ACCA Diploma in Financial and Management Accounting (RQF Level 3)

Paper MA2

Managing Costs and Finances

STUDY TEXT

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INTRODUCTION

This is the new edition of the FIA study text for MA 2 – *Managing Costs and Finances,* fully updated and revised according to the examiner's comments.

Tailored to fully cover the syllabus, this Study Text has been written specifically for FIA students. A clear and comprehensive style, numerous examples and highlighted key terms help you to acquire the information easily. Plenty of activities and self-test questions enable you to practise what you have learnt.

At the end of most of the chapters you will find practice questions. These are exam-style questions and will give you a very good idea of the way you will be tested.

THE EXAMINATION

Format of the examination

	Number of marks
50 objective test questions	100

Computer Based Exam (CBE)

The syllabus is examined via an on-demand CBE. The exam will contain 50 questions. Each question is worth two marks each and can take one of four formats:

- multiple choice questions (this is where a candidate must choose one of four options, A through to D)
- multiple response questions (this is where the candidate must select more than one response from the options provided by clicking the appropriate tick boxes).
- multiple response matching questions (this is where the candidate must match together related items. For example, statements on activity based costing might have to be categorised as either TRUE or FALSE)
- number entry questions (this is where the candidate will be provided with an on-screen box into which he/she must enter the correct number)

The ACCA provide the following guidance for attempting questions in the CBE:

- Read each question carefully.
- When you answer a question, your answer will automatically be saved.
- You can revisit questions and change your answers at any time during the exam.
- The only permitted characters for numerical answers are:
  - Numbers
  - One full stop as a decimal point if required
  - One minus symbol at the front of the figure if the answer is negative. For example: –10234.35
  - No other characters, including commas, are accepted

Questions assess all parts of the syllabus and will include both computational and non-computational elements.

Pass mark: 50%
Total time allowed: 2 hours

Tips for sitting CBEs

The ACCA have provided the following advice for sitting a CBE:

In a CBE you are presented with one question at a time. Displaying only one question at a time helps you focus on each question. Research tells us that the way we read information presented on a computer is different to how we read on paper. On the computer our eyes tend to jump around the screen rather than read it systematically as we would a printed page. Remember to take time to read the question carefully to ensure you don't miss any important information. Once you have entered your answer for a question, it is important to click on the 'Submit' button for your answer to be saved. You can revisit questions and change answers at any time until the exam duration has been reached – however, remember to click on 'Submit' to save your new answer once you have changed it.

Do not spend a lot of time on questions you are unsure of; instead, move on and come back to these questions at the end of the exam.

To make CBEs as user-friendly as possible we have incorporated features that will guide you through the exam. Part of the screen has been reserved for tools that will help you navigate between questions. In addition, questions that you have not attempted will be highlighted by an asterisk in the drop-down list of questions and you can quickly move to these questions by clicking on the relevant question number in the list. The exams also include a timer to show you how much time is remaining.

Preparing for the exam

- You can take a CBE **at any time during the year** –the exams are conducted at centres which are licensed by ACCA and there is lots of flexibility as to when the exam can be attempted.

- Be sure you **understand how to use the software** before you start the exam. If in doubt, ask the assessment centre staff to explain it to you. **Questions are displayed on the screen** and **answers are entered using keyboard and mouse**.

- Don't panic if you realise you've answered a question incorrectly – **you can always go back and change your answer.**

- Read the questions carefully and work through any calculations required. If you don't know the answer, eliminate those options you know are incorrect and see if the answer becomes more obvious. Remember that only one answer to a multiple-choice question can be right!

- At the end of the examination, **you are given a certificate showing the result** you have achieved.

Chapter 1

MANAGEMENT INFORMATION

This chapter describes the nature and purpose of management information, and the use of accounting information within a management information system. It also describes the use of responsibility accounting, with cost centres, profit centres and investment centres, and the role of IT in the provision of management information. This chapter covers syllabus areas A1.

CONTENTS

LEARNING OUTCOMES

At the end of this chapter you should be able to:

- describe the purpose of management information: planning, control and decision making
- describe the features of useful management information
- describe the nature, source and importance of both financial and non-financial information for managers
- describe management responsibilities for cost, profit and investment and their effect on management information and performance measurement
- explain the role of information technology in management information
- explain the role of the trainee accountant.

