

Accounting for Financial and Managerial Decision and Control

Unit 1

Financial and Management Accounting Information

Structure

- Concept, need, scope and sources of financial information
- Concept and need of management accounting information and its diversity
- Management accounting in the competitive business environment
- Management accounting information as a control tool
- Control system and control environment in an organization

After the completion of this unit, you should be able to:

- Understand the concept of financial accounting information
- Describe the need of financial accounting information
- Explain about the scope and sources of financial accounting information
- Understand the concept of management accounting information
- Explain the need of management accounting information
- Describe management accounting in the competitive business environment
- Recognize Management accounting information as a control tool
- Identify control system and control environment in an organization

1.1 Concept of Financial Accounting Information

Financial accounting is concerned with the summary, analysis and reporting of financial transactions related to a business. It is the process of recording, summarizing, analyzing and interpreting financial activities of business. Thus, financial accounting provides useful information to users, i.e., internal as well as external users.

Financial accounting attributes reporting and summarizing in financial terms the results of past decisions and transactions. Financial statements are the basic information of financial accounting. It contains statement of financial position, which is generally referred to as a balance sheet, income statement, cash flow statement, changes in the equity, and accounting policies and other explanatory information for the period. These financial statements are prepared as per common ground rules, i.e., GAAP, accounting standards, financial reporting standard and others account principals. Nepal Accounting Standard Board officially defined “Financial statements are a structured representation of the financial position and financial performance of an entity” (Section 9, Nepal Accounting Standard 1: Presentation of Financial Statements).

According to section 7 of NAS 1 explained “the general purpose of financial statements is those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs”. Section 9, NAS 1 further explained that “the objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management’s stewardship of the

resources entrusted to it". Financial statements provide information about an entity's such as (i) assets, (ii) liabilities, (iii) equity, (iv) income and expenses, including gains and losses, (v) contributions by and distributions to owners in their capacity as owners; and (vi) cash flows (Section 9, NAS 1).

Financial accounting information is used by managers and external parties to the organization. As per Anthony, Hawkins and Merchant (2102), financial reporting should provide information that

- is useful to present and potential investors and creditors in making rational investment credit decisions. (Related with all financial accounting information)
- is comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence. (Related with all financial accounting information)
- is about the economic resources of an enterprise, the claims to those resources, and the effects of transactions and events that change resources and claim to those resources. (Related to the balance sheet)
- is about an enterprise's financial performance during a period. (Related to the income statement)
- helps users assess the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale or redemption of securities or loans. (Related to the cash flow statement)

1.2 Need of Financial Accounting Information

There are a variety of purposes to use the accounting information as under:

- **Owners/Shareholders:** They use accounting information to know if they are getting a satisfactory return on their investment, and to assess the financial health of their business.
- **Directors/Managers:** They use accounting information for making both internal and external comparisons in their attempts to evaluate performance. Management is also concerned with ensuring that the capital invested in the company produces an acceptable return and that the company is able to fulfil its obligations and stay financially solvent.
- **Employees:** They use accounting information to know about the amount of bonus, assurance of salaries and their job security.
- **Money lenders/Creditors:** They are interested to know the solvency position of the company.
- **Prospective investors:** They use accounting information to assess whether or not to invest their money in the company.
- **Government:** Government uses the financial statements to determine tax amount, and determine the progress of the industry.
- **Other parties:** some other parties may also be interested to analysis the financial statements of a company such as stock exchange authorities, researchers, economists, customers etc. for various reasons such as determining the price of securities, knowing the contribution to society and country in economic development from the company.

