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ACCOUNTING

MANAGEMENT ACCOUNTING | BASIC

Video Transcription: Demystifying Management Accounting



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Hello, welcome to the management accounting videos.

It is important to your success in this discipline to understand why management accounting exists – why are you studying it? More importantly, it is crucial to your success as a future financial manager and chief financial officer, to understand what management accounting is.

Consider the following companies: MTN, Apple, Woolworths, SAB, Pick n Pay. What do you think about when you consider these companies? I think about success. The one thing that these companies have in common is sustainable success. They have been very successful and they have managed to sustain that success for a long time. Sustainable success is a function of good corporate governance, risk management and strategy.

This video aims to show how management accounting is an integral part of the process of ensuring that a company is sustainable.

Consider the following scenario.

The managers of the company are deciding whether to launch a new product. They estimate that they will invest R100 million in a production facility, where the product will be made. The managers also need to decide at what price the product should be sold.

So how do you think managers will make these decisions? Do you think they will just go based on their own feelings? It feels right that the product is a good product and therefore, they should go ahead? Or how would they decide on a price? Would it just be a thumb suck? I hope not.

Companies have to make similar decisions on a daily basis and these decisions affect the sustainability of the company. In order to make these decisions, managers will need as much relevant information as possible, to show them how the company's sustainability will be affected by these decisions.

For instance, investing in that production facility. We will have a look at a long-term profitability of the product before we make that decision. And, in terms of the pricing of the product, we will also consider how much it will cost to produce that product, what the demand for that product is, and what the market wants to pay for that product.

Management accountants are those who prepare the information for the managers and help them make the decisions. Management accountants assist in creating value and ensuring sustainable success by providing information and analysis that underpin sound decision-making. Supporting organisations in planning, analysing strategic decisions and controlling the execution of their strategy, do this.

You can see that understanding strategy is a very important part of being a management accountant. It is also useful to, at this point, emphasise that the information is provided to the people within the organisation. This is different to financial reporting and what financial accountants do. They prepare information for the users outside of the organisation.



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Notice that management accounting operates within the confines of creating value and ensuring sustainable success. If we were to use the metaphor of a building, ensuring sustainable success would be the role of the roof and creating value would be the function of the foundation. We know a solid foundation is the most important part of a building, if there are flaws or cracks in the foundation, this jeopardises the whole structure. In the same way, if you do not understand that creating value is the primary objective of a management accountant, you will struggle to make sense of the discipline. Value needs to be created for both the shareholders as well as other stakeholders.

Shareholders provide capital to the business, which is used to fund operations and capacities. For this, a shareholder expects a return. So, companies need to quantify the effect of decisions and identify whether the decisions will result in a sufficient return to the shareholders. The other stakeholders of the company include employees, customers, suppliers, the public and government, and these should also be considered. Maintaining a healthy relationship with these stakeholders is essential to the sustainable success of a company.

For a management accountant to assist in the decision-making, they need to provide relevant information that can be analysed. This data will include both financial information and non-financial information.

Financial information includes both costs and revenues; therefore financial information can be quantified. In fact, understanding costs within a company is a crucial function of the management accountant. It is the function that underpins all other functions. You need to understand where costs are being incurred, what the drivers of costs are, in other words, what causes costs to increase and decrease, and you need to know when costs are included in a report and when they are excluded from a report.

The non-financial information under consideration will impact decision-making but cannot be quantified. This will often be about how other stakeholders are affected. An example would be to consider how employees would feel about a division being closed; some of them will lose their jobs. How will this affect the community and the employees staying at the company? Or if we were to outsource the production of a component, how will this affect the quality of our product and how will customers react to it?

We can see that management accountants assist in creating value and ensuring sustainable success of a company. This is done through the use of a number of tools to analyse data and generate insight, which will be communicated to the managers making the decisions. This process requires skills such as problem solving, analytical thinking and critical thinking. These are the tools we will teach you in management accounting. They are organised according to their function: planning, decision-making and control.

Here are some examples of tools used by managers and examples of the types of decisions they will assist in making.

For the planning function, we have budgeting, which helps us to decide whether we need financing, and it also helps us to decide how many units we should produce to meet the demand.



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Under decision-making, we have a tool called relevant costing. We use this tool to decide, for instance, whether we should close a division or whether we should outsource the production of a component. Another decision-making tool is cost-volume-profit analysis. This helps us to decide how many units we need to produce to cover all our costs.

Under the control function, we have a tool called performance evaluation. This helps us decide whether we should pay a manager a performance bonus, and helps us to see what our actual costs were, compared to what our budgeted costs were.

Management accountants assist in planning, strategic decision-making and controlling the execution of strategy. They have a very important part to play in whether the company is sustainable and whether the company is successful. It is a very exciting discipline just for that reason, and it is interesting and it is challenging and I hope you are excited to learn more about it.

Thank you for watching.