Accounting for Management and decision Making

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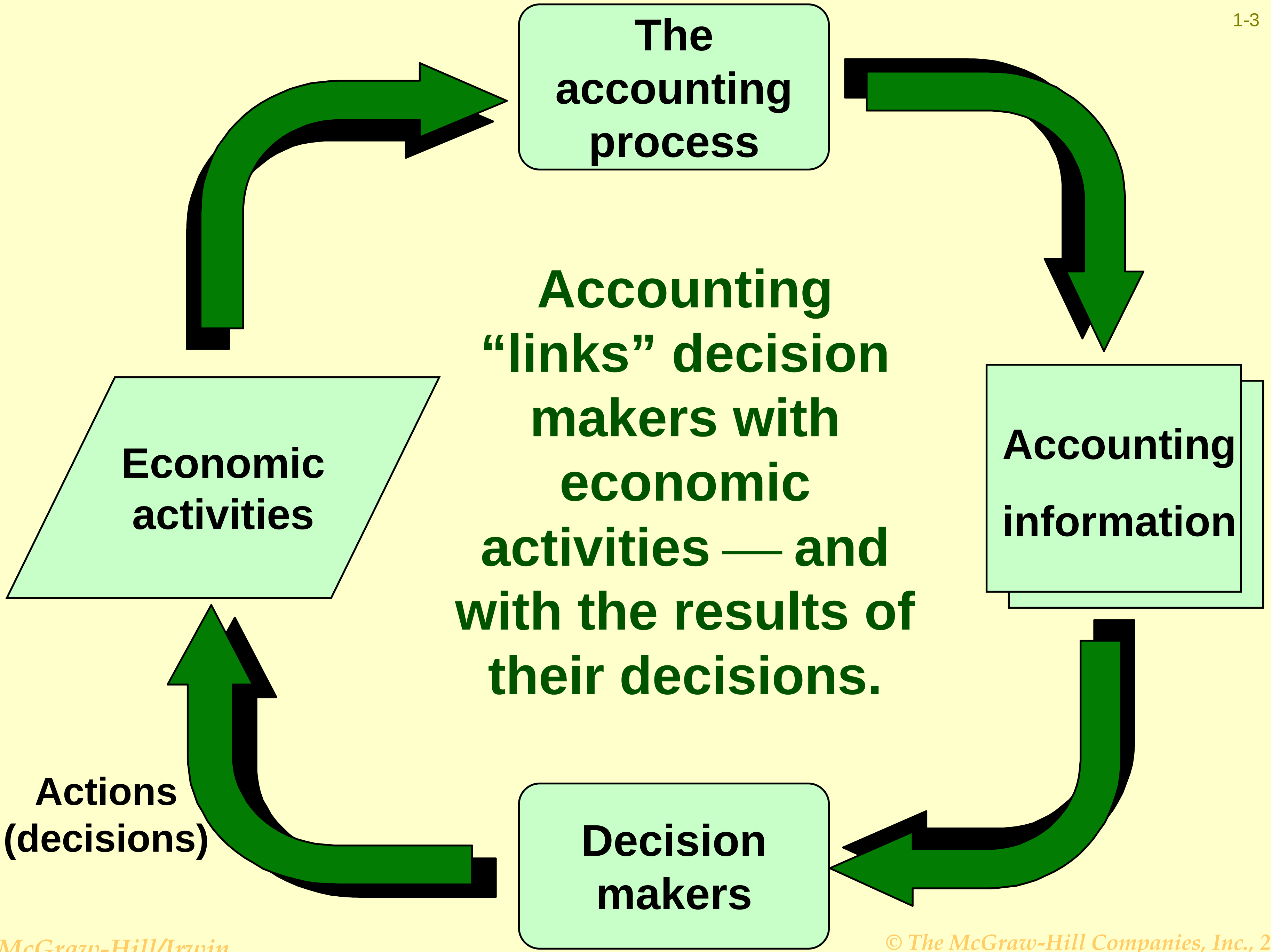
Part (1)

Introducing Accounting



Accounting "links" decision makers with economic activities — and with the results of their decisions.

