Glossary of management accounting terms (Pearson)

The definition of one word or phrase may depend on understanding another word or phrase defined elsewhere in the reference list. Words in **bold** indicate that such a definition is available.

A

ABC See **activity-based costing**.
AMTs See **advanced manufacturing technologies**.
absorb, absorbed See **absorption**.
absorption The process by which overhead costs are absorbed into units of output, or 'jobs'.
absorption costing All production costs are absorbed into products and the unsold inventory is valued at total cost of production.
accounting The process of identifying, measuring and communicating financial information about an entity to permit informed judgements and decisions by users of the information.
accounting rate of return Calculated by taking the average annual profits expected from a project as a percentage of the capital invested.
accrual See **accrued expense**.
accrued expense (accrued liability) An expense which remains unpaid at the accounting date and is therefore recognised as a liability.
activity any physical operation that takes place in an enterprise. For ABC see also **unit activity, product-sustaining activities, batch-related activities** and **cost drivers**.
activity-based costing (ABC) traces **overhead costs** to products by focusing on the **activities** that drive costs (cause costs to occur).
activity cost pool See cost pool.
actual overhead cost Overhead cost of the period, arising either through cash spending or through trade credit.
advanced manufacturing technologies New methods developed by engineers in order to compete more effectively.
adverse variance This arises when the actual cost is greater than the standard cost.
allocate To assign a whole item of cost, or of revenue, to a simple cost centre, account or time period.
allocated, allocation See **allocate**.
annual report A document produced each year by limited liability companies containing the accounting information required by law. Larger companies also provide information and pictures of the activities of the company.
apportion To spread cost over two or more cost units, centres, accounts or time periods on some basis which is a fair representation of how the cost item is used by each cost centre.
apportioned, apportionment See **apportion**.
assets Rights or other access to future economic benefits controlled by an entity as a result of past transactions or events.
average annual profit Calculated as average annual cash flow minus annual depreciation.
avoidable cost One which may be eliminated by taking a particular action.

B

balanced scorecard Links performance measures for key goals in customer perspective, financial perspective, internal business perspective and learning and growth perspective.
balance sheet A statement of the financial position of an entity showing assets, liabilities and ownership claim.
basic standard A **standard cost** that remains a permanent basis for comparison.
batch-related activities (in **ABC**) **Product-sustaining activities** that are fixed for a given batch of products.
benchmarking is the process of measuring the organisation's operations, products and services against those of competitors recognised as market leaders, in order to establish targets which will provide a competitive advantage.
bottom-up budget Initiated by inviting those who will implement the budget to participate in the process of setting the budget. Also called a **participative budget**.
breakeven analysis A technique of management accounting which is based on calculating the breakeven point and analysing the consequences of changes in various factors calculating the breakeven point.
breakeven chart Graph that shows sales and costs over a range of activity, including the activity level at which total costs equal total sales and at which the business makes neither a profit nor a loss.
breakeven point That point of activity (measured as sales volume) where total sales and total costs are equal, so that there is neither profit nor loss.
breakeven sales See **breakeven point**.
budget A detailed plan which sets out, in money terms, the plans for income and expenditure in respect of a future period of time. It is prepared in advance of that time period and is based on the agreed objectives for that period of time, together with the strategy planned to achieve those objectives.
budget committee A group of people brought together to manage each stage of the budgetary process.
budget manual A document setting out procedures and instructions including the timetable for **budget** preparation, formats to be used, circulation lists for drafts, and arbitration procedures where conflicts begin to show themselves.
budgetary planning and control Specialist techniques to quantify the strategy of tbe enterprise.
budgetary system Serves the needs of management in making judgements and decisions, exercising planning and control and achieving effective communication and motivation.
budgeted fixed overhead cost rate Fixed overhead cost rate per unit set in advance. See **predetermined overhead cost rate**.
business strategic planning Involves preparing, evaluating and selecting **strategy** to achieve objectives of a long-term plan of action within a defined business activity.

