounting information is to satisfy the management needing for information useful for planning, controlling and decision making. However, these criteria also face conflict amongst one another. Conflict simply refers to the incompatibility or interference of one’s idea, event, or activity with another. In this case, the conflict between criteria will happen when satisfying a criterion affects another criterion being difficult to fulfil as they are in collision with each other.

Accounting information should be useful for decision-making, must have relevance and reliability of these two main qualitative characteristics. However, these qualities often can conflict, requiring a trade-off between various degrees of relevance and reliability. A forecast of a financial variable may possess a high degree of relevance to investors and creditors. However, a forecast necessarily contains subjectivity in the estimation of future events. Therefore, because of a low degree of reliability, generally accepted accounting principles do not require companies to provide forecasts of any financial variables.

For examples, accounting information requirements associated with the timeliness, predictive value and feedback value, while the predictive value of accounting information may be due to a lack of verification, so that the reliability of damage; on the contrary, if always insisted truthfully, then wait until the conditions are ripe when the accounting information may have lost its predictive value. As the reliability and relevance cannot have both, one can only depending on the degree of emphasis by choosing one of the two, leading to a different accounting treatment. One of the most typical is the right choice of accounting measurement attributes.

Besides that, another conflict can be a result of the criteria of Timeless and verifiability. Information is useful when it is timely. To be timely, the information must be available when needed to define problem or to be begin to identify possible solutions. Those criteria might conflict with verifiability. It is because when needed verifiability information, it may take time to calculate or to get it after production process is end. Verifiability is the useful information when it is accurate. Before relying on information to make decisions, it is important to ensure that the information is correct.

For example, a production manager has to decide the actual amount of pineapple to be used in produce of 10000 units of pineapple juices. But, because of the time given is limited, he has to prepared the report to top management by forecast the amount of pineapple will be used. Although he is meet the criteria of timeliness, he is might not meet the criteria of verifiable. He do not used the actual amount of pineapple will be used. It is because there are some problems may occur during the production process: cost of pineapples is lower or others factors. When the production is end, he will able to know the actual amount of pineapple will be used. So, the criteria timeliness is conflict with the criteria verifiability.

Another conflict is between timeliness and reliability of information. Information is said to be reliable when they incorporate all aspects of a transaction as well as other events in order to facilitate users in deciding on any issue regarding the latter. However, most of the times in providing timely reporting, those aforesaid transactions or events are never taken into account as it occurs after the report is prepared and thus impairing reliability. In interest of timeliness, the reliability of the information is sacrificed, every loss of reliability diminishes the usefulness of information and as time pass, and either the reliability of the information drops or increase accordingly.

For example, the material supplier decides to supply only one of the Material A. Company Y is very interested and is capable to buy the Material A. The supplier is interested on selling the Material A to Company Y, but there is no contract signed between them. As time passes, the supplier received an offer from Company Z’s, with a higher price and shorter time compared to Company Y. Therefore, Material A is selling to Company Z and Y loses the Material A. Company Y is reliable on material supplier to get the Material A yet the supplier needed to sell the Material A in a shorter time to get the profit. So, supplier decides to sell it to Company Z. Thus, the criterion of timeliness is conflict with criteria of reliability.

## Question: 2 (Information for decision-making)

The overriding feature of information for decision-making is that it should be relevant for the decision being taken. However, decision-making varies considerably at different levels within an organization, thus posing particular difficulties for the management accountant.

## Describe the characteristics of decision-making at different levels within an organization.

Decision making is intertwined with the other functions, such as planning, coordinating and controlling. Decisions are made in order to change the company’s current status to a more desirable state of affairs. Therefore, relevant information needs to supply by the Management Accountant to top management to make decision. In an organization, different levels of management are making different types of decision. This can be showed at the figure below.

## Figure 1: Levels of decision making

Top level managers, or strategic managers, are also called senior management and executives, are individuals at the top one or two levels in an organization. The Chief Executive Officer (CEO), Chief Financial Officer (CFO), Chief Operational Officer (COO), Chief Informational Officer (CIO), President, Vice President, Chairman and Board of Directors are examples of top level managers. They have the long-term vision for the company. They are not involved in day-to-day tasks need to possess conceptual skill so as to set the goals for the organization as a whole. For example, Jerry Yang, the former chief executive of YAHOO!, was criticized when a $44. 6 billion acquisition bid from Microsoft failed under his watch. They frame the organizational policy. They are also responsible for mobilization of resources. They generally make large budgetary decisions for the company and are responsible to the shareholders and the general public. The success or failure of the organization rests on the shoulders of the top level management.

Middle level managers, or middle managers, are those in the levels below top managers. Middle manager’s job titles include General Manager (GM), Plant Manager, Regional manager and Divisional manager. Middle level managers are responsible for carrying out the goals set out by top management with setting goals for their departments and other business units. Tactical decisions, the medium term decisions about how to implement strategy, are delegated to middle managers. Middle management decisions might include marketing a new product, communicating with and managing lower management and determining what issues need to be addressed with top level managers. Each individual middle management department develops a strategy to meet its inner departmental goals.

Lastly, lower level management, which included office managers, shift supervisor, department manager, foreperson, crew leader and store manager, are responsible for the daily management of line workers – the employees who actually produce the product or offer the service. Although first line manager typically do not set goals for the organization, they have a very strong influence on the company. These are the managers that most employees interact with on a daily basis. Operational decisions, short term decision or also called administrative decisions about how to implement the tactics affect daily tasks and generally handled by lower level managers. Supervisors or team leaders may decide employee related issues, such as pay rates, training, evaluations and disciplining or terminating employees. For example, supervisor may decide to reward the most productive employee with an employee of the month award, or offer incentives such as gift certificates.