Types of Accounting Information

Financial

Tax

Managerial

Information System

Information Users

- Investors
- Creditors
- Managers
- Owners
- Customers
- Employees
- Regulators
  - -SEC
  - -IRS
  - -EPA

Financial Information Provided

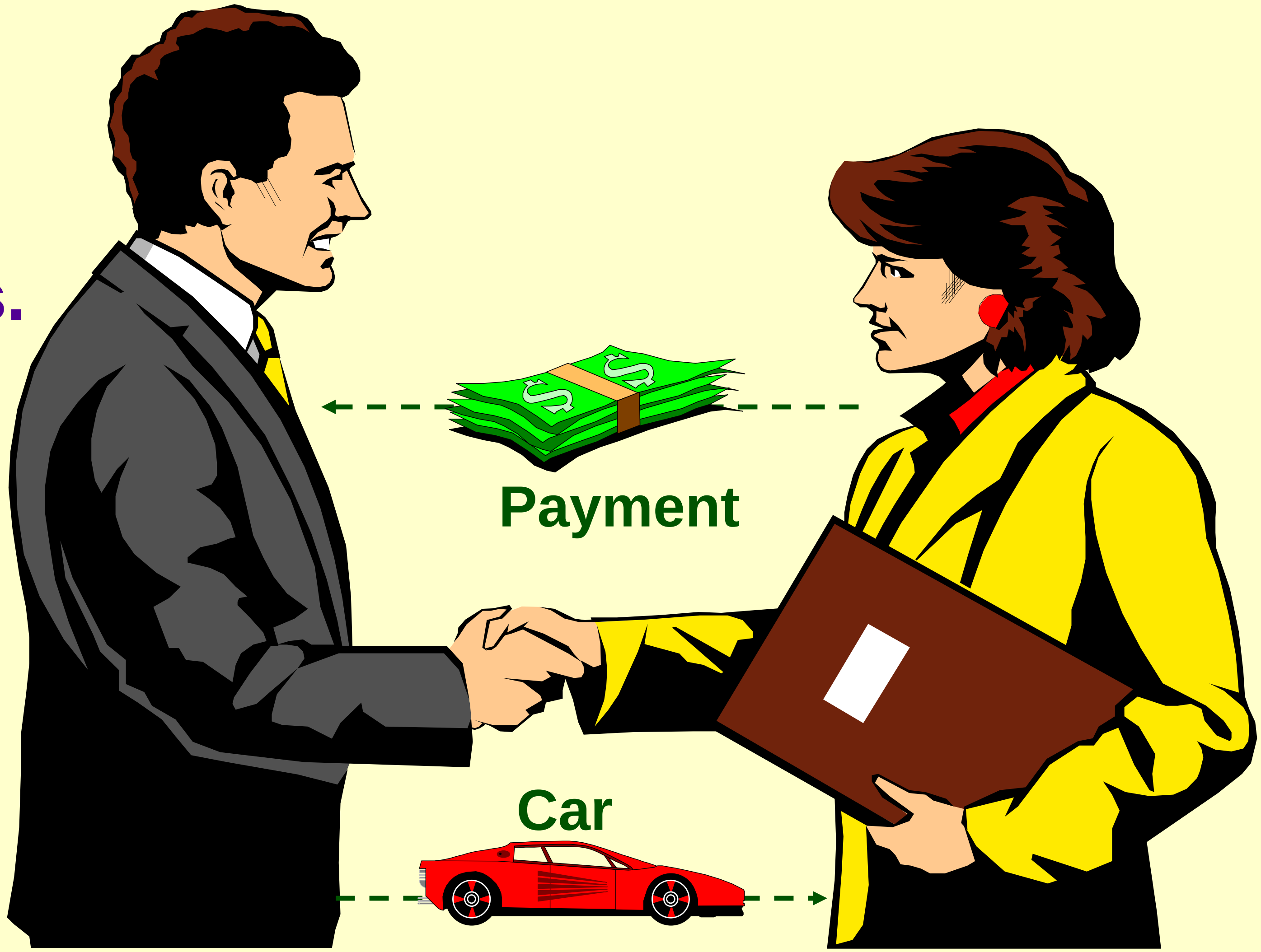
- Profitability
- Financial position
- Cash flows

