Chapter Seven: Variance Accounting 177
- Introduction 177
- Significance of Variance Analysis 178
- Responsibility for Variances 179
- Accounting for Variances 182
- Computation of Basic Variances 184
- Ledger Entries 190
- Sales Variances 195
- Cost Variances 201

Chapter Eight: Advanced Variances 209
- Introduction 209
- Advanced Materials Variances 210
- Advanced Labour Cost Variances 218
- The Derivation of the Labour Variances 219
- Advanced Sales Variances 238
- Sources and Causes of Variances 238
- Techniques for Variance Analysis ... ... 24[illegible]
- Investigation of Variances ... ... 24[illegible]
- Cost Reduction ... ... 2[illegible]
- Self-review Questions ... ... 2[illegible]
Examination Questions ... ... [illegible]
Bibliography ... ... [illegible]
Index ... ... [illegible]

CHAPTER ONE

MANAGEMENT ACCOUNTING THEORIES

INTRODUCTION

Management Accounting is a derivative or component of accounting. It is reasonable therefore to know what accounting is. Proper definition of accounting was hardly available until 1961 when the American Institute of Certified Public Accountants (AICPA) defined accounting as, "the art of recording, classifying and summarizing, in a significant manner and in terms of money, transactions and events and interpreting the results thereof". A second definition of accounting was proffered in 1966 by the American Accounting Association (AAA) as "a systematic process of identifying, measuring and communicating of financial information so as to enable the user of the information to make informed judgement and decision by users of the information".

We can have a holistic definition of accounting if we marry both definitions by the AICPA and A.A.A together to have a single definition thus, "a systematic process of identifying, measuring, recording, classifying, summarizing, interpreting and communicating of economic information so as to enable the user of the information to make informed decision therefrom". This definition of accounting is so complete as it shows what accounting

is, how it is processed and what users derive from it. We will discuss the components in turn to see that the absence of any will make the definition imperfect.

Identifying ensures that every transaction and the parties related thereto are separately identified by naming them. For instance, if an asset is bought for cash, the asset account will be named and Cash which received it will also be named. If the asset was bought on credit, however, then the asset account will be named as the Receiver while the party from whom the asset was bought would be identified as the creditor. Identifying is an important component of accounting definition because it enables proper double entry recording of the transaction.

Measuring is attaching value to a transaction. It is this valuation or monetization of economic activity or transaction that has made accounting to be quantitative thus facilitating additions to, and subtractions from, values of like items as assets increase in number or depreciate or are retired. Very importantly it facilitates the addition of unlike assets together to give the organization a single value. This facilitates planning and the ascertainment of organization's profitability and financial strength.

Recording is the documentation of the transactions thus creating a permanent record which becomes a good medium for future reference. Recording aids the memory and engender communication, subsequent processing and obviates conflict with customers.

Classifying is the grouping of accounting transactions according to common characteristics depending on the purpose for which the

subject of the transaction is intended to serve. For instance, the purchase of a car by a car dealing entity to be used in the business would be classified as Motor Vehicle (asset) whereas similar cars purchased for resale would be classified as purchases. On the other hand, a car purchased by the firm but retained for the personal use of the proprietor, would be classified as drawings. Thus classifying is crucial for proper profits determination and assets valuation.

Summarizing is the reclassification of already classified data so as to obtain a desired information. The operations budget as well as control reports are examples of management accounting summaries while the Income Statement and statement of financial position are important financial Accounting Summaries. Summaries are essentially the reports or information that is communicated to help the decision maker take decision.

Interpreting is the giving of meaning to accounting summaries. Summaries are not ends in themselves; they must be properly interpreted with regard to the surrounding circumstances to aid understanding and reasonably facilitate judgement and decision. For instance, a profit of one million naira is not meaningful unless it is considered in terms of sales, industrial average profit, past results or budgeted results. In the same vein a one million naira profit following a previous five million naira profit indicates dwindling results.

Communicating is the notification or reporting of accounting summaries obtained to the relevant user. Accounting summaries would aid someone's decision only when that person is in possession of the accounts. If the summaries are held in the files or ledger and not reported or communicated; the decision maker cannot use it. Essentially, it creates awareness.

Informed Judgement and Decision: Managers and individuals habitually make judgement, form opinions and take decisions in the course of their operations. The soundness of their decision will depend on how much they know of the subject matter. Accounting essentially and properly informs about the well-being of organizations as it systematically gathers and processes all economic details of such entity. It therefore fitly assists any user of the information to take factual decisions about the entity.

Accounting is customarily said to be the language of business. It is the voice of the organization and speaks of its profitability, its financial strength or weakness, its vision and mission as well as its resources. It equips diverse parties interested in the organization with such sufficient knowledge that enables them to make reasonable decisions about the organization. Incidentally, business undertaking entails the constant making of decisions and the success of the decision maker depends on his knowledge of the organization. Here then lies the importance of accounting - giving the desired knowledge. It gives form to decisions and through its component of recording it provides records of transactions and events so helping to avoid oblivion and conflict between parties to the transaction. It also facilitates planning and controlling so enhancing efficiency in operation.

