

# CPA

**CERTIFIED PUBLIC ACCOUNTANTS**

**PART III  
Section 5**

**ADVANCED MANAGEMENT  
ACCOUNTING**

*www.somekenya.com - Sample notes  
0707 737 890*

**STUDY TEXT**

**Revised: May 2021**

**PAPER NO.14 ADVANCED MANAGEMENT ACCOUNTING****GENERAL OBJECTIVE**

This paper is intended to equip the candidate with knowledge, skills and attitudes that will enable him/her to apply advanced management accounting techniques in business decision making.

**LEARNING OUTCOMES**

A candidate who passes this paper should be able to:

- Use cost estimation data in decision making
- Apply inventory management techniques to decision making
- Use financial and non-financial indicators to measure organisational performance
- Apply environmental management accounting concepts in practice.

**CONTENT****14.1 Nature of management accounting**

- Introduction to advanced management accounting
- Scope of management accounting
- Limitations of management accounting
- Ethical standards of management accountants

**14.2 Decision theory**

- Decision process
- Decision making environment – certainty, risk, uncertainty and competition
- Decision making under uncertainty - maximin, maximax, minimax regret, Hurwicz decision rule, Laplace decision rule
- Decision making under risk - expected monetary value, expected opportunity loss, minimising risk using coefficient of variation, expected value of perfect information
- Decision trees - sequential decision, expected value of sample information
- Limitations of expected monetary value criteria

**14.3 Cost estimation and forecasting**

- An overview of the methods of cost estimation and prediction; engineering, simulation and statistical methods, simple and multiple regressions, the statistical properties of regression
- Interpretation of ANOVA tables
- Learning curve and its application

**14.4 Inventory control decisions**

- Cost of holding and ordering inventory
- Stochastic inventory models
- Inventory models for perishable items
- Application of simulation models in inventory control

**14.5 Pricing decisions**

- External pricing methods
- Internal pricing methods (transfer pricing)
- Target costing
- Life cycle costing

#### 14.6 Short-term planning and decision-making

- Overview of single product and multiple product cost-volume-profit analysis under conditions of certainty
- Single product and multiple product cost-volume-profit analysis under conditions of uncertainty
- Risk assessment
- Application of marginal costing: product mix decisions, special orders, make or buy decision, pricing decisions and other similar short-run decisions, relevant information in decision making

#### 14.7 Budgetary control and advanced variance analysis

- Flexible and static budget, purpose of budgetary control; operation of a budgetary control system, organisation and coordination of the budgeting function
- Human aspects (motivational aspects) of budgeting, emerging trends in budgetary control; ERPS, ABB, ZBB, program budgeting
- Advanced variance analysis and performance evaluation; expost variances and opportunity costs in variances
- Variance investigation models

#### 14.8 Performance measurement and evaluation

- Linkage between performance measurement and organisational vision
- Responsibility accounting and responsibility centres, segmented reporting
- - Distinction between financial performance measures and non-financial performance measures
- Cost of information
- Methods of evaluating responsibility centre performance such as return on investment (ROI), residual income (RI) and economic value added (EVA) (importance and limitations of the methods)
- Other financial/non-financial performance measures: balanced scorecard, performance pyramid, Fitzgerald and Moon's building block model, performance prism
- Managerial incentive schemes
- Performance contracting
- Performance measures in the service industry

#### 14.9 Environmental management accounting

- Role of accountants in environmental management accounting
- Using environmental management accounting to manage costs
- Opportunities for environmental awareness in management accounting

#### 14.10 Emerging issues and trends

<b>TOPIC</b>	<b>PAGE</b>
<b>Topic 1:</b> Nature of management accounting.....	5
<b>Topic 2:</b> Decision theory.....	12
<b>Topic 3:</b> Cost estimation and forecasting.....	42
<b>Topic 4:</b> Inventory control decisions.....	85
<b>Topic 5:</b> Pricing decisions.....	106
<b>Topic 6:</b> Short-term planning and decision-making.....	141
<b>Topic 7:</b> Budgetary control and advanced variance analysis.....	191
<b>Topic 8:</b> Performance measurement and evaluation.....	241
<b>Topic 9:</b> Environmental management accounting.....	284

[www.someakenya.com](http://www.someakenya.com) - Sample notes  
 0707 737 890

## TOPIC 1

# NATURE OF MANAGEMENT ACCOUNTING

### INTRODUCTION TO ADVANCED MANAGEMENT ACCOUNTING

**Management Accounting** is 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 ensure appropriate use of and accountability for its resources.

**Management accounting** is concerned with providing information to managers – that is, people inside an organization who direct and control its operations. In contrast, **financial accounting** is concerned with providing information to shareholders, creditors and others who are outside an organization. Management accounting provides the essential data with which organizations are actually run. Financial accounting provides the scorecard by which a company's past performance is judged.