Decisions Supported

- Performance evaluations
- Stock investments
- Tax strategies
- Labor relations
- Resource allocations
- Lending decisions
- Borrowing

Basic Functions of an Accounting System

➊ **Interpret and record business transactions.**

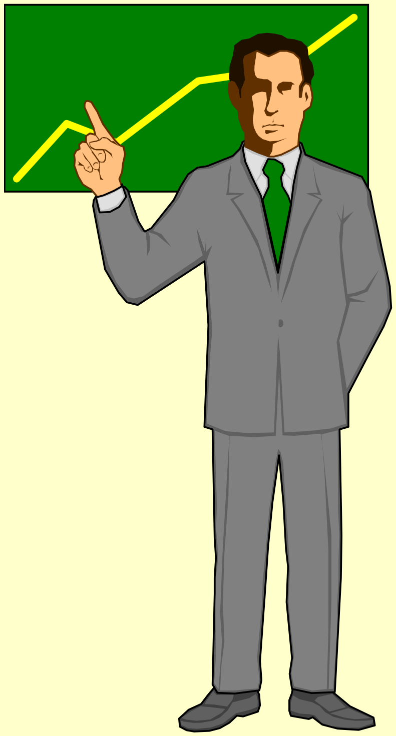


Basic Functions of an Accounting System

❶ **Interpret and record business transactions.**

❷ **Classify similar transactions into useful reports.**

❸ **Summarize and communicate information to decision makers.**



External Users of Accounting Information

- Owners
- Creditors
- Labor unions
- Governmental agencies
- Suppliers
- Customers
- Trade associations
- General public

Objectives of Financial Reporting

(Specific)