ACCOUNTING DEVELOPMENT

By accounting development we mean the progress made in accounting over the years. Accounting did not develop into its present state in a straight forward and orderly fashion. It is adaptive in the sense that it is able to change in response to the environment in which it operates. It should be recalled that accounting is the

language of business and it is information which facilitates the decision of the appropriate stakeholder. It is therefore prepared in response to the information needs of the respective stakeholder. Thus as businesses change in diversity and complexity, in ownership, in operational technology, in competitiveness, in areas of influence, in environmental innovations, and in legal framework, the information for reporting them have to change.

Until the recent information age, capital provided by the entrepreneur was the sole of business. It determined who was in business and the level of business. Then the provider of capital would want to know if his motive for the business was being achieved. Accounting must therefore be prepared in such a way as to provide the necessary information. Thus in the non-economic period wealth tended to accrue to the State and those who were high in status. With low level of literacy then, accounting records assumed a form appropriate to the illiterate community. The records were expressed in physical quantities only and later in financial terms when money and the means of recording became available. Then, Accounting practice was rudimentary and served the purpose of tracking goods and cash.

Between the 11th and 18th century, when commerce held sway, merchants and artisans organized themselves into guilds which enabled them to invest their money in stock-in-trade with little invested in productive equipment or fixed assets. The rapidly changing environment created new bookkeeping system and the ***single entry*** system became the accounting practice which was then used to prepare the "charge and discharge" report. As trading activities became more dynamic and transactions increased geometrically, the single entry method could no longer cope. Greater

exactness and care was required of the clerks and practice was needed to make falsification of records difficult. Then duties were divided among the increased number of personnel. Then too, the entrepreneurs or investors needed to periodically know the state of affairs of their business through periodic balancing of the books. Therefore the Double Entry Bookkeeping system was born in the 14th century and was subsequently popularized by Pacioli's *Summa* which was published in 1494 - Edwards (1989:11).

Between the 18th and early 19th century, there was the industrial revolution which was prompted by the discovery of new, energy sources and the development of the factory system. Then entrepreneurs invested on machines used in such industries as textiles, pottery, mining and iron making and greater transportation. Thus the manufacturing process rather than land became the main source of income. Business was much higher requiring higher levels of materials, labour and the maintenance of machines which had lives stretching over long periods so introducing the incidence of fixed assets into the business. Entrepreneurs then needed to have knowledge of the profitability of their business as well as the efficiency of workers and resources control. They laid greater emphasis on balance sheet so they could ascertain their capital being the excess of assets over liabilities - Porwal (2001:56). This demanded the extended use of the Double Entry system of accounting and the preparation of final accounts.

From the early 19th century to date, public utilities, especially the railways emerged. They required immediate outlay of massive capital which could not be available to single individuals. Then larger machines were invented and introduced into the factories all leading

to the rapid growth of the large scale limited liability companie which facilitated the raising of large sums of money beyond wha individual entrepreneurs could provide. This resulted in large an diverse investor/creditor group and companies began to acquire widespread ownership. This growth of corporation and the busines entity concept, according to Porwal (2001), led to a change i emphasis during the period from the Balance Sheet to Incom Statement.

In this period too, non-owner managers of business developed as ownership became separated from the management of companies. Investors became essentially uninvolved in the day-to-day running of the companies they owned - Mueller et al (1997:7). Then the law recognized the company as a separate entity and the Separate Entity Postulate developed. But the owners of capital who are interested in the return on their investment wanted to know the result of operations during an accounting period. This resulted in the development of accounting concepts of "income" and "periodicity". Also since the company was regarded as a going concern, fixed assets became valued at original cost less depreciation. Again the divesting of ownership from management necessitated another accounting practice of the auditing of the annual accounts by independent outside agencies to ensure the truth and fairness of the accounts. According to Porwal (2001), the basic accounting principles developed as well as the revenue principle and matching principles. Also, the principle of verifiability was developed in order to ensure the authenticity of the financial accounts.

Since the 1950s a greater revolution evolved in accounting practice. Large scale companies became more complex and new techniques of

analysis were evolved to face competition. Cost accounting and management accounting developed while financial statements were no longer taken as credible indicators of past financial position. Today, accounting has developed into a full-fledged information system and is no longer regarded as an art but a science. Various Accounting Standards Boards and Committees are established for issuance of standards just as international accounting is being developed to harmonize accounting techniques and practices in member countries.

Government has frequently intervened in the way businesses are run and accounts prepared in order to protect absentee business owners, through the company laws. Company law now prescribes what financial accounts must be prepared, the structure of the accounts and how they must be presented or disclosed. It compels organizations to have external professional body to audit their accounts for assurance purpose. In the same vein Professional Accounting Bodies, in collaboration with the Accounting Standard Boards, have issued standards of accounting practices and presentation. All these have great impact on accounting development.