1 PURPOSE OF MANAGEMENT INFORMATION

1.1 THE ROLE OF MANAGERS

Managers within any organisation are decision-makers. They have to make decisions about what should be done, and then issue instructions based on the decisions they have taken.

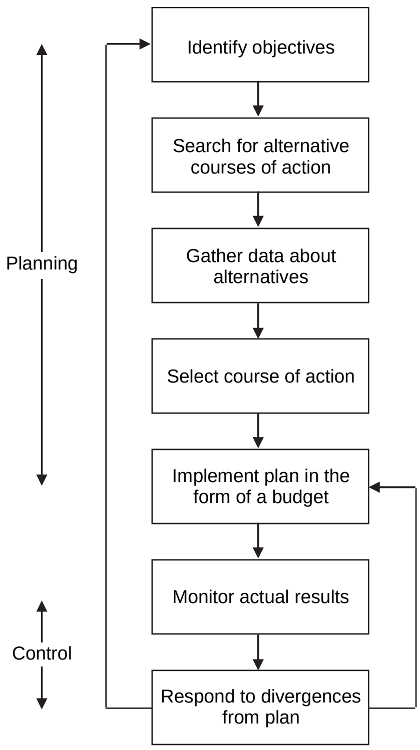
Decisions can be categorised as planning decisions and control decisions.

- **Planning decisions** are about what should be done. These can be decisions for the long-term or for the shorter-term. Many organisations try to work within the framework of an annual plan or budget. Much planning is done on a day-to-day or week-by-week basis and some planning, known as strategic planning, can be for longer periods ahead.

- **Control decisions** relate to monitoring what is actually happening, and if anything seems to be going wrong, deciding what should be done to correct the problem.

Many organisations produce or revise their forward planning annually, in the form of a budget. The budget cycle is illustrated in the following diagram.

The budget cycle



Identifying objectives

The first stage in a planning process is to identify the objectives; in other words, it is important to decide what the organisation is trying to achieve. Should it be trying to increase sales and profits, and if so by how much? Which products or services should it be trying to sell?

Assessing alternative action plans and selecting the preferred plan

There might be several ways of achieving the objectives. For example, sales and profits can be increased by raising selling prices, cutting costs or introducing new products or services to sell to customers. Alternative courses of action should be identified and evaluated. When they have been compared and evaluated the preferred course of action is selected and implemented.

EXAMPLE

Suppose the objective of an organisation is to increase production by 10%. The following alternative courses of action might be identified to achieve the 10% increase.

(a) Increase the workforce by 10% and introduce a night shift. Premium wage rates would have to be paid to the night-shift workers. Machinery servicing and maintenance costs will probably increase.

(b) Replace the existing machines with modern machines with a higher capacity and train existing staff how to use the new machines.

Information would be gathered for each of these alternatives. In particular, management would want to know how much each option would cost. Much of the information will be financial (the effect on costs) but some important information will be non-financial in nature (e.g. the attitude of the workforce to shift working, or to using new machines).

Implement plan

A long-term plan usually communicates an organisation's objectives and how they are to be achieved over a 5–10 year period. This plan is then broken down into annual targets or budgets, and annual budgets might be broken down further into month-by-month plans and targets. The budget communicates detailed plans to managers within the organisation.

Monitoring actual results

When the plan is put into action, actual results should be monitored and compared with the targets. Managers need to know whether the targets will be achieved (or exceeded) and if not, by how much are actual results short of budget, and for what reasons.

The results obtained by the comparison of actual and budget performance are reported to management as part of a 'feedback' process.

Responses to divergences: taking control action

When actual results differ significantly from the budget or plan, a manager responsible for achieving the results should be required to take control measures. Control is an integral part of the planning cycle.

1.2 INFORMATION AND DECISION MAKING

Management need information to help them to make decisions.