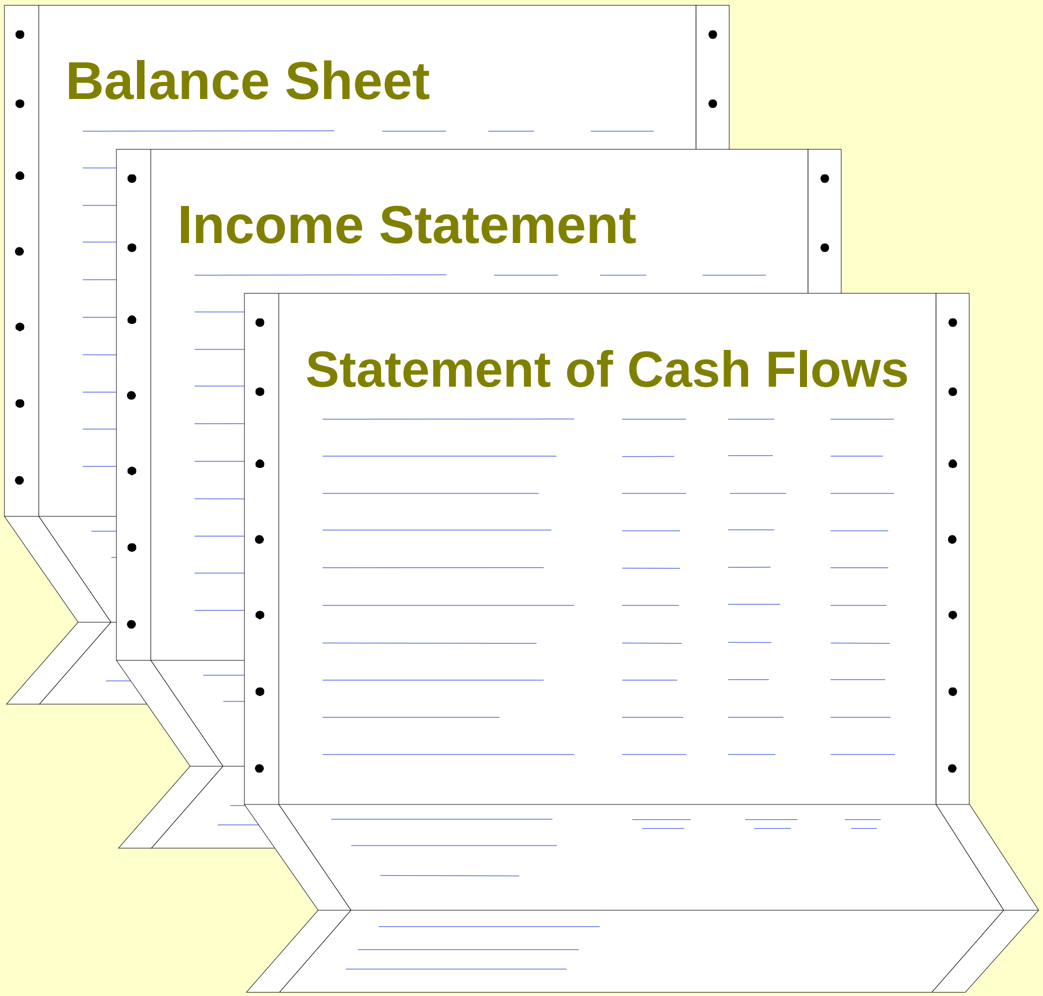
Provide information about economic resources, claims to resources, and changes in resources and claims.

Provide information useful in assessing amount, timing and uncertainty of future cash flows.

Provide information useful in making investment and credit decisions.

(General)

Objectives of External Financial Reporting



The primary financial statements.