1.3 Scope and Sources of Financial Accounting Information

The important sources of financial information are as follows:

- Quarterly report
- Auditors' report
- Annual report
- Board's report
- Internal sources
- External sources

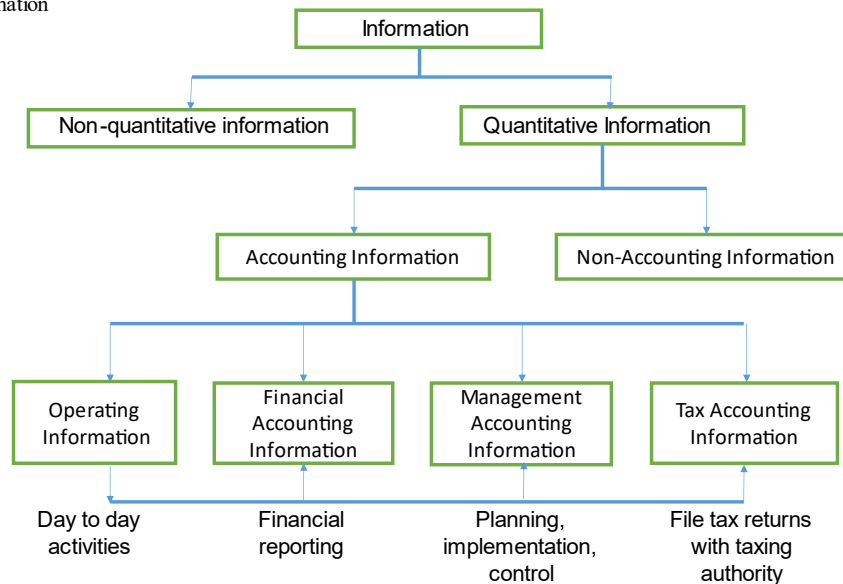
1.4 Concept of Management Accounting Information

Management Accounting is reframing, analyzing and presenting the financial data turning into information to management in such a way that they are helpful in solving various problems. The different data and facts provide and communicated by Management Accounting. Managers must have the various information which will enable them to their activities related with business.

Management Accounting information involves preparing reports and accounts that provided accurate and timely financial and statistical information to business owner and top management level in decision making. For planning, budgeting, decision-making and controlling in an organization the different data and reports are required. The collection of data and reports is known as Management Accounting Information. Thus, Management Accounting Information is the collection of reports and data that managers use to make financial decision.

Information may be either qualitative or non-quantitative (quantitative). Quantitative information can be expressed in numbers. Examples of the quantitative information are sales in amount, expenses, profit or losses in amount etc. On the contrary, qualitative (non-quantitative) information is not possible to measure in term of numbers, for example, conversations, visual impressions, television programs, and newspaper stories.

Table 1
Types of Information



(Source: Anthony, Hawkins & Merchant, 2012)

Quantitative information includes accounting as well as non-accounting. Accounting information usually is expressed in monetary value. But non-accounting information is basically non-monetary terms. For example, age and experiences of employees are quantitative information but these are non-accounting information. Regarding quantitative information, organizations report sales revenue including quantity of unit sold. The sales report shows revenue as the monetary value, but quantity of units sold is non-monetary information.

The financing of the resources, long-term or short-term additional investment decision as well as any kind of management decision, they need information. This information can be classified into four broad categories: (i) operating information, (ii) financial accounting information, (iii) management accounting information, and (iv) tax accounting information.

1.5 Need of Management Accounting Information

Hilton and Platt (2014) mentioned five major objectives of the management accounting, such as:

- (1) Providing information for decision making and planning, and proactively participating as part of the management team in the decision-making and planning processes,
- (2) Assisting managers in directing and controlling operational activities,
- (3) Motivating managers and other employees toward the organization's goals,
- (4) Measuring the performance of activities, subunits, managers, and other employees within the organization, and
- (5) Assessing the organization's competitive position, and working with other managers to ensure the organization's long-run competitiveness in its industry.