- Information for planning comes from a variety of sources, both inside and outside the organisation. Information about what the organisation has achieved in the past is often a starting point for making plans for the future. For example, knowing what a process or operation has cost in the past can be very useful for estimating the likely costs in the future.
- Information for control is largely obtained from internal sources within the organisation. Managers need to know what actual results have been achieved, in order to compare what has happened so far with what had been planned, and also in order to re-think what is likely to happen in the future unless corrective measures are taken.

A large amount of management information is financial in nature, although non-financial information can be just as important. In particular, managers need to know how much activities cost, and how much it costs to make and sell the products or services that the organisation provides to its customers.

This text will look at the nature of information about costs: how it is gathered, analysed and presented to management to help them with decision making. Cost accountants or management accountants have the job of providing information to managers about costs and profits. For the purpose of this text, cost accounting and management accounting can be taken to mean the same thing, which is the provision of management information about costs and profits.

2 DATA AND INFORMATION

A distinction can be made between data and information.

- Data is a collection of unprocessed facts or opinions.
- Information is data that has been processed so that it has a purpose and meaning.

Managers need information not data. The cost accountant processes data about expenditures into meaningful figures about the costs of products, services and processes. A simple example might help to illustrate the difference between data and information.

EXAMPLE

Suppose that a departmental manager wants to know how many of the department's staff have been employed for three years or longer.

The raw data for obtaining this information would come from the employment records of each of the department's employees, which should show when the individual started in the job. This raw data would then be processed to identify how many have been employed for three years or longer, and the information presented to the departmental manager might be: '25 out of 50 of the department's employees have been in their job for over three years, representing 50% of the department's staff'.

In cost accounting, raw data consists of expenditure transactions and sales invoices, and management information consists of items such as the costs of manufacturing an item or providing a service, the profitability of a product or the cost per unit of an item, and so on.

Data has no value to management, whereas information should have a value. However, there is a cost involved in processing data into management information.

3 QUALITIES OF USEFUL MANAGEMENT INFORMATION

Information is provided to management to assist them with planning, control and decision making. Management decisions are likely to be better when they are supported by better quality information.

'Good quality' information has several characteristics.

- It should have a **purpose**, and be **relevant** for that purpose.

  There is no point in providing a manager with a report if the manager does not know why he has been given it, or what he is expected to do with it. Similarly, the information within a report should be relevant to its purpose and should not contain details that can be ignored.

- It should be **timely**. This means that it should be provided to a manager in time for the manager to do something with it. For example, suppose that a business produces monthly performance reports for its cost centres, and that in May the manager of cost centre X receives a report about actual costs incurred by the centre in January. This information would be over three months old, and the cost centre manager is likely to ignore it because it is not relevant to his current situation.

  Similarly, suppose that a senior management team want to decide on their strategy for overseas expansion, and ask for a report on market conditions in Southern Africa. If they want to make their decision in February, a report submitted in March will be of no value, because the decision will already have been taken.

- It should be **understandable**. A manager should be able to understand what the information is telling him. If he doesn't understand it, he will not use it to make a decision. If he misunderstands it, he might make a bad decision. There can be a particular problem with the use of technical language ('jargon'), and accountants should always be careful about the way in which they present financial information to non-financial managers.

- Information should be **as accurate as it needs to be**. The degree of accuracy required will depend on the reason why the information is needed. A problem in accounting can be that reports are produced showing figures to the nearest pound or dollar, when managers are only interested in figures to the nearest hundred thousand or ten thousand. On the other hand, when calculating the cost of a unit of product manufactured in a factory, managers might want the cost to be accurate to the nearest penny or cent.

- Information should be **as complete as it needs to be**, but it should **not be excessive**. Managers should be given all the information they need to make their decisions, but it is often helpful to draw their attention to what seems significant. In control reports, for example, actual results might be compared with planned results, with differences between actual and plan reported as 'variances'.

  A report that highlights the most significant information, such as the biggest variances, can help to draw management attention to what is important. Sometimes, management only want to be informed when something exceptional or out-of-the-ordinary has happened. Reporting on this basis is called **reporting by exception**.

- Information should be **communicated to the right person**. Within a business, management information should be directed to the manager or managers who can use it and do something with it. For example, information about costs and revenues should be reported to the manager responsible, who is in a position to control them. There is little value to be gained in reporting costs to a manager who has no control over them.