Characteristics of Externally Reported Information

A Means to an End

Usefulness Enhanced via Explanation

Broader than Financial Statements

Based on General-Purpose Assumption

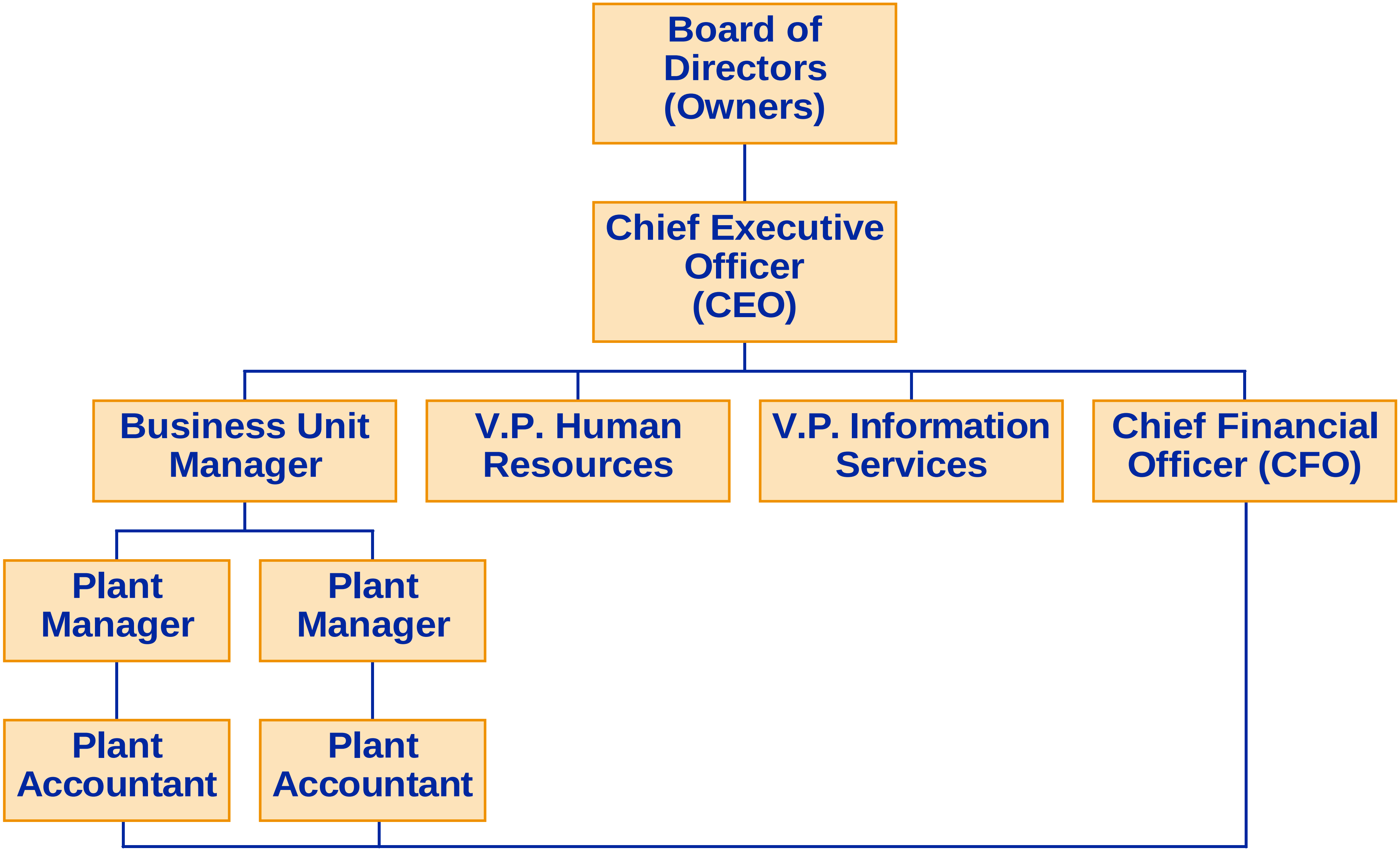
Historical in Nature

Results from Inexact and Approximate Measures

Users of Internal Accounting Information

- Board of directors
- Chief executive officer (CEO)
- Chief financial officer (CFO)
- Vice presidents
- Business unit managers
- Plant managers
- Store managers
- Line supervisors

