HOW TO PRODUCE
MONTHLY MANAGEMENT ACCOUNTS

A QUICK GUIDE

By: Mazhar Mahmood ACMA
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This guide is primarily aimed at fresh graduates, entry level job hires, professional students, and any individual related to the profession of accountancy (and management accountancy in particular), who wishes to have a quick overview of how a set of management accounts can be produced and what entails in its production, without having to read a 200 page book. Most of the knowledge set out henceforth is from the point of view of working in a service based industry and assumes the reader to have a reasonable knowledge of the fundamental concepts of accounting.

The scope of this guide is to give the readers a sequence of activities that I have followed, in my own experience, to put together a monthly reporting pack for my senior management team. This sequence of activities and the importance that I attach to each activity can be very different for the line of business that you are in. Having said that, I do expect that most of you will develop a more vivid and succinct picture of the production process, which you can then imitate and integrate into your own particular circumstances.

So, let’s begin!
What are we trying to produce?

In most organisations, the board or senior management requires the management accountant/chief accountant to produce a monthly profit and loss account/income statement, so that the organisation’s performance against set budgets (mostly prepared at the beginning of each financial year) and expected forecasts (mostly updated at each month end) can be gauged. A monthly management accounting reporting pack does not only include the monthly income statement, but a range of other useful reports too. However, an income statement does constitute the bulk of the reporting and this is what we will try to produce in this guide.

In a nutshell, through a certain set of activities and for a given period (usually a month), we determine: the revenues generated by the business, the costs incurred in the production of such revenues (commonly known as ‘cost of goods/services sold’) and the costs incurred to provide support to such revenue generation and goods/services production. This cost is sometimes referred to as the central overheads’ costs or support functions’ costs or the service-centre costs.

What you should know before you begin production?

Most businesses will use a “Chart of Accounts” in their accounting systems (may it be: Sage, SAP, Oracle, SUN, Viztopia etc.) to classify and record various types of transactions involving differing kinds of assets, liabilities, capital, revenues, and costs.

A Chart of Accounts or COA, as I like to call it, is a list of all nominal ledger accounts that a business intends to use to record its business transactions. This list of accounts can be in the shape of numbers, alphabets or alpha-numeric values. Due to my own experience, I prefer numbers.

So, to give an example, our full COA might range between the numbers 0001 and 9999 and within this range, we can have multiple ranges, each representing an asset, liability, capital, revenue or costs type. As an example, the range 5000-5999 might only represent different kinds of revenue streams for a business and the range 1000-1999 might only refer to all fixed assets held by the business.

These are just examples of how the COA could be divided. You need to know what range/s of nominal account codes in your business’s COA constitutes the revenues, the cost of goods/services sold, the central overheads, the assets, the liabilities, and the capital.

You will not be able to understand the income statement (which is what you are essentially trying to produce), unless you understand the Chart of Accounts. The income statement is basically reading all data held in the COA range/s relating to revenues and costs for a given month/period.
Once you have understood the division of the COA, you can then truly appreciate the monthly income statement template that your organisation already has in place. If you are assigned the task to build one from scratch, then this guide is not for you. In this guide, we have assumed that your organisation already has a certain monthly reporting template in place, of which the income statement is the main one.

A vast number of organisations produce their monthly management accounts in Microsoft Excel. The income statement, depending on the business, will be divided into multiple sections. For purposes of this guide, we will use the following sections that make up a typical income statement:

- Revenue
- Cost Of Goods/Services Sold
- Gross Profit
- Selling Expenses
- Marketing Expenses
- Contribution To Central Overheads
- Central Overheads Recharge
- EBITDA

Each of the above sections of the income statement will be made up of a number of nominal codes from the COA. As an example, the revenue section of the income statement in MS Excel might be pulling together/summing the data from codes 5000-5999 range from the main accounting software, for a given month. How does excel do that? Well, most organisations use some sort of intermediary excel tool to pull data out from the main accounting software (where a record of transactions sit) onto excel. That is why it is imperative to know your business specific COA, so that you know what makes up revenue and what makes up, lets say, cost of goods sold.