- Information should be **communicated by an appropriate channel**. A 'channel' of information refers to the method by which the information is given, such as verbally, in a formal report, in an informal report, by email, by electronic file transfer, and so on. It also refers to the individual or department or external organisation that provides the information.

  The appropriate channel of communication varies according to circumstances and the nature of the information. For example, it will depend on how quickly it is needed, how much information has to be communicated, how far the information has to be sent and the costs of sending it in different ways.

  Here are some examples.

Information	*Channel of communication*
A fire breaks out in the stores area.	The information must be transmitted immediately, using a fire alarm, internal and external telephone.
A cutting machine becomes badly adjusted and starts to produce components that are too short.	The machine operator must communicate verbally with his or her superior immediately. It would be wasteful to wait for the routine daily or weekly inspection.
An accounts clerk is processing petty cash vouchers from several departments that have not been properly authorised by the office manager.	The most efficient method of communicating information to several people internally, as is required in this case, is by email. However, before sending out an email, the effect on people's behaviour must be estimated. It would usually be appropriate to see people individually first in order to explain company policy.
Summary results of a subsidiary company in India need to be sent to the head office in the UK for consolidation.	A data file can be sent by email or a hard copy report could be sent by facsimile (fax).
A telephone order clerk needs to check the availability of an item of inventory before accepting a customer order.	One of the most efficient methods is to give the clerk a keyboard and screen connected to the computer system, which allows for direct interrogation of inventory levels.

3.1 THE VALUE OF INFORMATION

Another quality of good management information is that the value of the information to management should exceed the cost of producing it.

Management information has a value because it helps a manager to make decisions. If a decision by a manager is different from what it would have been without the information, the value of the information could be measured by the amount of money that has been saved as a result. The **value of information** results from actions by decision makers who use the information to improve profitability.

Here are some examples.

Reducing unnecessary costs	An investigation into the causes of unexpectedly high costs may uncover inefficiencies and wastage that can be eliminated in future. If a manager is not even informed that costs are running in excess of what they should be, he will not take any corrective action, and the excess spending will carry on.
Adopting better marketing strategies	Modern point-of-sales terminals in stores and supermarkets provide detailed analysis of sales by product. This information can be used to direct management attention to the products and store locations with the highest profit potential.
Better analysis of 'cost drivers'	With detailed information about the causes of costs and the factors which 'drive costs', more realistic budgets can be set. This in turn should result in scarce resources being applied in the most profitable way.

Information has a value as a strategic resource, and an efficient management information system can give a company a strategic advantage over its competitors. Information has no value if it is not used. Neither has it any value if it is known already (no 'surprise value'). In order to assess the value of information, the following questions can be asked:

- Who uses the information?
- What is it used for?
- How often is it used?
- How often is it provided but not used?
- What is achieved by its use?
- Are there alternatives to this source of information?

3.2 THE COST OF INFORMATION

The cost of producing information includes:

- the cost of gathering data
- the cost of processing data
- the cost of storing data and information
- the costs of providing the information
- the opportunity cost of management time.

In a business, management information systems can be very expensive, with large computer systems and databases, and large numbers of employees whose job it is to process and provide the information. These include management accountants. There might also be external costs, such as the cost of using a market research agency or a firm of management consultants.

4 SOURCES OF DATA FOR MANAGEMENT ACCOUNTING

Data for preparing management information comes from a variety of sources, both within the organisation (internal sources) and from outside the organisation (external sources).

4.1 INTERNAL SOURCES

There are many internal data sources for management accounting, not all of which are part of the accounting system. The boundaries of an accounting system are not always clearly defined, particularly in management accounting. The following internal accounting sources may be used.

Source	*Information obtainable from the data*
Sales ledger system	Number and value of invoices
	Volume of sales
	Value of sales, analysed by customer or product
	Receivables by age
Purchase ledger system	Number and value of invoices
	Value of purchases, analysed by supplier
	Payables by age
Payroll system	Number of employees
	Hours worked
	Time lost through sickness
	Wages earned
	Tax deducted
Records of non-current assets	Date of purchase
	Initial cost
	Location
	Depreciation method and rate
	Service history
	Production capacity

In addition the following internal, non-accounting sources may be used.

