

## Costing

A costing system is a set of processes, controls and reports that are designed to record, classify and allocate costs to different elements of a business. This includes customer groups, departments, processes, products, services, facilities or geographical locations.

### The purpose of costing:

- To record costs
- To control costs
- To price products
- To value inventory
- To aid decision making

## Types of accounting

Whilst most accountants will carry out a diverse range of duties and cover a number of different areas of responsibility, there are three types of accountants with clearly defined roles:

### Management accountants

- Assess internal accounting information
- Provide a basis on which management decisions can be made
- Focus on improving future performance

### Financial accountants

- Often external to a company
- Ensure compliance with financial and accountancy regulations
- Focus on the recording of financial transactions

- Summarise information in the financial statements
- Provide external parties with a view of the business's financial performance

**Cost accountants**

- A sub-category of management accounting
- Focused on the recording, classification and interpretation of costs
- Provide data for management accountants to base their analysis on
- Help facilitate improved cost control

**Key differences between accounting types**

	<b>Management accounting</b>	<b>Financial accounting</b>	<b>Cost accounting</b>
<b>Focus</b>	Broad, forward looking focus on future decisions	Historical focus on past transactions and results	Narrow focus on cost calculation, control and reduction
<b>Basis</b>	Financial and non-financial information	Actual financial information on past performance	Both past and present cost information
<b>Demographic</b>	Management and decision makers within the business	External parties: shareholders, creditors and public regulators	Internal management and management accountants
<b>Construction</b>	Format depends on the needs of the user	Set formats inline with accounting standards	Format depends on the needs of the user
<b>Availability</b>	Confidential	Publicly reported	Confidential

## Definition

### CIMA Definition of Management Accounting

"The application of the principles of accounting and financial management to create, protect, preserve and increase value for the stakeholders of for-profit and not-for-profit enterprises in the public and private sectors."

## Planning, decision making and control

The key processes that management are involved in are planning, decision making and control.

### Planning

The planning process concerns setting the direction and objectives of the business and can be short-term (tactical planning) or long-term (strategic planning).

During the planning process a business will use a mission statement to help set effective goals and objectives.

### Decision making

Decision making involves selecting the best path towards the realisation of the plan's objectives, using relevant and reliable information to facilitate the process.

### Management accounting techniques that can be applied to tactical decision making:

- **Budgeting** – To help with planning and cost management
- **Variance analysis** – To help with spending decisions
- **Forecasting trends** – To plan for the future
- **Investment appraisal** – To analyse financial implications of future decisions
- **Product costing** – To assist in pricing decisions

## Control

Control centres around using regular feedback to compare the expected results to the actual outcome. This allows management to assess whether objectives are being achieved effectively, to reassess the original plans and make changes to improve performance.

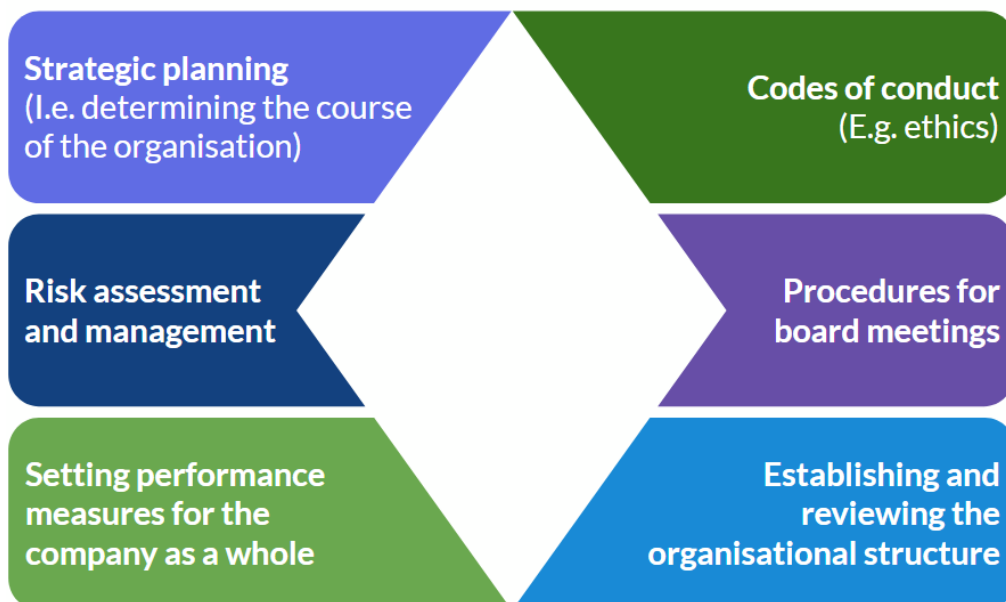
## Levels of management, planning and control