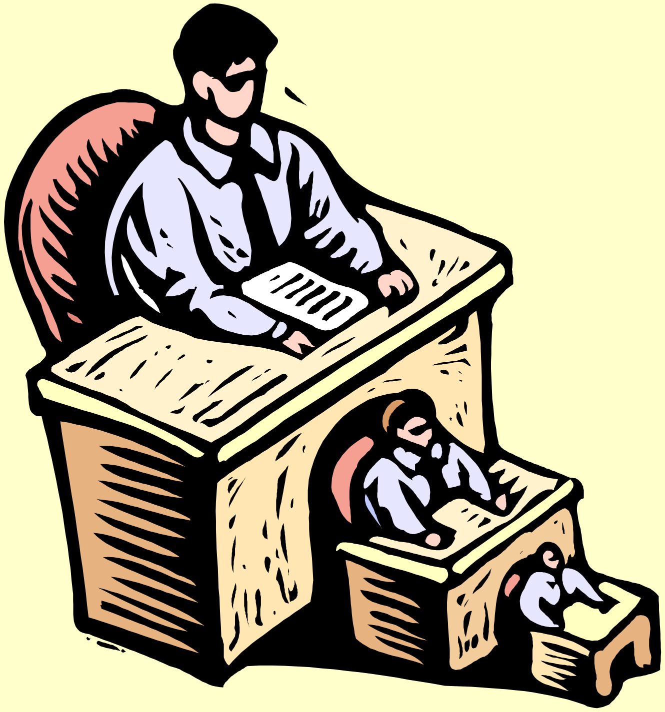
Typical Simple Organization Chart



Objectives of Management Accounting Information

To help achieve goals and missions

To help evaluate and reward decision makers



Characteristics of Management Accounting Information

Timeliness

A Means to an End

Identify Decision Maker

Measures of Efficiency and Effectiveness

Oriented Toward Future

Integrity of Accounting Information

Institutional Features

- **Generally Accepted Accounting Principles (GAAP)**
- **Financial Accounting Standards Board**
- **Securities and Exchange Commission**
- **Internal Control Structure**
- **Audits**
- **Legislation**

Integrity of Accounting Information

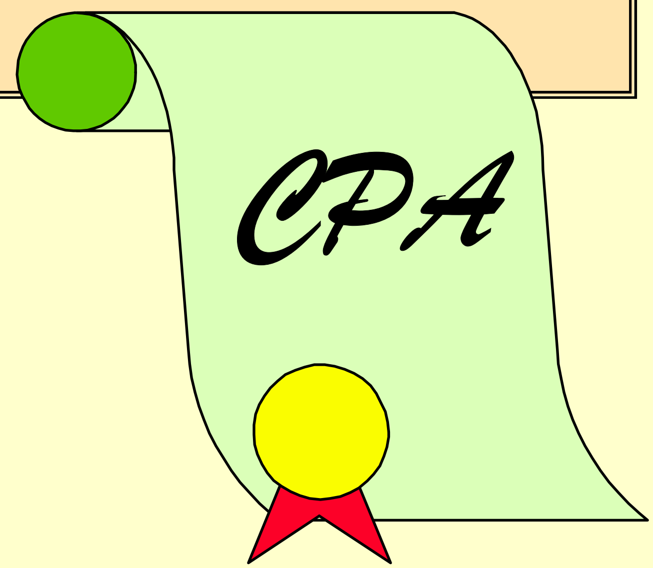
Professional Organizations

- American Institute of Certified Public Accountants
- Institute of Management Accountants
- Institute of Internal Auditors
- American Accounting Association

Integrity of Accounting Information

Competence, Judgment and Ethical Behavior

- **Certified Public Accountants (CPAs)**
- **Certificate in Management Accounting (CMA)**
- **Certificate in Internal Auditing (CIA)**
- **Code of Professional Conduct**