To recapture what we have just said above:

- Before you even open up your business’s monthly reporting pack, of which the income statement template is the most important, you need to understand your Chart of Accounts.
- Most management accounts’ packs/templates, are made in excel
- Transactions are recorded using some accounting software, such as Sage, Sun, Sap etc.
- The monthly income statement template is divided into sections, such as Revenue, Cost of Sales, Gross profit etc. Each section is reading a number of nominal codes from the main accounting software and summing them up for a given periodic month in the ms excel reporting templates.
- This summing/collation of information into excel from the accounting software, using nominal codes, is usually done with the help of an excel Add-on tool.

Hopefully, so far, so good! Let’s move ahead now.
The Production Process

Broadly speaking, the finance department of almost all businesses, ranging from small and medium to big publicly listed companies, can have the following sub-departments, either separately or combined, within the main finance function:

- Sales Order Processing – SOP
- Sales Ledger
- Credit Control
- Purchase Ledger
- Management Accountancy
- Financial Accountancy

On a day to day basis, orders are processed on the sales ledger system. The sales ledger system can exist within a company’s main accounting software or it could be a separate system altogether. The result of sales order processing is the production of sales invoices.

These sales invoices are then chased by the credit control department for collection of the monies due. Once monies are receipted at the bank, such receipts are recorded by the sales ledger department onto the main accounting system.

Alongside this, on a daily basis, the purchase ledger department is processing ‘purchase invoices’ i.e. bills that the business has to pay. For most businesses, the recording of purchase invoices involves:

- Categorizing / classifying each bill to a cost type/s
- Assigning the cost to a specific product &/or department &/or business unit

E.g. If a business has spent £5,000 on printing and binding of a magazine (assuming a magazine is a “product” / “revenue stream” for the business), the purchase ledger manager would record this cost as a direct cost (giving it a direct cost nominal ledger code from the Chart of Accounts) and assign the cost incurred to the “Production Department” and the “Print Publications” Business Unit of that organisation.

The bill is settled in due course by the purchase ledger manager.

The bottom line is that on a day to day basis, sales invoices are being raised and monies received, alongside bills being recorded and settled. At the end of each month or at a cut off date just before the end of a month, you will request all relevant departments to make no further entries in the period for which management accounts are to be prepared. Your management accounts start here!
MPL Media Plc

For the purpose of this quick guide, we will create a fictional organisation, operating in the media industry producing monthly magazines. We shall call it MPL Media Plc.

MPL media has all the above mentioned finance functions as well as the following in its organisational structure:

- Production Department
- Editorial Department
- Data and Marketing Department
- IT
- Facilities
- HR

MPL media derives revenue from selling advertising space on its magazines. All orders relating to a particular magazine are invoiced upon publication and distribution of the magazine. All design work and editorial content of the magazine is created in-house by the editorial and production departments, whereas the printing, binding, wrapping and distribution of the magazines are carried out by selected outside suppliers.

MPL media uses an excel tool to pull data out from its accounting software into excel. It can do this on a transactional level as well as mere summaries.

**ACTIVITY 1 – Direct Cost Prepayments**

Having instructed/stopped any further entries to be made in the month for which the management accounts are to be produced, the first in the list of sequential activities that the management accountant carries out is the prepayment of the direct costs.

As mentioned earlier, some of the nominal codes in the COA will relate to the cost of goods/services sold. In the case of MPL media, all nominal ledger codes relating to printing, wrapping, design, editorial content and distribution of a magazine are treated as “direct costs” of producing such a magazine. In addition, each magazine being sold by the business will carry a publication date. By virtue of this publication date, we can ascertain what and how many magazines to recognize as revenue and costs in the month, for which management accounts are being produced.

Any direct costs relating to magazines whose publication dates fall beyond the last date of the month for which the management accounts are being prepared, will need to be taken out of the income statement and pushed to the balance sheet as a “Direct Cost Prepayment”. The simple journal entry to do this would be to credit the relevant direct costs nominal accounts and debit the balance sheet prepayment account.