C

capital budgeting A process of management accounting which assists management decision making by providing information on the investment in a project and the benefits to be obtained from that project, and by monitoring the performance of the project subsequent to its implementation.
capital expenditure Spending on resources which bring a long-term benefit to an organisation, in generating cash flows or providing other benefits relating to the purpose of the organisation.

capital investment See **capital expenditure**.
capital investment appraisal The application of a set of methods of quantitative analysis which give guidance to managers in making decisions as to how best to invest long-term funds.
capital rationing There is not sufficient finance (capital) available to support all the projects proposed in an organisation.
cash flow projections Statements of cash expected to flow into the business and cash expected to flow out over a particular period.
cash flows Calculated as profit before deducting depreciation and amortisation.
contingency theory An explanation that management accounting methods have developed in a variety of ways depending on the judgements or decisions required.
contribution Sales minus variable cost.
contribution per unit The sales price minus the variable cost per unit. It measures the contribution made by each item of output to fixed costs and profit.
contribution per unit of limiting factor Used in ranking, choosing the highest value of this ratio to make the most profitable use of restricted resources.
control The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. One of three functions of management that are supported by management accounting. See also **decision making** and **planning**.
controllable cost A cost which is capable of being regulated by a manager within a defined boundary of responsibility.
controlling See **control**.
corporate strategic planning Involves preparing, evaluating and selecting strategies to achieve objectives of a long-term plan of action for the corporate **entity** as a whole.
cost centre A unit of the organisation in respect of which a manager is responsible for costs under her or his control.
cost code A system of letters and numbers designed to give a series of unique labels which help in classification and analysis of cost information.
cost coding Codes used for recording costs in an accounting system.
cost driver rate Total costs in a **cost pool** divided by the number of times that the **activity** occurs.
cost drivers The factors that most closely influence the cost of an activity.
cost of capital The cost to the business of raising new finance.
cost of quality All costs incurred in achieving a quality product or service.
cost-plus pricing Setting a price based on full cost of production plus desired profit. Also called **full cost pricing**.
cost pool The costs collected that relate to each **activity**.
cost(s) An amount of expenditure on a defined activity. The word 'cost' needs other words added to it, to give it a specific meaning.
cost–volume–profit analysis Emphasises the relationship between sales revenue, costs and profit in the short term.
creditors persons or organisations that are owed money by the **entity**.
current asset An asset that is expected to be converted into cash within the trading cycle.
current liability A liability that is expected to be repaid within a short period of time, usually within one year.
currently attainable standard A **standard cost** based on expectations under normally efficient operating conditions.

D

debtors Persons or organisations who owe money to the **entity**.
decision making One of three functions of management which are supported by management accounting. See also **planning** and **control**.
depreciable amount The cost of an asset, or another amount such as replacement cost substituted for cost, less its **residual value**.
depreciation The systematic allocation of the depreciable amount of an asset over its useful life.
direct cost Cost that is directly traceable to an identifiable unit, such as a product or service or department of the business, for which costs are to be determined.
directing attention One of three functions of management accounting to support management actions of **planning, decision making** and **control**. See also **keeping the score** and **solving problems**.
discount rate Most suitable rate of interest to be applied in calculating **present value**. Could be based on one particular type of finance but more usually is the cost of mixed sources.
discounting The process of calculating **present value** of projected cash flows.
division A part of the organisation where the manager has responsibility for generating revenues, controlling costs and producing a satisfactory return on capital invested in the division.

E

e-business Electronic business: the use of technology to automate business practices.
e-commerce Electronic commerce: the use of electronic media for transactions between the company and its customers or suppliers; one aspect of **e-business**.
entity An identifiable organisation for which accounting information is needed (e.g. limited liability company, public sector body). Also a legal/economic unit which exists independently of its owners.

F

facility-sustaining activity (in ABC) Activity that is not driven by making products.
favourable variance This arises when the actual cost is less than the standard cost.
feed forward control Means making predictions of outputs expected at some future time and then quantifying those predictions, in management accounting terms.
feedback control Involves comparing outputs achieved against outputs desired and taking corrective action if necessary.
financial accounting A term usually applied to external reporting by a business where that reporting is presented in financial terms.
financial statements Documents containing accounting information presented to meet the needs of users.
fixed asset An asset that is held by an enterprise for use in the production or supply of goods or services, for rental to others, or for administrative purposes on a continuing basis in the reporting entity's activities.
fixed cost One which is not affected by changes in the level of output over a defined period of time.
flexible budget A **budget** that is designed to change when the volume of activity changes, to achieve comparability.

full cost of production Direct cost plus **indirect cost** of production. Also calculated as **prime cost** plus **production overhead cost**.
full cost pricing See **cost-plus pricing**.
functional strategic planning also called **operational planning.** The detailed plans by which those working within an organisation are expected to meet the short-term objectives of their working group, based on the functions that are carried out by the group.

