Chapter 01: Section 02 Part I

Strategic Management Accounting Techniques

Learning Outcomes

Leaning outcome	Techniques
Examine the principles of **modern management accounting techniques** and Their effectiveness in **optimising business processes and cost structures** to suit organization's strategic objectives	Modern Manufacturing Techniques • Activity Based Management • Process Reengineering • Life cycle costing • Target costing
Examine the application of techniques related to continuous improvement and Their role in enhancing organisational agility and reducing waste.	Continuous Improvement Techniques • Kaizen costing • Learning curve model • JIT principles
Examine advanced management accounting techniques and How they facilitate quicker strategic adjustments and improve financial performance	Advanced Management Accounting Techniques • Throughput Accounting • Blackflush Accounting

Modern Management Accounting Principles

1. Activity Based Management (ABM)

- Traditional costing: cost allocated using simple volume based measures
- ABM: Dividing the operation into activities and assign costs to the identified activities that will enable accurate costing and operational improvement
- Activity Based Costing (ABC): Is a sub category of ABM that deals with overhead costing. Following are the terms of ABC.
  - Activities: Different activities or functions of the company
  - Cost Pool: The cost under different activities
  - Cost driver: A factor that causes a change in the cost of an activity
  - Cost per driver: Cost pool divided by relevant cost drivers. Used to assign cost to products and manage efficiency.

1. Activity Based Management (ABM)

Process in ABM

1. Identify activities
2. Create activity cost pools
3. Select cost drivers
4. Allocate costs to products
5. Evaluate value adding and non-value adding activities
6. Identify improvement opportunities

1. Activity Based Management (ABM)

- A company produces two products (Basic and Premium) and the budgeted overhead for the month is Rs 1,100,000 with 110,000 machine hours. Other details are as follows.

	Basic	Premium
Prime Cost	200	300
MH per unit	10	20
Number of units	5,000	3,000

The company is moving on to ABM and obtained the following details to practice ABC.

1. Activity Based Management (ABM)

Activity	**Cost Pool**	**Cost Driver Details**			
		Cost Driver	Total	Basic (No of Cost Drivers)	Premium (No of Cost Drivers)
Manufacturing related OH	770,000	Machine Hours	110,000	50,000	60,000
Packing Related OH	330,000	Labour Hours	150,000	75,000	75,000

Calculate cost per unit of Basic and Premium products under traditional method and ABC.

1. Activity Based Management (ABM)

Benefits

Accurate costing
Better pricing
Better product mix
Enhances efficiency
Identify non value adding activities

Limitations

Complexity in implementation
Costly to implement
Time requirement
Subjective choice of cost drivers
Benefits could be lower than costs

Practice Questions: 1 and 2

2. Business Process Reengineering

- Radical redesigning of processes to achieve dramatic improvements in performances

Benefits
Improve cost, quality, service and speed
Rethink existing processes
Breaks down functional silos
Align processes with strategic goals

Limitations

High risk – high reward initiative
Possible resistance from employees
Risk of failure without executive support

3. Life Cycle Costing

- Traditional method: Ignored costs of design, development and disposal.
- Life cycle costing: Capturing costs from all the stages of the product including design, development and disposal.

Benefits
Improve capital investment and product design decisions
Leads to more sustainable and financially viable decisions

Limitations
Forecasting costs will be problematic or inaccurate
Data collection could be expensive or time consuming

3. Life Cycle Costing

Process in Life Cycle Costing

1. Estimating Total Life Cycle Costs
2. Applying Discounted Cash Flow Techniques
3. Conducting Sensitivity Analysis

3. Life Cycle Costing

Discounting Cashflows

Future value of CF = Present Value of CF x $(1+r)^n$

Present Value of CF = Future Value of CF x $\frac{1}{(1+r)^n}$

r = return per time period

n= number of time periods between Yo and future CF

Practice Questions: 3 and 4

4. Target Costing

- Arriving at the target cost by determining the feasible market price and subtracting the expected profit margin. The product designing will then take place to match the target cost

Benefits
Market driven approach
Focuses on cost
Promotes cross-functional collaboration
Encourages innovation in cost reduction

Limitations
Exert extreme pressure on design team
Might compromise quality and creativity
Heavy reliance on reliable market intelligence

4. Target Costing

Target Costing Process

1. Determine a Competitive Market Price
2. Establish a Target Profit Margin
3. Calculate the Allowable Cost
4. Achieve the Target Cost

Practice Questions: 5

Cost Behaviour and Breakeven Analysis

- Analysing cost behaviour helps an organization categorize the variable and fixed cost
- This will enable to make short term decision making
- Breakeven analysis is one aspect of S/T decision making where it demonstrates the point where there is neither profit nor loss
- Breakeven can be calculated as number of units or sales revenue

Cost Behaviour and Breakeven Analysis

High-Low method can be used to categorise variable and fixed cost

Total Cost = Total Variable Cost + Total Fixed Cost
Total Cost = (VC per unit x # of units) + Total Fixed Cost

Break even units = Fixed cost / Contribution per units
Break even revenue = Fixed cost / CS Ratio

*CS Ratio = Contribution / Sales

Practice Questions: 6 and 8

Net Present Value (NPV) and Profitability Index (PI)

NPV= Present Value of Cash Inflows – Initial Cash Outflow

PI = Present Value of Cash Inflows / Initial Investment

NPV: Higher the better

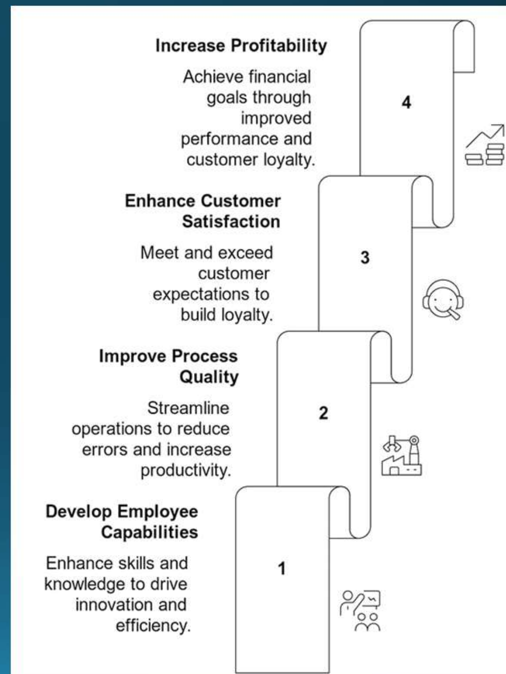
PI: Should be more than 1 and higher the better

Practice Questions: 9 and 10

Strategic Alignment and Optimization

1. Developing a Strategy Map

Strategy map is a the visual representation of the Balanced Scorecard



2. Analyse cost structures to see whether it reflects the strategic choices

Ex: Objective to be market leader - Higher proportion of marketing cost

3. Strategic resource allocation – Prioritizing products and projects using Lifecycle Costing, NPV and PI

4. Link management accounting function as a tool to add value

5. Cascade strategy to operational levels

Implementation Excellence and Change Management

1. Assessing Implementation Readiness: Poor preparation leads to project delays, budget overruns, and outright failure
2. Manage stakeholder engagement
3. Building organisational capability
4. Establishing governance structure
5. Develop communication and resistance management strategy
6. Mentoring and Knowledge Transfer