ACCOUNTING CLASSES

In the foregoing chapter it is obvious that accounting has developed in response to information requirement which itself changes with varying business environments. Even then as business activities vary in size and importance different managers require the information of the accounting system to be presented or reported differently - Horngren et al(2006). This has given rise to different types of accounting today.

As entrepreneurs require information about what has happened so that they could know how their investment is fairing, financial accounting developed. It was impossible however to know how the investment is fairing unless the cost of the product is determined. Cost accounting thus developed. As the Internal Revenue required information on companies for tax purpose, Tax accounting evolved. As the industrial revolution gave rise to Joint-stock companies, it was impossible for all the shareholders of a company to collectively manage the affairs of the company. This resulted in the separation of ownership from management. But the entrepreneurs required to be assured of the proper stewardship of those they have employed to manage the affairs of the company for them, assurance accounting or more exactly auditing evolved. As operations become complex and diverse people are increasingly employed to carry out various activities of the company, the need for efficiency arose and management accounting evolved.

Today, there are advances in manufacturing urged on by global competition which has made managers in the industry more conscious of the need to have accurate cost information for planning, controlling, continuous improvement and decision making. Advances in the manufacturing environment and in information technology have resulted in manufacturing management approaches which allow firms to increase quality, reduce inventories and become more efficient. The availability of computer integrated applications also result in automated manufacturing where computers are used to monitor and control operations. This has resulted in rapid and timely information generation which enables managers to know what is happening operationally almost as it happens. All these are shaping management accounting which exists to generate the information required to make decision in these changing environments.

CamScanner

In summary, innovations in accounting practice are continuously driven by the information needs of new strategies as companies become more complex, technologies change and competition intensifies. Apparently, we have today different classes of accounting in response to the information needs. They include Financial accounting, cost accounting, assurance accounting (auditing), tax accounting (taxation), management accounting and government accounting. We will elaborate effectively on the three important groups of financial accounting, cost accounting and management accounting.

Financial Accounting

This is the branch of accounting which is concerned with measuring, recording, and classifying of the transactions of a business. At the end of a period, usually a year but sometimes less, a profit and loss account and a balance sheet are prepared to show the performance and position of the business. Financial accounting is primarily concerned with providing a true and fair view of the activities of a business to parties external to it. To ensure that this is done correctly, considerable attention is paid to accounting concepts and to any legislative requirements, accounting standards, and where appropriate, the regulations of the Stock Exchange (Oxford Dictionary of Accounting 2005).

Financial accounting processes economic information with a view to apprising stakeholders, especially shareholders, of the profitability and financial strength of a company in a financial reporting period. It is expressed only in financial (monetary) terms and must cover the entire organization's activities for a specified period, usually a year. It reports only on what has happened and so retrospective. Both

internal and external persons are interested in financial accounti information. Nevertheless, because of the preponderance of outsi interest on financial accounting information, they are said to *external reports* for investors' decision.

We can define financial accounting properly by applying th operational or holistic definition we constructed earlier as, " systematic process of identifying, measuring, recording, classifyin summarizing, interpreting and communicating of econom information to enable stakeholders to make investment decisio therefrom".

Cost Accounting

This is defined as "the process of accounting for cost from the point which expenditure is incurred or committed to the establishment o its ultimate relationship with cost centres and cost units. In its wide usage, it embraces the preparation of statistical data, the applicatio of cost control methods and the ascertainment of the profitability o activities carried out or planned". Cost accounting is purposed t determining the cost of a product or service as well as of inventories It provides cost information to facilitate the ascertainment o financial accounting profit and financial position.

Production activities for obtaining the cost of a product or service ar regular and routine and cost information which are required for thei planning and control are similarly routine. They are intended to be used by managers of the organization who perform routine activities for their routine decisions. Cost accounting is therefore internal reports purposed to directing mediate managers' attention to routine situations that need to be resolved in the short period.

Since cost accounting is a branch of accounting, we can redefine cost accounting using the holistic or operational definition constructed earlier as, "the systematic process of identifying, measuring, recording, classifying, summarizing, interpreting, and communicating of economic information to enable mediate managers to take routine decisions".

