

Research Article

ROLE OF MANAGEMENT ACCOUNTING IN PLANNING PROCESS

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ABSTRACT

Aim of accounting is to communicate economic information in such a manner that allows users or receivers to take decisions. It can involve managerial accounting that manages this information for internal users or financial accounting that concerns with information requirement of external business users like customers and other stakeholders. Thus, accounting process is useful in assisting management in taking decisions that are financially viable and profitable. The information provided to the management decision makers would be used by them to formulate operational plans for the organization. High level planning is possible with budgeting system using management accounting such that control may be established over planning mechanisms. This paper explored the role management accounting plays in the process of planning. Various ways management accounting can be used in the planning process include investment planning, budgeting, evaluation of strategic operations, modeling of future performance and establishing of budget expenditure or project schedule. With accounting practices used for decision making and planning, all the individual components and plans can be aggregated to form a complete business plan considering all financial requirements and achievements. The report begins with the introduction to the management accounting practice and the use of the same in the planning process. Further, it illustrated the need for having the management accounting in place. Moreover, it included literature review on accounting practices which would explore the control and decision making through accounting, understanding relationship between two forms of accounting, understand planning processes and explore various tools that can be used for planning under the purview of management accounting. Various planning processes that are explored in this research are related to product, cost, price and marketing. The report would be useful in understanding how accounting can be assisting organizations in managing control and decision making while building strategic plans.

Keywords: *Financial Accounting, Management Accounting, Planning, Decision Making, Control, Strategy, SWOT, PEST*

INTRODUCTION

Overview of Management Accounting in Planning Process

Management accounting can be used for making plans related to product, cost, price and marketing. New product design and development process is crucial to the success of a new product and it can be augmented by the information generated through the use managerial accounting such that right decisions on product development can be made (Holst, 1997).

For an organization to survive in the modern competitive world, it is important to have a steady flow of new and improved products which demands significant amount of investment (CGMA, 2013). At the same time, investments come with the risk of low-margin pressures. Trade-offs has to be faced between adequate investments and risk of losses. An insufficient investment may lead to loss of an opportunity while over expenditure can lead to losses. An appropriate investment decision is thus, required to be taken to have a balance between the two tradeoffs which can be done using managerial accounting (Nixon *et al.*, 2011). While use of management accounting for costing and pricing decisions is obvious, the use of accounting procedures and information for making marketing efficient is a widely accepted practice as marketing takes a significant chunk of budget in any organization and thus, while creating a marketing plan, how the marketing plan would affect the costs and investments done by the organization is important to understand which is made possible with the use of managerial accounting (Business Performance Management, 2008).

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Need for the Study

Planning is a process that involves forecasting of activities that would be performed in order to achieve strategic objectives of a business (Teece *et al.*, 1997). It can be done for a short term or for a long term. Management accounting can be useful in taking appropriate decisions on such short term and long term planning by providing accounting information such that future plans can be created (Teece *et al.*, 1997). Decisions like what products to be sold, what markets to be targeted and how much to spend on marketing can be made using accounting information such that future plans can be made efficient. Such plans are mostly long term (Teece *et al.*, 1997). However, management accounting can also be very useful in short term planning. For instance, budgets may be prepared using accounting information for allotment of funds for immediate activities already planned as a part under the long term plan of an organization (Bufan, 2013). Long term plans are often converted into short term plans at later stages when execution starts such that a general plan may be made for whole business. Use of accounting in planning can ensure that this holistic plan can be executed within that allotted budget for the long term plan created earlier (Clarke *et al.*, 2001). Thus, understanding how accounting is used for planning is crucial to ensure that the plan is able to attain business objectives and has positive impact on its financial performance. The feasibility of any actions that are part of plan can also be judged by exploring its impacts on the financial performance of the organization which can be made possible with the use of management accounting.

Aim and Objectives

Aim of this study is to understand the role management accounting plays in control and decision making in the planning process in an organization. This aim can be fulfilled with attaining following research objectives:

- To understand fundamental principles of management accounting used for controlling and strategic decision making.
- Understanding management and financial accounting and establish relationship between them.
- Understand the process of planning involving products, pricing, costing and marketing.
- Understand how management accounting can be used for making plans in planning process for products and marketing.
- Identify and explore various management accounting tools that can be used for planning processes.