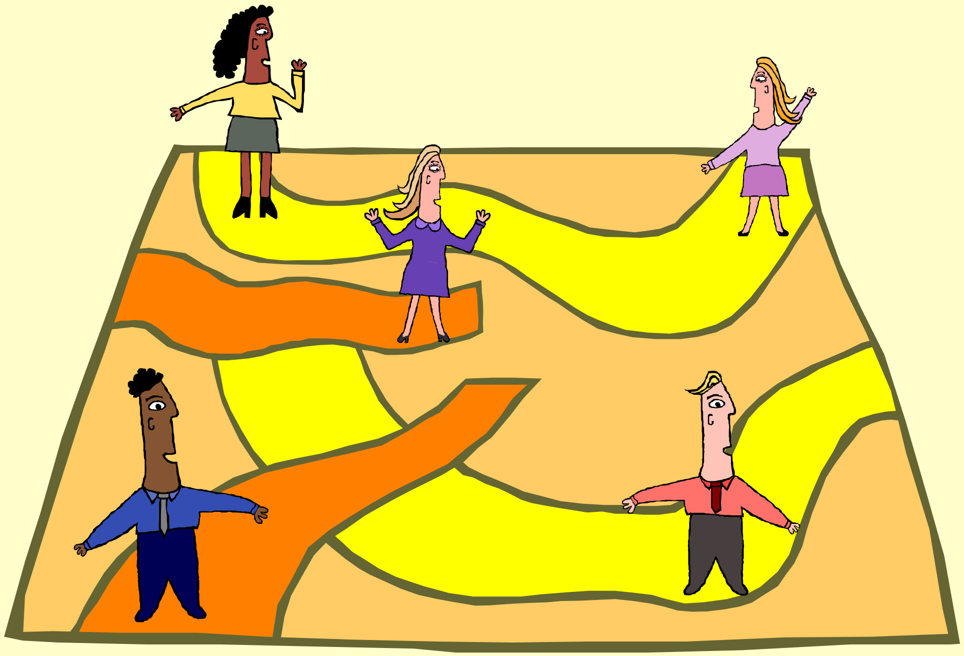


Integrity of Accounting Information

Careears in Accounting

- Public Accounting
- Management Accounting
- Governmental Accounting
- Accounting Education

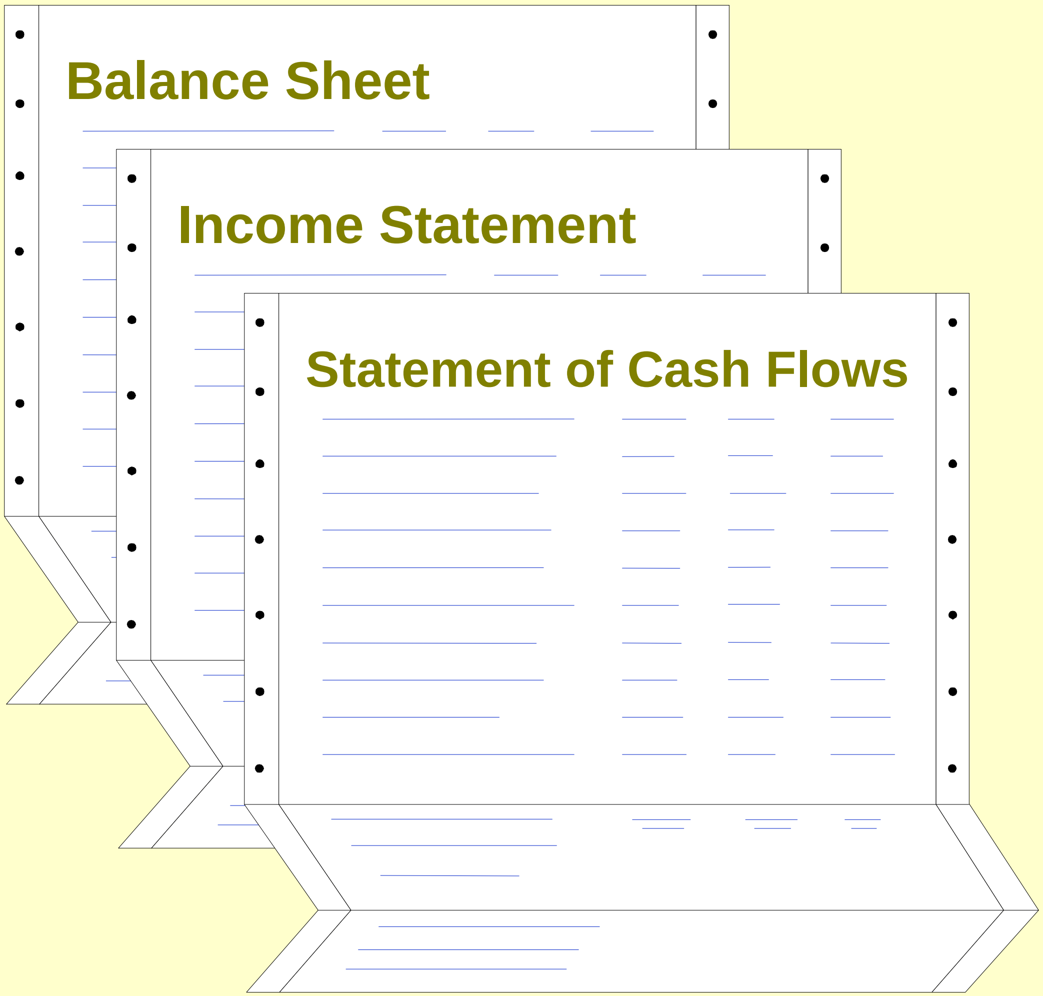
End of Part (1)