## Explain how the management accountant must tailor the information provided for the various levels.

Nowadays, management accountant is provides the information to users who are part of the organization in various level. But different level management has different information needed. Therefore, management accountant must tailor the information for them.

First, before management accountant provide any information, he / she must clear with the company vision as the middle and bottom management of organization. Usually the top management is responsible for the long term strategic plans with the strategic decisions for the next 5 years to 10 years. Therefore, top management will create a mission, which is more specific goal that unifies company wide efforts. So, management accountant should prepare budgets for top management accountant to decide which projects have to undertaken to achieve the company’s goals. Budget is a strategic plan that details the action that must be taken during the following year. It also pinpoint the responsibility of achieving the budgets to respective managers inline the company policies. For example, management accountant prepare the imposed budgets to top management before imposed to middle management to achieve targets.

In middle management, they are responsible for developing and carrying the tactical plans to accomplish the organization’s mission. Tactical plans specify how company will use resource, budgets and people to achieve company goals within its mission. In this level, management accountant will use various methods to decide the profit with minimum production costs. Profit volume analysis is one of the methods to calculate changes in cost and sales in determine the profit. Management accountant will calculate breakeven point where the level of sales of company needs to achieve at zero profit. After that, management accountant also prepared the report on scare resources which the supply of resources is limited by define the limit factor. Then, management accountant will produce the product that give higher contribution per limiting factor and take considerations of qualitative factors before final decisions is made. Final decisions is means whether to make or to buy the decision. It is situation where an organization is given a choice to produce by own resources or pay other organization to make the product. After management accountant prepare the information in form of cost volume profit, limiting factors analysis and decisions about activities either to buy or to make, middle management have to decide, carrying the tactical plans and delegating the responsibility of jobs to the operational management.

Lower lever management is responsibility to carrying the operational plans where is related to day to day plans in producing products or services. For example, management accountant will determine the economic order quantity for lower management to know the amount of inventory they should reorder order to minimize ordering cost and holding costs. Therefore, lower level management will order the maximum order.

There is the information that will be management accountant provided to various levels in order to suit various levels’ needs.

## (c)Give an example of a typical management decision, state at which level this would normally be taken and what specific information shoud be supplied to the decision maker.

A typical management decision is that the pricing which to determine how much the customer need to pay and the seller receives in exchange for a product. To get the firm’s sales objective need to set for the prices. In determining the firm’s revenue is that the manager’s pricing decision is extremely important . The selling price times the number of units sold will know how much is the revenue gain. The pricing decision need to be determine by the manager, then provide a simple and useful pricing structure taking into consideration all of your business costs. Continue with choose one of the suitable pricing strategy so that can establish a market presence and last fine tune and adapt the general pricing policy in response to trends, in the market place the manager should also practices new innovative strategies to help solidify the competitive position.

Companies that set prices to maximize the profits want to set the selling price to sell the number units that will generate the highest possible total profits. If a company sets prices too low, it will probably sell many units but may miss out additional profits on each unit (and even lose money on each exchange). If company sets prices too high , it will make a large profits but will sell fewer units. Again the companies will losses money, and it also will leave with excess inventory.

If the managers decide to maximize the profit, Firstly, the middle managers who responsible to carry out the goals that set by the top management will held this tactical decision which how to held this pricing decision. They need to know the price setting tools to measure the potential impact which is to count out the cost and how much need to charge for the selling price . Before deciding on final prices, middle managers can use cost oriented pricing and breakeven analysis to determine how much sales volume the company needs to start making profit and to measure the potential impact.

A music store manager would price the CDs by calculating the cost of making them available to shoppers. How much that the manager need to charge for the product is need to depends on how much the company pay for the inventory and the supplier. They also need to count for the operating cost , and how much is the company profits goal plus the company price will affect by the competitive pressures, industry standards and the perceived value of your product or the services in the eyes of the company customer. Thus, price would include the costs of store rent, employee wages, utilities, insurance, and the CD manufacturer’s price. If the manufacture price is RM 8 if the manager decided to sell it for RM 8 then will not get any profit. So, the manager need to decide to sell for higher then rm8 so that can earn profit. To be profitable, the manager must charge enough to cover the product and other cost. These factors determine the mark up. So, the manager should charge a reasonable markup of RM 7 over the purchase cost means at RM15 selling price. The markup percentage is 46. 7 because RM 7 divided by RM15 times 100% equal 46. 7%. If the markup is RM 8, so the selling price is RM16. The manager need to determine how much to sell to break even. Knowing that the variable cost is RM 8 means that the company is depending on how many CDs are sold. Say that fixed cost for keeping the company open for one year is RM 100000(no matter how many CDs are sold) The number that the managers need to sell is RM 15 each, the manager need to sell it in the breakeven point which is 14286 CDs. Breakeven point equal RM100, 000 divided by RM15 minus RM 8 equal 14286 CDs. If the company sells less then 14286 units then their company will lose money. If sell more then 14826 units then will earn profit. Assume that all the cost and variable cost is the same so the manager need to determine how much the price need to charge to the product and how much units they need to sell so that to maximize the profit.

As a conclusion, the decision of the manager is very important to the company because it will affect the whole company whether it will earn profit or loss in the short run or even in the long run.