In organisations, there are different levels of management; strategic, tactical and operational. These decision-making levels can also be used to distinguish the organisational control levels:

### Strategic control

Control operating at board level, focussed on long-term decision making and setting the control environment as a whole. Controls at this level include:

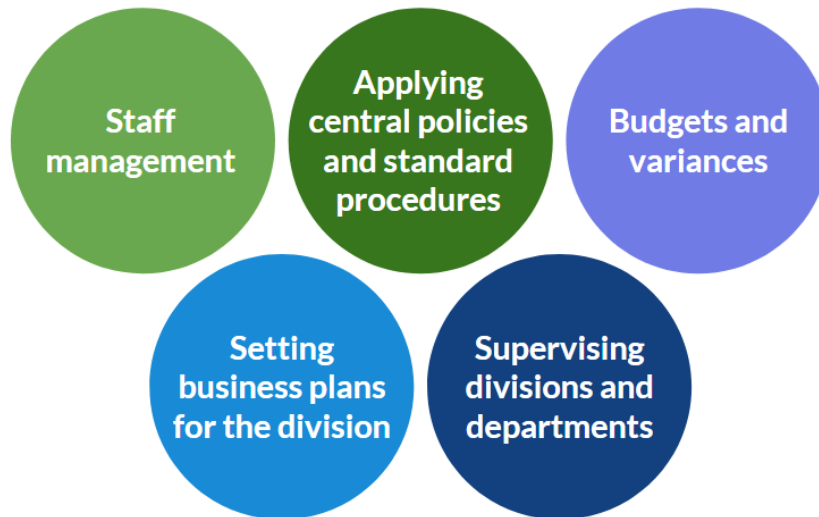
### WHAT DOES STRATEGIC CONTROL INCLUDE?



## Tactical control

Control at the middle management level of the organisation which is focussed on making short-term decisions related to divisional business units. Controls at tactical level include

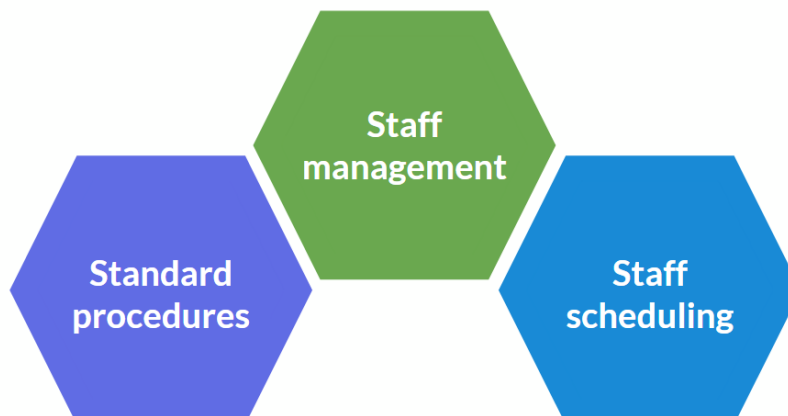
### WHAT DOES TACTICAL CONTROL INCLUDE?



## Operational control

Control at the lower levels of an organisation, designed to control structured and repetitive activities according to pre-set rules. Controls at this level include:

### WHAT DOES OPERATIONAL CONTROL INCLUDE?



## Control and the management accountant

Management accountants support control activities by providing decision makers with relevant information, such as budgets of competitor analysis, against which the success of strategic objectives can be measured.