Literature Review

Management Accounting in Control and Decision Making

Management accounting is mostly used in planning processes for assessing future strategies such that future goals can be formulated for achievement of strategic objectives. It may involve decisions on adoption of production system in case of a manufacturing unit, establishing of pricing or trading policy for an export unit, and decisions on capital investments in case of any business while planning for new product launch or new market entry (Nixon *et al.*, 2011). Management accounting also helps in establishing control over processes by verification of the ongoing processes on whether they are able to achieve the objectives as formulated in the plan. This involves assessment of actual performance in comparison with the goals set in the planning process. This control is important to establish as it would ensure that the plan achieves its objectives as desired (Breuer *et al.*, 2013).

Relationship of Management Accounting and Financial Accounting

Management and Financial account are both key systems in accounting information systems and both deals with organization's financial measure like expenses, revenues, assets, liabilities, cash flows and so on. Financial statement development is a part of process of accounting in both areas. Both disciplines are similar except that they have difference in their audience (Breuer *et al.*, 2013). While management accounting provides accounting in information to internal users for decision making, planning and control management, financial accounting involves disbursement of information to various external stakeholders in including external investors through company stocks, customers and creditors (CIMA, 2016). Financial accounting involves creation of a company scorecard that may be used for assessing the performance of the company in the market (Nixon *et al.*, 2011). Financial accounting is a mandatory accounting

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procedure that has to be adhered to by all the organizations but management accounting is more of a choice that can be made to support the management with financial information such that appropriate decisions can be made to remain profitable. There are no specified formats used in management accounting as available for financial accounting. While financial analysis can be used both by internal and external users, the management accounting information is only for the internal use (Singh, 2008). Another difference is in the way reports are presented such that the reporting is made brief in financial accounting while management accounting usually involves a very details analysis to be made (Richardson, 2002).

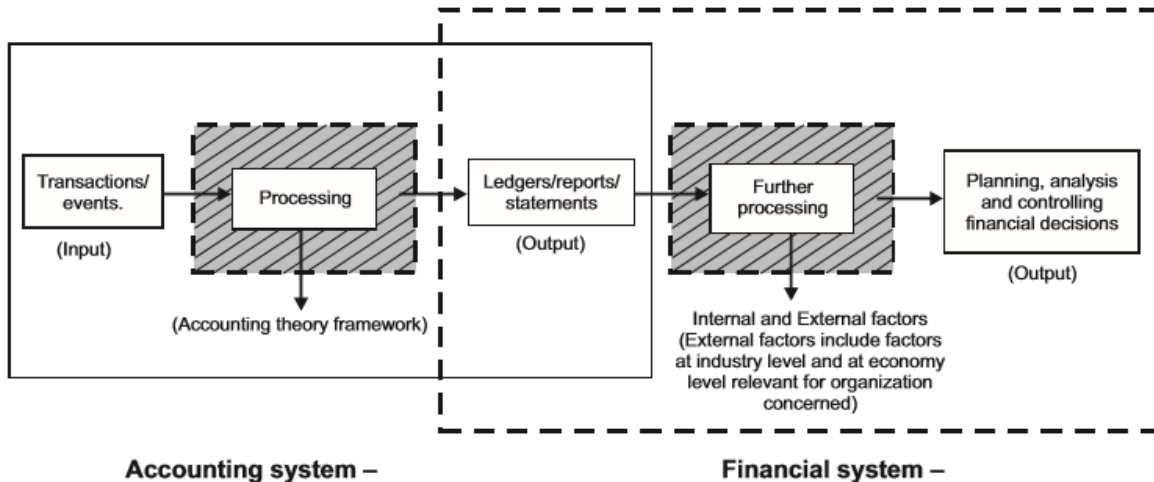


Figure 1: Accounting and Financial System

Source: Singh, (2008)

Financial accounting has been dominating management accounting and there have been disputes in making decisions on which one to use in practice by organizations or where the two disciplines connect (Nixon *et al.*, 2011).

However, connect has been seen between the two disciplines through the accounting system which is used by both. The reporting procedures that are the output of accounting system are used for the financial system and management accounting system. While financial system processes it further to develop standard accounting statements or reports, management accounting processes use these reports for decision making, planning and establishing control procedures in management (Martin, 2000; Breuer *et al.*, 2013).