G

gross Before making deductions.

H

I

ideal standard A standard cost set under the most efficient operating conditions.
impairment An asset is impaired when the business cannot expect to recover the carrying value of the intangible asset (as shown in the balance sheet), either through using it or through selling it.
imposed budget See top-down budget.
incremental analysis means analysing the changes in costs and revenues caused by a change in **activity**.
incremental budget Prepared by adding a percentage to the **budget** of the previous year, usually to represent the effects of inflation.
incremental costs The additional costs that arise from an activity of the organisation. To justify incurring incremental costs it is necessary to show they are exceeded by **incremental revenue**.
incremental revenue The additional revenue that arises from an **activity** of the organisation. To justify accepting incremental revenue it is necessary to show it exceeds **incremental costs**.
indirect cost Cost that is spread over a number of identifiable units of the business, such as products or services or departments, for which costs are to be determined.
indirect labour Labour costs that cannot be allocated directly to an identifiable unit for which costs are to be determined.
indirect materials Materials costs that cannot be allocated directly to an identifiable unit for which costs are to be determined.
integrated system Accounting records that serve the needs of both financial accounting and management accounting.
internal rate of return The discount rate at which the present value of the cash flows generated by the product is equal to the present value of the capital invested, so that the net present value of the project is zero.
internal reporting Reporting financial information to those users inside a business, at various levels of management, at a level of detail appropriate to the recipient.
inventory, cost of holding The costs related to storing inventory until it is sold.
inventory, cost of ordering The administrative costs related to buying and receiving materials.
investment centre A unit of the organisation in respect of which a manager is responsible for capital investment decisions as well as revenue and costs.

invoice A document sent by a supplier to a customer showing the quantity and price of goods or services supplied.

J

job cost The cost of a product or service provided to a customer, consisting of **direct** and **indirect** costs of production. See also **product cost**.
job cost record Shows the costs of materials, labour and overhead incurred on a particular job.
job-costing system A system of cost accumulation where there is an identifiable **activity** for which costs may be collected. The **activity** is usually specified in terms of a job of work or a group of tasks contributing to a stage in the production or service process.
just-in-time purchasing is a system of contracts with suppliers to deliver goods as closely as possible to the time when they are required for operations. Just-in-time theory can be applied to manufacturing, management systems, etc.

K

keeping the score One of three functions of management accounting to support management actions of **planning, decision making** and **control**. See also **directing attention** and **solving problems**.

L

limiting factor An item which is temporarily restricted in availability.
line item budget Each line in the budget relates to a function in the organisation.
liquidity The extent to which a business has access to cash or items which can readily be exchanged for cash.
long-range planning Begins with a vision statement setting out a vision for the future direction of the organisation. From this vision the long-range objectives are set covering a period of perhaps three to five years.

M

management Collective term for those persons responsible for the day-to-day running of a business.
management accounting Reporting accounting information within a business, for **management** use only.
management control system A system of organisational information-seeking and gathering, accountability and feedback designed to ensure that the enterprise adapts to changes in its substantive environment and that the work behaviour of its employees is measured by reference to a set of operational sub-goals so that the discrepancy between the two can be reconciled and corrected for.
margin Frequently used as a short description of **profit**, particularly in the financial press. May be expressed as a percentage of **sales** or percentage of **revenue**.
margin of safety The difference between the **breakeven sales** and the normal level of sales (measured in units or in £s of sales).
marginal costing See **variable costing**.
master budget Combination of budgeted profit and loss account, cash flow statement and balance sheet, created from detailed budgets brought together within a finance plan.

mutually exclusive Investment projects that are competing for scarce resources, where choosing one eliminates another.

N

net After making deductions.
net present value The net present value (of a project) is equal to the present value of the cash inflows minus the present value of the cash outflows, all discounted at the cost of capital.
non-controllable cost One which is not capable of being regulated by a manager within a defined boundary of responsibility, although it may be a cost incurred so that the responsibility may be exercised.
non-financial performance measures Measurement of performance using targets that are not available in the financial reporting system.
normal level of activity Estimated by management, taking into account the budgeted level of activity in recent periods, the activity achieved in recent periods, and the expected output from normal working conditions.