Management Accounting

Management accounting is, "the application of professional knowledge and skill in the preparation and presentation of accounting information to assist managers in the formulation of policies and in making strategic decisions". The Oxford Dictionary of Accounting (2005) defined management accounting as, "the techniques used to collect, process and present financial and quantitative data within an organization to help effective performance measurement, cost control, planning, pricing, and decision making to take place". Atkinson et al (2012) see management accounting as, "a discipline that helps an enterprise to develop and implement its strategy. This requires the linkage of strategic objectives with reporting on, and improving operations". Brewer (2006) describes management accounting as, "first and foremost about managing internal operations to optimize organizational performance". Thus from Atkinson et al and Brewer's viewpoint respectively, management accounting is all about internal operations and strategies for the enhancement of organizational performance. But strategies belong to top management; so we can also define management accounting as, "the application of professional knowledge and skill in the preparation and presentation of accounting information to assist top management in policy formulation and strategic decisions". The professional knowledge

and skill has to do with the systematic process of identifying, measuring, recording, classifying, summarizing and especially, interpreting and reporting of accounting information. Since management accounting is a branch of accounting, we can also apply the holistic definition we derived previously and have management accounting as "a systematic process of identifying, measuring, recording, classifying, summarizing, interpreting and communicating of economic information to enable top management to make strategic decisions".

Characteristically, management accounting is management focused and so internal information which help managers make decisions to fulfill organizations' goals. Management accounting reports on what has happened in so far as it can help to predict what would be done so as to do them efficiently and effectively. Specifically it is concerned with how cost information and other financial and non-financial information should be used for planning, controlling, continuous improvement and decision making. It has an overall objective of making sure that organizations make effective use of resources so that value is maximized for shareholders, customers and other interested parties - Hansen and Mowen (2006). Management accounting is timely but can take days, weeks, months and even a year depending on the decision it affects. It produces both quantitative and qualitative information and can use data that are less objective and less verifiable than the data used in the financial accounting system. Its reports are of three main types (Horngren at al, 2006) being:

- *Score Keeping:* The accumulation of data and reporting to management how the organization is doing and how well it is implementing its strategies.

CamScanner

- ***Problem Solving:*** Choosing the best from among several alternatives.

- ***Attention Directing:*** Reporting on what has been done, and directing attention to what is needed to be done well and other issues that should be resolved. This report also alerts managers to opportunities that would add value to the organization.

SCOPE OF MANAGEMENT ACCOUNTING

By scope is meant the range of view, perception or grasp. It means the area of coverage of an activity or a range of things or issues that a subject covers or deals with. There is no definition of the specific area of coverage of management accounting as it is with financial accounting. In the view of Franchochu (2009), there is no single definition of what management accounting is or the area of work that it includes. Nevertheless, the following areas were noted by him as comprising the field of management accounting.

- Budgeting, planning and forecasting
- Profitability of products, services and operation
- Measuring organizational, divisional and departmental performance
- Comparing results and performance within and between organizations
- Assisting in the process of increasing effectiveness and efficiency.

- Assessing the performance of past and future capital investments
- Advising on decisions about product mix, markets to be served and selling prices.
- Advising on decisions on whether to outsource products components, activities and services.
- Advising on decisions involving the investment of scarce funds between a range of possible alternatives.
- Assisting in the making of a wide range of strategic decisions.

Kaplan & Atkinson (1981) appear to think in the same view when they said that the scope of management accounting extends beyond the traditional measures of the costs and revenues from the transactions that have already occurred to include also information on sales backlogs, unit quantities, prices, demand on capacity resources, and extensive performance measures based on physical or non-financial measures. They viewed that management accounting enhances decision making, guides strategy development and evaluates existing strategies and focuses efforts related to improving organizational performance and evaluating the contribution and performance of organizational units and members.

According to Mohan and Goyal (1948), the scope of management accounting is so wide and broad-based that it encompasses, within its fold, a searching analysis of all aspects and branches of business operations. We can therefore authoritatively say that management accounting covers all economic information which enable managers to manage the activities of the organization effectively and efficiently.

We may need to appreciate that management accounting is a compounded term of two distinct business activities of "management" and "accounting". Thus management accounting effectively provides information which enable management at whatever level and in whatever aspect of the organization, to execute their duties efficiently and effectively. Management accounting is, therefore, without boundaries as the information it provides cover virtually all areas that require management decision, whether they be strategic, tactical or operational. We can then conveniently say that all economic information is management accounting information and hence all accounting is management accounting. Management accounting is thus pervasive and so indistinct in scope.

THE PLACE OF THE MANAGEMENT ACCOUNTANT IN ORGANIZATION

Managers are often responsible for various activities required to provide the product or service that the organization offers. Their work is to decide on what to do, how to do it, and by whom it would be done. They need reliable accounting information to be able to decide well. In the first instance, a manager need to choose a strategy which should specify how the organization or its section of it matches its own capabilities in the economy to achieve its objectives. Strategy gives competitive advantage. It is the management accountant that provides input that aids in the development of a strategy and in its implementation.

The role of the management accountant in an organization is support and team work. He assists other managers who carry out the various activities that must be performed to achieve the organization's objectives. Those who are directly responsible for producing the

product or service are line managers while those who assist the line managers and so indirectly responsible for the production of the company's product or service are staff managers.

Generally, the work of management include planning, organizing, directing and controlling. It is the management accountant that provides the relevant information to assist the relevant manager to decide effectively and reasonably.