In particular, manager that management team need management accounting information for the following reasons:

- (a) Assistance in Planning and Formulating Future Policies
- (b) Help in the Interpretation of Financial Information
- (c) Helpful in Controlling Performance
- (d) Helps in Organizing
- (e) Helpful in Making Decision
- (f) Helps for Coordinating
- (g) Helping in Motivating Employees
- (h) Helps in Communication
- (i) Use of Qualitative Information

1.6 Diversity of Management Accounting Information

Management needs variety of information to plan, to control and to make decisions. That information is provided by Management Accounting. So, the Management Accounting is related to a number of fields. They are as follows:

- (a) Financial Accounting

- (b) Cost Accounting
- (c) Budgeting and Forecasting
- (d) Statistical Method
- (e) Internal Audit and Control
- (f) Tax System and Planning
- (g) Office Services
- (h) Interpretation and Analysis of Accounting
- (i) Management Reporting

1.7 Management Accounting in the Competitive Business Environment

Now a day, every organization is facing fast changing competitive business environment. That's why, organizations need to take quick decisions in day-to-day activities and develop strategies for competitive advantages. Managers need to evaluate the competitive position of the company and collaborate with other managers to ensure the long-term success of the organization in their industry. Organizations are using new technologies day by day to take advantage from highly increasing competition in the market. Customers want to have specialized products and service including accurate information convening product they purchasing, product availability, order status, and delivering time. On the other hand, shareholders expect greater value from their investment and accurate information of the financial status of the company.

The growth of national and international competitive environment therefore requires the ability of companies to create value for their customers and to distinguish themselves from their rivals by formulating business strategy. Appropriate operational factors such as accounting information systems, organizational structure and efficient manufacturing process should help the business strategy. Managerial accounting deals with provision of information inside the company - that is, the process of identifying, measuring and forecasting, analyzing, interpreting, communicating information for the pursuit of an organization's goals. Bamber, Braun and Harrison (2008) argued that the technological advancement, and globalization change the business environment, thus the requirement of changing the management accounting has been felt by the business organization. In this way, managers or decision-makers demand the details information provided by managerial accounting systems.

The changing business environment has a significant impact on the processes of management accounting. The business environment has brought some improvements to the management accounting system. Hilton opined that managerial accounting continually evolves and adapts as the business environment changes.

1.8 Management Accounting Information as a Control Tool

One of the important objectives of the management accounting is assisting managers in directing and controlling operational activities. Similarly, the institute of Management Accountants identifies the role of management accounting information as supporting strategies (planning), operational (operating), and control (performance evaluation) management decision-making. The main issue is to maintain the competitive business environment and ensure the organization's long-run competitiveness. So that managers use management accounting information as a control tool, which help to achieve organization's goal including long-term competitiveness in the industry.

In this regard, organization establish responsibility centers to measure the performance of managers and sub-units within the organization. Organization may also use standard costing technique to control various cost, such as, direct materials, direct labor and overhead cost through variance analysis, where compare the difference between the standard cost and the actual expenditure of cost. Similarly, direct costing is based on the separation of variable and fixed costs, reflecting the dependence of costs on the output volume -used for short term planning as well as control purposes. Additionally, financial statement analysis, break-even analysis, return on investment (ROI), residual income (RI) and budgetary control are used as a control tool based on management accounting information.

1.9 Control System and Control Environment in an Organization

Management accountant needs to satisfy customers, shareholders and other stakeholders. Similarly, management accountant involves assisting managers in directing and controlling operational activities. She/he actively participates for motivating managers and other employees toward the organization's goals.

More innovative, useful and effective accounting management accounting techniques are needed to improve efficiency, reduce costs, improve quality, assess correct product costs, planning, decision-making and proper monitoring. Thus, control system and control environment are very important aspect in an organization.

Regarding organization control, every manager and employee behave accordingly to ethics and best interests. Management accountants developed internal control systems to protect the organization's assets from fraud or theft. To achieve the goal of organization, there should be control environment within the organization. Control environment includes organization's ethical standard, information system, structures to motivate employees and monitoring compliance with the organization's best interest. Management accountant develops structures to motivate and monitoring employees, effective information system, and organization's ethical standard as well evaluate the appropriateness of management's governance and strategies choices.

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