O

operational budgets Budgets representing the quantification of **operational planning**, including materials and labour budgets.
operational planning The detailed plans by which those working within an organisation are expected to meet the short-term objectives of their working group. See also **functional strategic planning**.
opportunity cost A measure of the benefit sacrificed when one course of action is chosen in preference to another. The measure of sacrifice is related to the best rejected course of action.
output The product or service provided by the enterprise or one of its operating units.
overhead cost Cost that cannot be identified directly with products or services. See also **indirect costs**.
overhead cost rate Overhead cost divided by a measure of activity such as production to give a cost per unit of activity.
overhead cost recovery **Absorbing** overhead cost into a unit of product so that the overhead cost will eventually be **recovered** in the sale of the product.
over-recovered fixed overhead cost The overhead **recovered** (applied) using a **predetermined overhead cost rate** is greater than the actual overhead cost of the period.
ownership interest The residual amount found by deducting all of the entity's liabilities from all of the entity's assets.

P

participative budget See **bottom-up budget**.
payback period The length of time required for a stream of cash inflows from a project to equal the original cash outlay.
percentage mark-up on cost adds a percentage to the total cost to calculate a selling price.
performance evaluation Requires the management accountant to decide on what to measure, plan how to report and consider the behavioural aspects.
period costs Costs that are treated as expenses in the period in which they are incurred.

planning Involves setting objectives, then establishing, evaluating and selecting strategy, tactics and actions required to achieve those objectives. One of three functions of management which are supported by management accounting. See also **control** and **decision making**.
planning programming budget system (PPBS) An output-based approach to **budgets** that focuses on programmes of action in the enterprise.
post-completion audit A review of the actual results of a project in order to compare these with the expectations contained in the project proposals.
predetermined overhead cost rate Estimated before the start of a reporting period.
prepayments Expenses paid in advance, such as rent or insurance, where a future benefit remains at the accounting date.
present value A sum of £1 receivable at the end of *n* years when the rate of interest is *r*% per annum equals

$$\frac{1}{(1+r)^n}$$

where *r* represents the annual rate of interest, expressed in decimal form, and *n* represents the time period when the cash flow will be received.
primary records Provide the first evidence that a transaction or event has taken place.
prime cost of production Equal to the total of direct materials, direct labour and other **direct costs**.
product cost Cost associated with goods or services purchased, or produced, for sale to customers. See also **job cost**.
product differentiation The business may be able to charge a higher price (a premium) for the reputation or quality of its product.
product life cycle The sequence of development of a product from initial development through maturity of sales to eventual decline in sales.
product-sustaining activities (in ABC) Activities that are performed to enable output of products but are not closely dependent on how many units are produced.
production Creating output in a business process, by using materials, labour and other resources available within the business.
production cost centre Cost centre that produces output of goods or services.
production overhead (cost) Comprises **indirect materials, indirect labour** and other **indirect costs** of production.
production plan Sets out quantities of resource inputs required, for use in **operational budgets**.
products See output.
profit The increase in the ownership interest in an entity over a specified period of time, due to the activities of the entity. The word 'profit' needs other words added to it, to give it a specific meaning.
profit centre A unit of the organisation in respect of which a manager is responsible for **revenue** as well as **costs**.
profit margin Profit as a percentage of **sales**.
profitability The ability to generate profit, based on a comparative measure e.g. profit as a percentage of sales; profit per month; profit related to capital investment.
profitability index The **present value** of cash flows (discounted at the **cost of capital**) divided by the present value of the investment intended to produce those cash flows.
profit–volume chart A graph showing on the horizontal axis the volume, measured by activity level in £s of sales, and on the vertical axis the profit at that activity level.

profit/volume ratio Contribution as a percentage of **sales** value.

Q

R

recovered, recovery Costs are recovered by charging a selling price that covers **costs** and makes a **profit**.
relevant costs Those future costs which will be affected by a decision to be taken. Non-relevant costs will not be affected by the decision.
relevant revenues Those future revenues which will be affected by a decision to be taken. Non-relevant revenues will not be affected by the decision.
re-order level The point at which the buying department places its order for replacement materials.
reporting period The period in respect of which the accounting information is prepared. In management accounting the period may be as frequent as the management chooses – weekly, monthly, quarterly and annual reporting are all used.
residual value The estimated amount that an entity would currently obtain from disposal of an **asset**, after deducting the estimated costs of disposal, if the asset were already of the age and condition expected at the end of its useful life.
responsibility centre An area of responsibility which is controlled by an individual. It might be a cost centre, a profit centre or an investment centre.
retention of title A supplier provides goods to a customer but retains ownership (title) the right to claim the goods if they are not paid for.
return (in relation to investment) The reward earned for investing money in a business. Return may appear in the form of regular cash payments (dividends) to the investor, or in a growth in the value of the amount invested.
revenue Is created by a transaction or event arising during the ordinary activities of the business which causes an increase in the **ownership interest**.