Source	*Information available from the data*
Production records	Machine breakdown times
	Output achieved
	Number of rejected units
Sales and marketing records	Types of customer
	Market research results
	Demand patterns, seasonal variations, etc.

4.2 EXTERNAL SOURCES

In addition to the internal information sources, information can be obtained from a wide range of external sources, as illustrated below.

Source	*Information*
Suppliers	Product prices
	Product specifications
Newspapers, journals	Share price
	Information on competitors
	Technological developments
Government	Industry statistics
	Taxation policy
	Inflation rates
Customers	Product requirements
	Price sensitivity
Employees	Wage demands
	Working conditions

ACTIVITY 1

Suppose that you are a manager in a general hospital.

List some of the cost information that you might want to know about and have reported to you.

For a suggested answer, see the 'Answers' section at the end of the book.

4.3 FINANCIAL AND NON-FINANCIAL INFORMATION

It should be noted that much of the data collected will be of a non-financial nature. For example, if you examine the information coming from the payroll system above we can divide this as follows:

Financial Information	*Non-Financial Information*
Wages earned	Number of employees
Tax deducted	Hours worked
	Time lost through sickness

Both elements are of equal importance to managers for their planning, control and decision making purposes.

5 COST CENTRES, PROFIT CENTRES AND INVESTMENT CENTRES

The nature of internal reporting systems will vary according to the way the organisation is structured, and the responsibilities that different managers are given. Within businesses, the focus of attention is largely on profit, and managers are held accountable for the revenues earned by their team or department, or the costs they incur.

5.1 RESPONSIBILITY ACCOUNTING

Definition **Responsibility accounting** is a system of providing financial information to management, where the structure of the reporting system is based on identifying individual parts of a business which are the responsibility of a single manager.

Definition **Responsibility centre.** A responsibility centre is an individual part of a business whose manager has personal responsibility for its performance.

Many businesses are structured into a hierarchy of responsibility centres. These might be called cost centres and revenue centres, profit centres and investment centres.

- At the 'lowest level' of structured financial reporting, there are cost centres and revenue centres. Their managers are responsible for the costs incurred by their centre or the revenues earned by the centre.

- At a higher level, there might be profit centres. Their managers are responsible for both the revenues and the costs of the centre, and so are accountable for the profit or loss the centre makes.

- At the highest level in the reporting hierarchy, there might be investment centres. In a large group of companies, an investment centre might be an entire subsidiary company, or even several subsidiary companies (a 'strategic business unit'). The manager is responsible not only for the revenues, costs and profits of the centre, but also for its capital investments and the return on investment it achieves.

5.2 COST CENTRE

Definition A **cost centre** can be defined as 'a production or service location, function, activity or item of equipment whose costs may be accumulated and attributed to cost units'.

For example, cost centres in a manufacturing company might be the machining department, the assembly department and the finishing department. Other cost centres might be order handling and despatch, stores and warehousing, and transport. Within the accounting system, the costs incurred by a cost centre are charged to that centre, so that information can be gathered about the total costs it has incurred.

The performance of a cost centre manager is judged on the extent to which cost targets have been achieved.

5.3 REVENUE CENTRE

Definition A **revenue centre** is a part of the organisation that earns sales revenue. Its manager is responsible for the revenue earned, but not for the costs of the operation.

Revenue centres are therefore generally associated with selling activities, and within a company, the sales teams under each regional sales manager might be treated as responsibility centres. Each regional manager would have sales targets to reach, and would be held responsible for the achievement of those targets.

The management information system must therefore be capable of tracing all sales revenue earned to the individual revenue centres.

5.4 PROFIT CENTRE

Definition A **profit centre** is a part of the business for which both the costs incurred and the revenues earned are identified.

The performance of a profit centre manager is measured in terms of the profit made by the centre. The profit centre performance can also be measured in terms of profit per unit, profit margins and by comparing actual profit with target profit. The manager must therefore be responsible for both costs and revenues, and in a position to plan and control both. He or she is therefore likely to have a substantial amount of authority.