Because it is manager oriented, any study of management accounting must be preceded by some understanding of what managers do, the information managers need, and the general business environment. As the organizations and the business environment changes then the role of management accounting changes.

Management accounting focuses on both monetary and non-monetary information (for example, cost drivers such as labor hours and quantities of raw materials purchased) that inform management decisions and activities such as planning and budgeting, ensuring efficient use of resources, performance measurement and formulation of business policy and strategy. The collective goal of all this is to create, protect and increase value for an organization's stakeholders. Thus, Management accounting activities include data collection as well as routine and more strategic analysis of the data via various techniques (such as capital investment appraisal) designed to address specific management needs.

### SCOPE OF MANAGEMENT ACCOUNTING

The main purpose of management accounting is to utilize the accounting information in solving the business problems and taking scientific decisions. Moreover, the scope of management accounting is very wide. Therefore, it is very difficult of pinpoint the exact scope of management accounting. However, the scope of management accounting are listed below.

#### 1. Financial Accounting

Financial accounting is relating to the recording of business transactions immediately soon after the transaction taken place or afterwards incurring the expenses. The business

transaction may be relating to income, expenses, inventory movement, assets, liabilities, cash receipts and payments and so on.

The process of financial accounting includes the preparation of financial statements regularly at the end of each accounting year for knowing operating results for a definite period. The term financial statements includes profit and loss account and balance sheet. Management is unable to exercise the coordination and control out of the information supplied by financial accounting system. But, the financial accounting system information is the basis of future business planning and financial forecasting.

## **2. Cost Accounting**

Cost accounting is concerned with the ascertainment of various elements of costs for different business operation and activities. These cost data are used in the management accounting system for further analysis so as to solve business problems and take quality decision.

## **3. Budgeting and Forecasting**

Management accounting includes budgetary control and forecasting techniques also. Under budgetary control system, the budgets are prepared on functional basis and measure the actual performance, find the difference between the actual and standard for taking corrective actions. In this way, budgeting assists the management for identifying responsibility and ensuring coordination.

## **4. Revaluation Accounting**

This type of accounting system is ensuring that the capital is maintained intact in real terms. By keeping this fact in mind, correct amount of profit is calculated and used for managerial decision making.

## **5. Cost Control Procedures**

Cost control procedures are an integral part of management accounting process. It includes inventory control, cost control, time control, budgetary control, standard costing etc.

## **6. Statistical Methods**

In order to analyze the financial accounting data, tables, diagrams and graphs are used in the management accounting system. These are nothing but statistical methods.

## **7. Inventory Control**

Inventory control refers to exercising control over the utilization of raw materials, processing of work in progress and disposal of finished goods for a specific period.

## **8. Reporting**

Reporting is divided into two types. They are interim reporting and external reporting. Interim reporting is supplying information to the top management. External reporting is supplying information to outsiders i.e. shareholders, banks and financial institutions.

Interim reporting deals with the submission of financial results by means of weekly, fortnightly, monthly, quarterly or half yearly accounts or statements to the top management.

## **9. Taxation**

It includes the computation of corporate income tax in accordance with the tax laws, filing of returns and making tax payments.

**10. Methods and Procedures Design and Installation**

Management accounting is relating to the most efficient and economic system of accounting suitable to any size and type of undertaking. Moreover, it employ best use of mechanical and electronic devices.

**11. Internal Audit**

Internal audit is conducted by the business organization with the help of paid employee who has thorough accounting knowledge. All the relevant records are maintained under the management accounting system so that the internal audit is conducted in an effective manner.

**12. Office Services**

It includes maintenance of proper data processing and other office management services.

**13. Financial Management**

Every owner of the business concern expects fair rate of return on investments. It is possible through the effective utilization of the finance. Hence, it is termed as financial management and considered as separate discipline. The tools in financial management are developed through management accounting system.

**14. Interpretation**

Management accounting is relating to the interpretation of financial data to management and advising them on decision-making.

**LIMITATIONS OF MANAGEMENT ACCOUNTING**

The origin of management accounting can be traced to overcome the limitations of financial accounting and cost accounting.

Financial accounting is very useful to the different categories of persons but it suffers from the following limitations:

**(i) Historical Nature:**

Financial accounting is of historical nature. It does not provide the necessary information to the management for planning, control and decision-making. It does not tell how to increase the profit and maximize the return on the capital employed.

**(ii) Recording of Actual Cost:**

In financial accounting assets and properties are recorded at their cost. No effect of changes in their value is recorded in the books after its acquisition. Thus, it has nothing to do with their realizable or replaceable value.

**(iii) Incomplete Knowledge of Costs:**

In financial accounting data relating to cost is not available according to different products or jobs or processes in order to judge the profitability of each. Information regarding wastages and losses is also not available from the financial accounts. It is also difficult to

fix the prices of the products without the availability of a detailed analysis of costs which is not available in financial accounts.