S

sales Delivering goods or services to a customer, either for cash or on credit terms.
sales budget Budget of sales volumes and prices for a future period.
scrap Unwanted material sold for disposal, usually at a very low price in relation to its original cost.
semi-variable cost One which is partly fixed and partly varies with changes in the level of **activity**, over a defined period of time.
sensitivity analysis Asks 'what . . . if' questions such as 'What will be the change in profit if the selling price decreases by 1%?' or 'What will be the change in profit if the cost increases by 1%?'
service cost centre Cost centre that provides services to other **cost centres** within the organisation.
short-term finance Money lent to a business for a short period of time, usually repayable on demand and also repayable at the choice of the business if surplus to requirements.
single period capital rationing Capital rationing in one period only during the life of a project (usually in the first period).

solving problems One of three functions of management accounting to support management actions of **planning, decision making** and **control**. See also **directing attention** and **keeping the score**.
standard cost Target cost which should be attained under specified operating conditions. Expressed in cost per unit.
standard hour The amount of work achievable, at standard efficiency levels, in one hour.
statement (from supplier). A document sent by a supplier to a customer at the end of each month summarising all **invoices** awaiting payment by the customer.
step cost A fixed cost which increases in steps over a period of several years.
strategic management accounting The provision and analysis of financial information on the firm's product markets and competitors' costs and cost structures and the monitoring of the enterprise's strategies and those of its competitors in these markets over a number of periods.
strategic planning Involves preparing, evaluating and selecting *strategies* to achieve objectives of a long-term plan of action.
strategy A plan setting out the actions and resources needed to achieve a stated objective of the long-term plan.
sunk cost Cost that has been incurred or committed prior to a decision point. It is not relevant to subsequent decisions.

T

time value of money The name given to the idea that £1 invested today will grow with interest rates over time (e.g. £1 become £1.10 in one year's time at a rate of 10%).
top-down budget Set by management without inviting those who will implement the budget to participate in the process of setting the budget. Also called an **imposed budget**.
total cost Calculated as **variable cost** plus **fixed cost**; or **direct cost** plus **indirect cost**; or **product cost** plus **period cost**.
total product cost Comprises **prime cost** plus **production overhead cost**.
trade creditors Persons (suppliers) who supply goods or services to a business in the normal course of trade and allow a period of credit before payment must be made.
trade debtors Persons (customers) who buy goods or services from a business in the normal course of trade and take a period of credit before paying what they owe.
traditional approach to overhead costs. **Allocate** and **apportion** to cost centres and then **absorb** into products which pass through those **cost centres**.
transfer price The price charged between two **divisions** of an organisation in transferring goods and services between each other.
turnover The **sales** of a business or other form of **revenue** from operations of the business.

U

unavoidable cost A cost that is **not** eliminated by taking a particular action.
under-recovered fixed overhead cost The overhead **recovered** (applied) using a **predetermined overhead cost rate** is less than the actual overhead cost of the period.
unit activity (in ABC) an **activity** that is performed each time a product is produced.
unit cost The **cost** of one unit of **output**.

V

value chain A way of describing and analysing the sequence of activities that bring on product/service from initial stage of production to final stage of delivery.
variable cost One which varies directly with changes in the level of **output**, over a defined period of time.
variable costing Only **variable costs** of production are absorbed into products and the unsold inventory is valued at variable cost of production. **Fixed costs** of production are treated as a cost of the period in which they are incurred.
variance The difference between a planned, **budgeted** or **standard cost** and the actual cost incurred. An adverse variance arises when the actual cost is greater than the standard cost. A favourable variance arises when the actual cost is less than the standard cost.
variance analysis Quantitative breakdown of cost **variance** into main causes, e.g. price and usage.

W

waste Any materials that have no value.
working capital Finance provided to support the short-term **assets** of the business (inventory and **debtors**) to the extent that these are not financed by short-term **creditors**. It is calculated as **current assets** minus **current liabilities**.
work-in-progress A product or service that is partly completed.

X

Y

Z

zero-based budget (ZBB) Budget preparation starts with a blank sheet of paper and justifies every item entered.