Planning: This is the delineation of objectives, the formulation, evaluation and selection of strategies and tactics required to achieve the objectives of the organization. Planning may be strategic, tactical or operational. Management accounting provides the relevant information by developing such models as capital budgeting, operational budgets, forecasting, network analysis, cash flows, linear programming and cost-volume-profit analysis. Very importantly, the management accountant formulates and communicates strategy, identifies and manage organizational risks, develop measurement systems for assessing organizational performance and analyzes decision alternatives.

Organizing: This is the deliberate segmentation of the organization into departments, divisions, territories, product lines, etc for the effective performance of the activities of the organization for the realization of its objectives. Management uses operation alignment to create and execute short-run (annual, bi-annual, quarterly, monthly, weekly or daily) objectives. Management accounting facilitates this by providing information for

(a) planning for the near future,
(b) communicating vertically,

(c) coordinating horizontally, and
(d) evaluating and rewarding employees for the desired motivation.

Directing: This is the activity of leading the staff for the optimal achievement of organizational goal. It ensures goals congruence. Large and decentralized organizations, according to Brewer (2008) need to be properly directed by infusing the organization with shared beliefs. This requires reinforcing the organization's mission, ethical tone, and attitude toward its employees. Management accounting information helps to effectively manage the behavioural interactions of culturally diverse human beings who ultimately shape decision outcomes. It helps to manage organizational resistance that often emerges in response to organization wide change initiatives.

Controlling: Is the management process of ensuring that no wastes or losses arise from operation. This involves the creation of feedback that permits the comparison of actual performance with expected results, reporting to the appropriate level of management and then taking corrective action. Management accounting facilitates this by providing planning information in the nature of targets, budgets, and operational policies as well as performance reports through the technique of variance analysis.

In summary, the management accountant is very relevant to the entire organization.

RELATIONSHIP OF THE THREE INFORMATION CLASSES

The three accounting classes of financial accounting, cost accounting and management accounting are highly interrelated in that they are a accounting and follow the same process of preparation from economic data to accounting information. Cost accounting information of the cost of inventories and finished products is very invaluable for financial accounting profit determination.

Notwithstanding the interrelationship of the three accounting classes as above, they are very different hence the varied classification. The difference can be seen from three important view-points of

(1) The user of the information
(2) The use to which the information is put, and
(3) The nature of the information.

Although cost accounting and management accounting are both internal accounting they are different in the sense that while cost accounting is for the use of mediate managers for routine decision management accounting is for the use of top managers for strategic decisions.

Financial accounting is external information as it is used by stakeholders, who are not connected with the running of the organization, for various investment decisions. By nature, it is different from cost accounting and management accounting on the following grounds.

Freedom of Choice: Financial accounting reports must be prepared in accordance with statutory requirements and regulations through

accounting standards and by professional accountancy bodies, so that it could meet the decision needs of the various users. On the contrary, internal reports of cost accounting and management accounting do not adhere to any specific regulations such that the manager has freedom to determine their form, content, scope and frequency.

Time Span: While financial accounting is for specific period, usually a year, cost accounting and management accounting reports can be prepared at short intervals or adhocly to meet specific decision situations.

Currency: Financial accounting reports deals with historical effects and so retrospective but cost accounting is predictive or futuristic in nature.

Approximations and Estimation: Internal accounting approximates and even estimates when full information is not available because of the urgency demanded by their use. They are used to the bearest minimum in financial accounting reports which are desired to show a true and fair view of financial performance and position of the organization.

Appropriations: These are distributions of profits such as taxation, dividends and reserves and so are peculiar to financial accounting. They are not applied to internal accounting.

Duality Concept: This requires that every transaction must simultaneously have both debit and credit entries (double entry) which is essential to financial accounting but not compulsory in internal accounting.

Monetary Concept: Financial accounting reports are expressed only in monetary terms whereas internal reports are expressed both monetarily and non-monetarily.

Degree of Details: Cost accounting reports usually relate to certain sections of the organization's operations and are more detailed, whereas financial accounting reports usually cover the entire organization's operation but with less details.

SOME TYPES OF ACCOUNTING INFORMATION

Accounting information are different in nature and purpose. Some types of accounting information are given below:

1. **Financial Accounting Information**
   - Income Statement
   - Statement of Financial Position
   - Statement of Debtors
2. **Cost Accounting Information**
   - Cost Per Unit of a Product
   - Cost of Running a Department
   - Machine Hour Rate Statement
   - Operating Statement
3. **Management Accounting Information**
   - Budgets
   - Strategic Plans
   - Cash Flows
   - Performance Reports
   - Target Costs
   - Standard Cost

CS CamScanner

IMPORTANCE OF ACCOUNTING INFORMATION

Accounting information is very important because it speaks for the organization for which it is prepared. It gives the user to whom it is communicated knowledge about the organization that facilitates opinion making. It creates awareness. Specifically accounting is important for the following reasons:

1. **Behavioural Change:** Information creates awareness and so motivates to action which may result in attitudinal change. The knowledge of a company's profitability and the interpretation which shows higher future profits automatically prompts investors to rush for the companies share so affecting the foreign exchange market immediately. On the contrary, the report of losses conjure the fear of possible higher losses in future resulting in divestment which affect the stock market negatively.