Profit centres are often found in large organisations with a divisionalised structure, and each division is treated as a profit centre. Within each profit centre, there could be several cost centres and revenue centres.

When a business has a profit centre structure, data for revenues and costs must be collected and attributed to the appropriate profit centres. This data is then used to measure profit trends, profit per unit, profit margins and to compare actual profit with target profit.

5.5 INVESTMENT CENTRE

Definition The CIMA *Official Terminology* defines an **investment centre** as 'a profit centre with additional responsibilities for capital investment and possibly for financing, and whose performance is measured by its return on investment'.

An investment centre might include several profit centres.

Managers of investment centres are responsible not just for decisions affecting revenues and costs, but also for investment decisions. They should therefore be accountable not just for profits, but also for the performance of the capital invested. Performance is measured in terms of the profit relative to the level of investment. In its simplest form, this means monitoring return on capital employed (ROCE).

$$\text{ROCE} = \frac{\text{Profit}}{\text{Capital employed}}$$

To operate an investment centre system, it is necessary to collect data to provide information on costs, revenues and amounts invested (assets less liabilities).

EXAMPLE

An investment centre has recorded the following information:

	20X5 ($000)	*20X6* ($000)
Profit	180	234
Capital employed	1,000	1,200
Sales	2,000	2,400

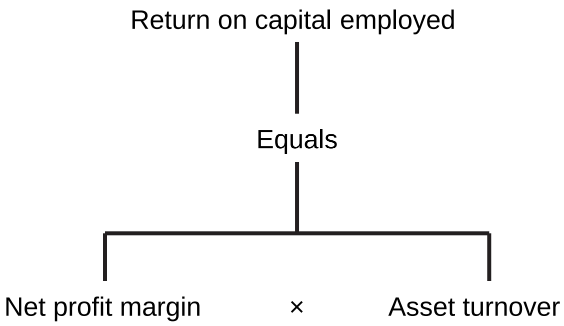
The performance of the investment centre can be measured by calculating the ROCE and the secondary ratios, net profit margin and asset turnover.

	20X5		*20X6*	
ROCE	$\frac{180}{1,000}$	= 18%	$\frac{234}{1,200}$	= 19.5%
Net profit margin	$\frac{180}{2,000}$	= 9%	$\frac{234}{2,400}$	= 9.75%
Asset turnover	$\frac{2,000}{1,000}$	= 2	$\frac{2,400}{1,200}$	= 2

The return earned by the investment centre has increased from 18% to 19.5%. This has been achieved by increasing the net profit margin from 9% to 9.75%, either by increasing sales or by reducing costs. The asset turnover has remained the same at 2, which means that the same sales are being generated for each $ of capital employed.

Overall performance could be compared with other similar investment centres.

5.6 THE LINK BETWEEN ROCE, NET PROFIT MARGIN AND ASSET TURNOVER



ROCE = net profit margin × asset turnover

For example, we can calculate the ROCEs using the information in the previous paragraph as follows:

20X5 ROCE = 9% × 2 = 18% (as calculated above).

20X6 ROCE = 9.75% × 2 = 19.5% (as calculated above).

5.7 THE IMPACT OF RESPONSIBILITY ACCOUNTING ON MANAGEMENT INFORMATION AND APPRAISAL

The way in which an organisation is structured, into a hierarchy of cost centres and revenue centres, profit centres and investment centres, affects the nature of management reporting. Data has to be gathered and information provided to management that will enable managers to plan and control their area of the business, and the activities for which they are responsible.

In addition, managers will recognise that their performance as a manager will be assessed in terms of costs, revenues, profits or returns on investment for their centre. Individual managers will therefore be likely to take whatever decisions seem appropriate to optimise the results of their centre.

6 IT AND MANAGEMENT ACCOUNTING

Computer technology has transformed management information systems. Many years ago, when computers were comparatively slow and with limited storage capacity, there were severe limitations to the quantity of data that could be collected, stored and analysed. Computers were able to produce regular reports, such as monthly budget performance reports, but it was difficult for managers to interrogate a system on-line and extract up-to-date information.