Management accounting further provides certain tools that may be used for making various types of decisions for the organization and these tools may include financial statements, cash flows, fund flow analysis, ratio analysis, various analyses and budgeting (Breuer *et al.*, 2013). Decisions that are made can be short term called working capital decisions or long term that involve capital budgeting. Financial accounting helps maintain records of performance scores, and other information that may be used for directing and problem solving, the same information is processed in management accounting to develop reports or metrics that can be used for taking financial investment and dividend related decisions. Accounting system generates information that is utilized by the two disciplines in different ways (Mauriello, 1951).

Overview of Planning Processes

Planning processes involves decisions to be mad in primarily four categories that include product, price, cost and marketing. Plans can be made for new product designing, for marketing or for taking appropriate decisions on investments and deciding appropriate pricing for competing in the market and at the same time remaining profitable (Radev, 2014). Such decisions on various fronts are important for an

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organization and management accounting can be used for contributing to such planning processes (Burnett, 2008).

Product Planning: There can be 6 different types of products that include products that are new to the world, new product lines for new market entries, revisions or other forms of improvements in existing products, repositioning of same product, and cost reductions in production (Kotler, 1997). A portfolio approach is usually taken by organization to take decisions on what type of product to be launched and in which market. This method allows a company to take decisions on planning not just a single product but an entire range or multiple products under one brand (Radev, 2014).

Cost and Pricing: Business planning usually involves taking decisions on where to invest and how the generate revenues. Thus, business plans have costing and pricing components in it. They could include information on purchases, pricing options, quantitative discounts for customers, coupons, deals, offers, contract rates, and so on (Local Government Association, 2012; Radev, 2014).

Marketing Plan: A marketing plan includes collection of information on the external and internal environment of an organization such that major strengths as well as weaknesses can be identified (Papulova & Papulova, 2006). Based on this information, some assumptions regarding success potential of marketing efforts are made. Further, organizational objectives of marketing are formulated and plans and programs are formulated that would ensure attainment of the objectives. Marketing plan also involves recording of progress metrics such that the progress of plan can be reviewed over the time after the implementation of marketing plan (Radev, 2014).

Tools Used for Management Accounting in Planning Process

Some management accounting tools that are prominently used by accountants include strategic scorecards, Enterprise Risk Management, and strategic planning tools like Mission and vision statements, SWOT analysis, PEST analysis, balanced scorecard, strategic mapping, porter's five forces analysis, KPIs, benchmarking, performance prism, forecasting, activity based costing, contingency planning, scenarios, cash flow modeling, lean tools, quality management tools like TQM and sig sigma, value chain analysis and customer relationship management (Armitage & Scholey, 2007; Nixon *et al.*, 2011).

For the strategic planning, key tools that are used by management accountant are vision and mission statements that are developed to establish a business objective and guideline for the professional principles to be used by the organization and mission statements that involve development of pathways for achieving the vision. SWOT analysis is used for identifying organization's strengths including resources and organization capabilities, weaknesses that include limitations and constraints, likely threats and available opportunities (Ehmke & Akridge, 2005; Breuer *et al.*, 2013).

While SWOT analysis helps an organization understand internal environment of the business, PEST analysis is used for assessing external environment of the company that is affected by political, economic, social and technological aspects. When these planning tools are used, they help an organization determine priorities, efficiently allocate resources, and align employees' objectives with companies' objectives through formulation of vision and mission statements (Martin, 2015).

Discussions and Conclusion

This study discussed concepts of financial and management accounting including understanding of differences and relationships between them. Further, it was found that management accounting is used for internal decision making of organization used the same accounting resources as used in financial accounting but there are differences majorly in the audience.

Moreover, financial accounting is a mandatory procedure but management accounting can be used as a choice for management decision making. The report targeted in understanding how management accounting may be used for making decisions on planning processes involving decisions on products, pricing, costs and marketing.

It was found that there are many accounting tools available that can be used by organizations with some targeted to strategic planning such as vision statements, mission statements, SWOT analysis and PEST analysis. These tools can be used by management accountants for planning and allocating resources, determining business plan priorities, and aligning employees towards organizational objectives.

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Though management accounting is not a mandatory practice but it can be very useful for an organization while building plans for its products and for marketing as it uses financial and accounting information for delivering reports that can be used for making decision in such a way that they remain profitable for the organization and are aligned with their business goals.

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