   The communication of a company's budget compels the holder to quickly take measures to meet his/her own aspect of the budget.

2. **It provides a record of transactions** and so facilitates future reference. It thus facilitates credit dealings which obviates conflict between transacting parties. This engenders trust and enlarged business dealings.

3. ***It fosters entrepreneurship* and hence economic growth** as the existence of accounting information which facilitates stewardship reporting encourages people who have fund but lack managerial ability to invest in capital intensive businesses managed by persons who have the necessary business acumen. Accounting informs the diverse investor of how well their fund is being managed.

4. ***Enhances Organizational Efficiency:*** It provides reliable and timely information which facilitates planning and control, thus avoiding wastes and losses so facilitating organizational efficiency.

5. ***General Success of Organizations:*** Accounting information leads to better decisions and hence greater profitability and general business success.

CHARACTERISTICS OF MANAGEMENT ACCOUNTING INFORMATION

Management accounting information is generated to facilitate decision making by relevant managers. To achieve the desired effect, management accounting information must have the following attributes.

1. ***Completeness:*** The information must be sufficiently detailed to enable top managers to take decision without the need for additional information. Information which makes the decision maker to ask for more information is not information but a means to information.

2. ***Relevance:*** Accounting information must be relevant to the specific action being taken. It must be such information whose presence or absence will result in alternative decisions. For example in deciding whether to continue to use existing plant or buy a new one, the wages of the operators of either plant if they

do not change, will not be relevant to the decision even though they would be necessary as cost to be incurred in actual operation. If the maintenance cost would be higher with the old machine than the new one, it will be a relevant cost.

3. *Promptness:* The decision maker has a time frame within which to make his decision. Accounting information must be produced timely to impact the decision for which it was needed. If it comes later, it will not inform the decision maker and so would not be information for that purpose.

4. *Accuracy:* The purpose of information is to guide or influence decision. Information needs, therefore, to be accurate. For instance if a kilogramme of an input material cost ₦25 each and it was mistakenly recorded to have cost ₦52, the result would not be correct and would be misleading. It would also result in wrong future plan.

5. *Clarity:* Accounting information must be presented with clarity so as to facilitate quick understanding. The report must be clear and unambiguous and should be devoid of professional jargon. It must therefore be cognizant of the audience or receiver.

6. *Cost Effectiveness:* Information has value and is obtained at a cost. The benefit or ***gross value*** of information is the difference between the value of our decision when the information is used and the value of our decision without the information. The difference between the gross value of information and the cost of providing it is called the ***net value*** of information. Information will be of no use if it has no net value.

Self-review Questions

1. Define Accounting.
2. Give the AICPA (1961) as well as the AAA (1966) definition of accounting.
3. Can either of the accounting definition in 2 above be complete if standing alone.
4. Give a holistic or operational definition of accounting, and explain the essence of each of the component of the definition you have given.
5. Why is accounting said to be the language of business?
6. How has accounting developed to the stage it is today?
7. Identify those factors that have shaped accounting development.
8. Why is business environment significant in accounting development?
9. Identify the classes of accounting that evolve from accounting development.
10. How has the existence of the joint stock company shaped accounting development?
11. Define financial accounting and state its purpose.
12. Define cost accounting using the specific and holistic definitions respectively. Does the difference in the two definition signify a difference in the character of cost accounting? If not why?

CamScanner

13. What is the purpose of cost accounting? Give its distinctive features.

14. Define management accounting, using the specific and holistic definitions respectively.

15. What is the purpose of management accounting?

16. What is the scope of management accounting?

17. What do we mean by "management accounting is without boundaries"?

18. Give the place or relevance of the management accountant in organizations.

19. What are the main activities of management and how is management accounting relevant in those activities?

20. Financial accounting, cost accounting and management accounting are distinct classes of accounting. Do they share any commonality or relationship? How?

21. Identify the important areas where the three classes of accounting are different.

22. List the areas external accounting is different from internal accounting.

23. List three types of accounting information.

24. Explain the importance of accounting information.

25. Give the attributes or characteristics of accounting information.

26. Accounting information must be cost-effective. What do we mean by cost-effectiveness?

CHAPTER TWO

PLANNING

INTRODUCTION

Planning is the consideration of uncertain future events in the light of some objectives and the selection of the means of attaining those objectives. It is the detailed formulation of future actions for achieving a particular goal. Simply, it is deciding in advance what to do, why to do it, when to do it, where to do it and who to do it. Planning ensures that management is not a random but well thought out activity where objectives are carefully considered and the best alternative courses of action are taken to achieve them. Planning seeks optimum resource utilization by ensuring that the best objective is considered, the best means is selected to achieving the objective, and the best operator is employed on the best equipment and applies the best resource to implement the chosen means of attainment. This thus enhances efficiency and effectiveness in operation.