Today, businesses can develop information systems with enormous processing and storage capacity, providing access to vast stores of internal and external data (e.g. through the Internet). The challenge, however, is to produce information systems that:

- are designed to provide the information that managers need, both in routine reports and through ad hoc enquiries
- provide information that has value in excess of the cost of providing it.

Small businesses might limit themselves to simple systems, to avoid the cost.

6.1 FEATURES OF IT SYSTEMS

Several features of IT systems are worth noting, in the context of management information systems.

- **Data collection**. In many businesses, data can be collected electronically, which means that large volumes of data can be gathered for analysis. For example, in stores and supermarkets, point of sale (POS) systems gather data about the goods that customers purchase, mainly through bar code readers. This data is stored and analysed to provide management with information about sales volumes for each product, for each group of products, for each storage shelf in the store or for each day and for each part of each day. This can be used to analyse customer buying patterns and preferences, and to calculate the profitability of each product sold.
- **Data files**. Computer systems can have a vast storage capacity, which means that large quantities of data can be held at a relatively small cost. With database systems, data can be structured and organised so as to make it readily accessible. Data mining techniques might also be used to extract more information from databases.

- **Speed of communication and networks**. Data can be transmitted quickly to remote locations. The Internet and more particularly business intranet systems, allow managers to access business data from a laptop computer anywhere in the world. Managers can have constant access to information.

- **Processing capability**. Data can be processed quickly. Managers with on-line access to the information systems of their business might therefore be able to ask for and obtain instant 'ad hoc' information for planning, control or ad hoc decision making purposes.

- **Computer software**. Managers have access to a wide range of software for processing data and preparing management information. In particular, spreadsheet software is used extensively for planning and forecasting. Software packages are also available for financial accounting, stores control, statistical forecasting and so on.

7 THE ROLE OF THE TRAINEE ACCOUNTANT

As part of the cost accounting team, the trainee accountant is likely to be involved in gathering and processing data to measure the costs of an organisation's activities, products or services. For example, in a manufacturing business, the trainee accountant could be involved in measuring and analysing:

- the cost of raw materials used in product manufacture
- the value of raw materials inventory
- the valuation of work-in-progress and finished goods – in other words, what are the costs of production;
- the costs of the labour used/employed in each period
- the costs of other expenses in the period
- overhead costs for each cost centre
- overhead absorption rates
- the total cost of each type of product made by the business
- the cost per unit sold
- the profitability of each product.

CONCLUSION

Measuring costs and revenues is an important first step in providing management with information to assist them with planning and control decisions. A variety of costing methods and techniques are described in the following chapters.

KEY TERMS

Responsibility accounting – a system of providing financial information to management, where the structure of the reporting system is based on identifying individual parts of a business which are the responsibility of a single manager.

Responsibility centre – an individual part of a business whose manager has personal responsibility for its performance.

Cost centre – a location, function, activity or item of equipment for which costs are accumulated and attributed to cost units.

Profit centre – a part of the business for which both the costs incurred and revenues earned are identified.

Investment centre – a profit centre which is also responsible for capital investment.

SELF TEST QUESTIONS

		Paragraph
1	What is the purpose of management information?	1.2
2	What is the difference between data and information?	2
3	List six qualities of good information.	3, 3.1
4	Define responsibility accounting.	5.1
5	Define a cost centre.	5.2
6	Define a profit centre.	5.4
7	Define an investment centre.	5.5

EXAM-STYLE QUESTIONS

1 A profit centre is:

A the profit attributable to a business unit

B a business unit whose manager is responsible for operating costs and revenues from the activities of the unit

C a unit of product or a service for which costs and revenues are measured

D a business unit whose manager is responsible for investment decisions within the unit.

2 Which of the following is always a desirable quality of information?

A Instant availability

B Complete accuracy

C Brevity

D Understandability

3 Which of the following is an example of data?

A A graph showing sales by product for the previous year

B A list of employees of an organisation

C A report showing the percentage of rejects by machine

D A table showing inflation projections by business sector

4 Information should be produced if:

(i) Its cost exceeds its value

(ii) It is relevant and timely

(iii) It has always been produced

Which of the above statements are true?

A (ii) only

B (ii) and (iii)

C (i) and (iii)

D All of them

For the answers to these questions, see the 'Answers' section at the end of the book.