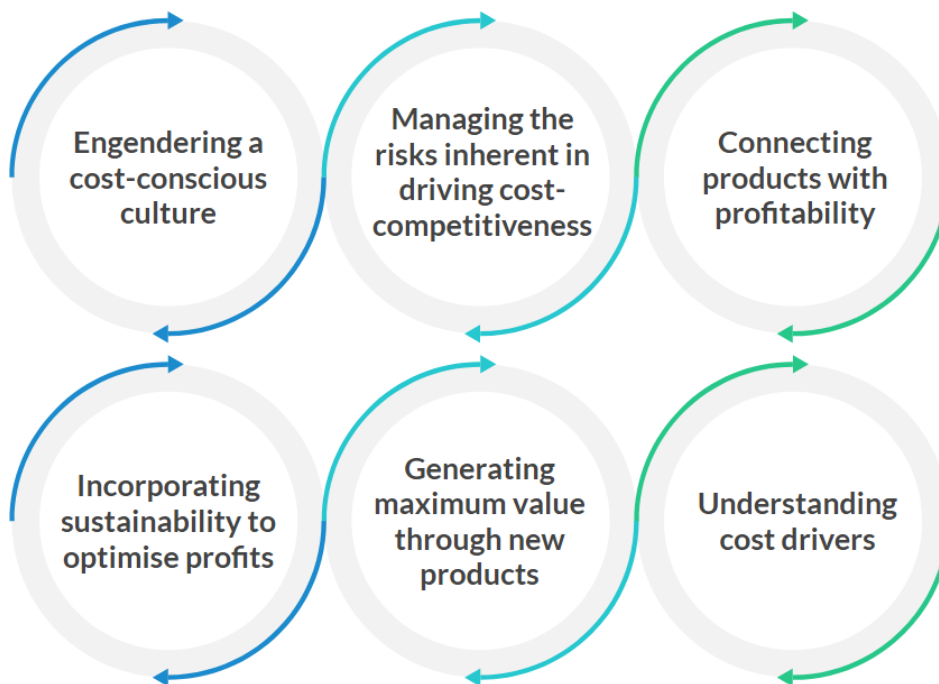
## Cost transformation and management model

The cost transformation and management model is a practical planning and control tool that has the ultimate aim of helping businesses to achieve and maintain cost-competitiveness.

### The model

The model is made up of six interrelated areas that when viewed as a set, will help organisations achieve and maintain cost-competitiveness in the long-term.

## COST TRANSFORMATION AND MANAGEMENT MODEL



## **Engendering a cost-conscious culture**

To be successful cost-competitiveness must be a key focus for a business and the value the company provides to its customers must be enhanced and preserved.

Employees must be aligned to the organisation's purpose and the business must be agile, with staff that are able and willing to respond.

### **How is this achieved?**

- Making cost transformation and management an integral part of the strategy
- Supporting, enabling and motivating staff to deliver the company's objectives
- Identifying capability gaps and understanding how these can be overcome
- By viewing change as a continuous process
- Utilising tools such as Porters 5 Forces, the balanced scorecard and Kaizen costing

## **Managing the risks inherent in driving cost-competitiveness**

Understanding the factors that have the potential to prevent a business from achieving its cost transformation and management goals.

### **How is this achieved?**

- Using tools to analyse opportunities and associated risk
- Considering a businesses resources to withstand risk
- Defining how willing management are to expose the business to risk
- Utilising tools such as Enterprise Risk Management (ERM) and risk heat maps

## **Connecting products with profitability**

Understanding the value a company's products and services generated for its customers.

### How is this achieved?

- Analysing profitability of products and services
- Analysing profitability of different customer groups
- Forming strategies to maximise profitability
- Utilising tools including Kotler's five product level model

### Generating maximum value through new products

New products and services should be designed with an element of flexibility so they can be adapted without sacrificing the profit they are able to contribute.

### How is this achieved?

- Involving all relevant stakeholders in the early stages of new product design
- Encouraging creative, development and production functions to collaborate
- Considering price and margins before production begins
- Understanding customer wants and needs, including price and demand
- Using tools such as Target costing and Product Family Master Planning (PFMP)

### Incorporating sustainability to optimise profits

A business needs to consider the impact its operations has on the planet's natural resources and must take steps to protect the future availability this natural capital.



### How is this achieved?

- Including sustainability practices in the strategy
- Outlining the general approach and measures to be taken
- Implementing these practices across all areas of the business and its supply chain
- Life cycle costing and environmental management accounting

### Understanding cost drivers

Successful implementation of the model is dependent on decision makers having access to the right information. A business must keep comprehensive records and have in place the necessary reporting systems and processes.

### How is this achieved?

- Critical evaluation of systems and processes, ensuring they continue to support effective decision making
- Planning for the future needs of decision makers, considering the future business model, future plans and strategies
- Using tools including Activity Based Costing (ABC), Activity Based Budgeting (ABB), Lean production, beyond budgeting and Value Chain Analysis (VCA)

## Stop!

### By this stage you should know:

- What the purpose of costing is
- Why businesses utilise costing systems
- Three different types of accounting and the characteristics of each
- The importance of planning, decision making and control within a business
- How strategic, tactical and operational control differ
- Which tools and strategies can be used to achieve cost-competitiveness

### Got it?

If not, go back and re-read the study text before moving on.

## Question Time

It's now time to practise questions.

If **you've signed up** for our practice questions or are on our fully inclusive course, here's a direct link to questions for this chapter:

[Go to Practice Questions](#)

If **you want to sign up** for our practise questions here's where you will find more details:

[Sign Up for Questions](#)