TYPES OF PLANNING

Plans can be classified in terms of their nature or their duration. There are a variety of plans by nature. They could be mission, objectives, strategies, policies, rules, procedures, programmes, and budgets. Each of these can be redefined in terms of their duration, and we would have long range plans and short range plans. There is no

general agreement as to what constitutes the long or medium range plans, but a majority take plan covering a period of between one year and five years as medium range term while plans stretching over five years are regarded as long range. Plans which are for duration of a few days to one year are regarded as short-range plans.

Short - range plans are also said to be operational plans. They focus, on the current period, usually a year or less, and generally cover subsections of the organization's operation such as sales, purchasing, production, distribution, financing, etc. They apply tactics for the attainment of their objectives. Characteristically they are fairly well defined, less risky and easy to control. They are important in that:

1 They facilitate the attainment of medium and long-range plans, and
2 They enhance competitive spirit.

Long-range plans are also known as strategic or corporate plans because they cover the entire organization's operation. On the other hand, their objectives are achieved by means of strategies, hence strategic plans. Because they are for the very long term, they are characterized by uncertainties; they are riskier than short range plans and are difficult to control. Corporate planning is important because:

1 It gives the organization insight

2 Enables the organization to identify long-term opportunities, manage long term resources, and know general trend especially, market demand.

3 It is the basis of the short and medium range plans.

CORPORATE PLANNING STAGES

Corporate planning consists of four main stages, which are position audit, objective setting, evaluation of strategies and documentation.

Position Audit Stage

This involves the assessment of both external and internal environment in what is generally called SWOT, so as to identify opportunities and threats as well as strengths and weaknesses which may facilitate or limit the realization of the planned objectives. In the view of Lucy (1996:92), the assessment stage includes the external environment, the organization, the future, and the expectations

1. **The External Environment** is assessed so as to identify the existence of opportunities in the economic, political, social, legal, technological changes, competitors' activities and infrastructural development, etc that can be exploited. Of course factors, which may hinder such exploitation, are also examined.

2. **The Organization** is assessed so as to determine its strengths and weaknesses in terms of resource availability such as men, materials, machines and money as well as its structure and culture. Consideration is given to whether the existing men can meet the manpower needs of the intended objective in terms of age, number, technical competence and culture or orientation. Would the fixed assets be adequate in terms of capacity and efficiency having regard to age, new technology, changing market demand, and competition? The financial feasibility also needs to be considered.

CS CamScanne

3. **The Future** is assessed in terms of what it holds for both the external and internal environment. The focus is "having regard to the prevailing premises what might the future be in terms of economic, political, social, technological and competitors' changes". They are difficult to assess but they could be very crucial to the long term effect of the plan.

4. **The Expectations of the Stakeholders** are analyzed so as to determine how their differing interests may facilitate or hinder the exploitation of the opportunities discovered in the environment. While employees' expectations usually include job security and better reward, customers expect quality, price, product availability and delivery. Very importantly, the shareholders expect higher profits, dividends and capital growth while the general public expectations focus on environmental and pollution matters as well as the organization's contribution to the social environment.

Objective Setting Stage

This is the crux of corporate planning and it involves the formulation of goals, which will enable the organization to take advantage of the opportunities discovered in the external environment. Objective gives direction to the plan. Drucker (1977:91) recognized eight *important areas where corporate objectives could be set. They include:*

a) *Market Standing - the organization's share of the market.*

b) *Innovation - variation of existing products, finding better use for existing products.*

c) Productivity - efficient use of facilities and personnel.

d) Physical resources - assets increase, replacement (reassignment.

e) Financial Resources - internal and external sources.

f) Human organization - motivation, training, replacemen reassignment.

g) Profitability - net worth, dividends.

h) Public (Social) Responsibility - provision of public faciliti such as roads and water, wastes disposal, environment pollution.

Impact of objective setting: Objectives, Drucker added, enable to do five things:

1. To organize and explain the whole range of busine phenomena in a small number of general statements,
2. To test these statements in actual experiences,
3. To predict behaviour,
4. To test the soundness of decisions while they are still bei made, and
5. To let managers at all levels analyze their own experience a improve their own performance.

The Evaluation Stage

This is concerned with the consideration of the best strategy f achieving the objectives. Strategies are essentially routes, method

schemes, or ways to achieving the objectives. While general strategies might include: new products, acquisitions, trade promotion, product restriction, change in management strategies, management personalities, etc, the three grand strategies are:

a. Expansion
b. Stabilization
c. Contraction

It is from these grand strategies that the sub or general strategies emerge. All possible alternatives are analyzed and a choice is made of that strategy which, in the opinion of management, is best likely to achieve the objective.