**(iv) No Provision for Cost Control:**

Costs cannot be controlled through financial accounting as there is no provision for corrective action because of expenses being recorded after their incurrence. No technique to check the reasonableness of any expenditure or no system for fixing definite responsibility on any authority for wastage or excessive expenditure is available in financial accounting.

**(v) No Evaluation of Business Policies and Plans:**

There is no device in financial accounting by which the actual progress can be measured against the targets in order to evaluate the business policies and plans, to know the reasons for deviations and how to correct them, if need be.

**(vi) Not Helpful in Decision-Making:**

As the data available is of historical nature, the financial accounting is not of much help to the management in selecting a profitable alternative. There are many situations where management is required to take decisions but information provided by financial accounting is not adequate.

**(vii) Technical Subject:**

Financial accounting is highly technical in nature. Financial accounts can be prepared and interpreted only by those persons who possess adequate knowledge of accounting concepts and conventions and are well conversant to the practice of accounting.

Though cost accounting came into existence to remove the limitations of financial accounting but its scope as compared to management accounting is limited as it deals primarily with the cost data. In actual practice, cost accountants are doing the jobs of management accountants.

Further, most of the techniques of management accounting are also being used by the cost accountants. That is why; management accounting is treated as extension of cost accounting. But for our purpose of study we treat the management accounting more broad as compared to cost accounting as management accounting, includes many more aspects of the study besides the cost accounting.

Thus, the science of accounting is not in a finished state. It is in the process of evolution. The role of accounting has changed after the Second World War.

Now, it is not a mere recording of business transactions in the books of original entry, then classifying them into the ledger and finally summarizing them by preparing the profit and loss account and balance sheet as is done in financial accounting or calculation and control of cost as is done in cost accounting.

Rather accounting helps in forecasting, planning and controlling the business events and taking managerial decisions. Keeping this in view a new branch of accounting known as Management Accounting has been developed to cope with the limitations of financial accounting and cost accounting.



## Characteristics of Management Accounting:

### 1. Technique of Selective Nature:

Management Accounting is a technique of selective nature. It takes into consideration only that data from the income statement and position state merit which is relevant and useful to the management. Only that information is communicated to the management which is helpful for taking decisions on various aspects of the business.

### 2. Provides Data and not the Decisions:

The management accountant is not taking any decision bu.: provides data which is helpful to the management in decision-making. It can inform but cannot prescribe. It is just like a map which guides the traveller where he will be if he travels in one direction or another. Much depends on the efficiency and wisdom of the management for utilizing the information provided by the management accountant.

### 3. Concerned with Future:

Management accounting unlike the financial accounting deals with the forecast with the future. It helps in planning the future because decisions are always taken for the future course of action.

### 4. Analysis of Different Variables:

Management accounting helps in analysing the reasons as to why the profit or loss is more or less as compared to the past period. Moreover, it tries to analyse the effect of different variables on the profits and profitability of the concern.

### 5. No Set Formats for Information:

Management accounting will not provide information in a prescribed proforma like that of financial accounting. It provides the information to the management in the form which may be more useful to the management in taking various decisions on the various aspects of the business.

## ETHICAL STANDARDS OF MANAGEMENT ACCOUNTANTS

Ethics in accounting is of utmost importance to accounting professionals and those who rely on their services. Certified Public Accountants (CPAs) and other accounting professionals know that people who use their services, especially decision makers using financial statements, expect them to be highly competent, reliable, and objective. Those who work in the field of accounting must not only be well qualified but must also possess a high degree of professional integrity. A professional's good reputation is one of his or her most important possessions.

The general ethical standards of society apply to people in professions such as medicine and accounting just as much as to anyone else. However, society places even higher expectations on professionals. People need to have confidence in the quality of the complex services provided by professionals. Because of these high expectations, professions have adopted codes of ethics, also known as codes of professional conduct. These ethical codes

This is a **SAMPLE** (Few pages extracted from the complete notes: Page numbers reflects the original pages on the complete notes).

It's meant to show you the topics covered in the notes.

**Download more at our websites:**

[www.someakenya.co.ke](http://www.someakenya.co.ke)

or

[www.someakenya.com](http://www.someakenya.com)

To get the [complete](#) notes, contact us:

**Call/text/whatsApp [0707 737 890](tel:0707737890)**

**Email:**

[someakenya@gmail.com](mailto:someakenya@gmail.com)

[info@someakenya.co.ke](mailto:info@someakenya.co.ke)

[info@someakenya.com](mailto:info@someakenya.com)

*Get news and updates about kasneb by liking our page*

[www.fb.com/studycpa](http://www.fb.com/studycpa)

**Pass on first attempt**

**“Buy quality notes and avoid refers/retakes which costs more money and time”**

**Sample/preview is NOT FOR SALE**