The Documentation Stage

Having chosen the best alternative, the detailed corporate plan is prepared and documented. This documentation is important as it includes all inputs into the plan, especially premises, objectives and alternatives (whether or not utilized in the plan) thus facilitating communication, implementation and control. They become very useful when reviewing the failure and success of the plan. Documentation should cover the following phases:

1. Review of previous plans, appropriate past and current developments, major successes, failures, structural changes, etc. to know how they may impact the current plan.

2. Environmental factors such as the economy, political, social-cultural, technological and competition which are seen to affect the plan should be identified.

3. The agreed corporate/subsidiary objectives which are pivotal to the corporate plan should be listed.

4. The agreed strategies for achieving the objectives, whether currently selected or not should be stated including time scale for achievement. This timing is essential because strategies that may be successful today, may fail tomorrow since it might be affected by different environmental factors.

5. The divisional and operational plans, which are required to support the various strategies and ensure their realization should be detailed. If there is a strategy for expansion, for instance, the various operational divisions must expand their scope of operation to realize the objective. Financial department would provide more fund, while the production department would be required to increase production to affect the expansion strategy.

6. The effect of the corporate plan on personnel should be stated and should include:
   a) Manpower projections
   b) Training and development programmes
   c) Recruitment, redeployment and retrenchment programmes

7. The effect of the plan on the organization's finances should be elaborately documented to show forecast operating statements, balance sheet, funds flow statement and capital expenditure programmes for each year of the plan period.

CS CamScar

Some writers add implementation and review as stages of planning. But they are essentially different operational activities. **Implementation**, for instance, is the process of putting the plan that has been made into action while review is another process or activity of ensuring that the implementation accords with the plan or if the plan needs to be changed or modified in some aspects. They should therefore not be regarded as stages in the planning process.

ADVANTAGES OF CORPORATE PLANNING

Corporate planning is important to organizations because of the following advantages:

1. **Direction:** Like every other planning, corporate planning gives direction to corporate operations thus ensuring that operations do not drift aimlessly.

2. **Clarification of Policies and Objectives:** The processes and discussions involved in setting corporate objectives clarify policies and strategies and actually provide the essential framework for realistic operational planning.

3. **Offsets Uncertainties:** Planning aids the accomplishment of future objectives. The future is seldom certain and the uncertainty increases with longer future period. By evaluating alterative courses of action, planning reduces the uncertainties in each step taken.

4. **Coordination:** Corporate planning enables the overall needs of the organization to be seen thus avoiding shortsighted concentration on operational activities. It particularly enables adequate attention to be paid to long term assets and projects, which have high values that should be protected.

5. **Gaining Economy in Operation:** Planning exposes weaknesses and compels improvement in the organization's information system. By ensuring that the best resource, method, technology and operatives are applied, planning enhances efficiency and effectiveness in operation.

6. **Motivation:** Planning has a psychologically motivational effect on staff, especially the top-level management, as it stimulates them to strive to achieve the objectives and targets of the plan.

LIMITATIONS OF CORPORATE PLANNING

Corporate planning is based on forecasts, judgments and assumptions about an increasingly uncertain future period. The accuracy or efficiency of the plan will depend on the correctness and consistency of the premises on which it was based. Inefficient forecast, poor judgments, insufficient or inaccurate information and changing premises will affect or limit the accuracy and effectiveness of the corporate plan.

PLANNING TOOLS

There are many tools or techniques that are used to facilitat planning. They include budgets, forecasts, cash flow projection network analysis, regression analysis, and cost-profit-volum analysis. These help to give form to plans and facilitat understanding.

Self-Review Questions

i. What is planning and why do people plan?

ii. How may planning be classified?

iii. Distinguish short range from long-range plans.

iv. What is corporate plan? List the stages of corporate planning.

v. Of what relevance are position audit, objective setting, evaluation and documentation to planning?

vi. What is position audit in planning?

vii. What is documentation in planning?

viii. Give the advantages of planning, especially corporate plan.

ix. Has planning any limitation? Discuss.

x. What tools do management apply in planning?

Examination Questions

2.1 In the area of business planning, it has been suggested that 'objectives' need to be thought of in terms of:

i. a central purpose;

ii. responsibilities which an organization has its many stakeholders; and

iii. a field of activities within which the organization intends to operate:

a) Illustrate the extent to which a changing environment makes an impact upon 'objectives' thought of in this way.

b) Give three examples, with appropriate detail, of how 'happenings in the environment might change such objectives.

CIMA

2.2 Lack of co-ordination between strategic planning and operational planning may result in *unrealistic plans, inconsistent goals, poor communication and inadequate performance measurement.* Explain.

a) State key features or characteristics, which should be incorporated in each of strategic planning and operational planning.

CamScanner