Part (2)

FINANCIAL STATEMENTS

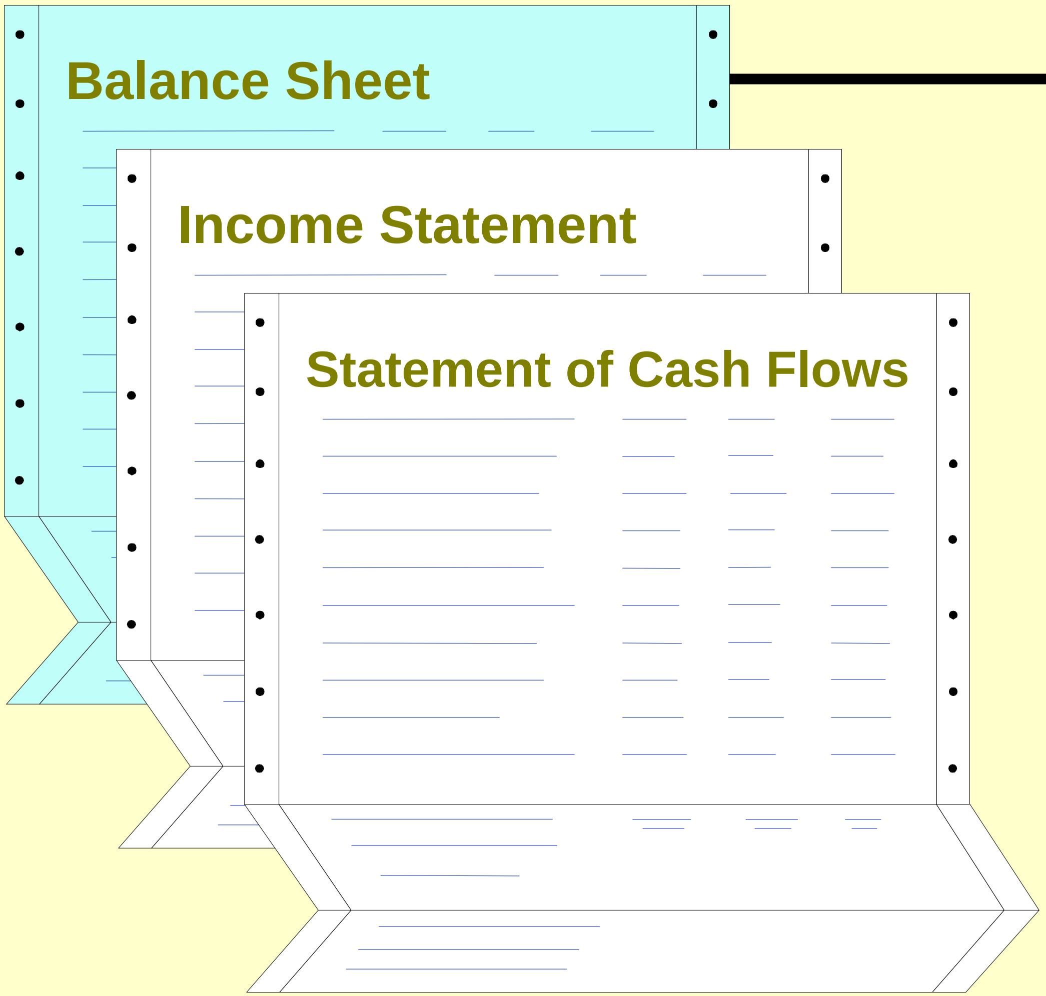
Introduction to Financial Statements



Three primary financial statements.

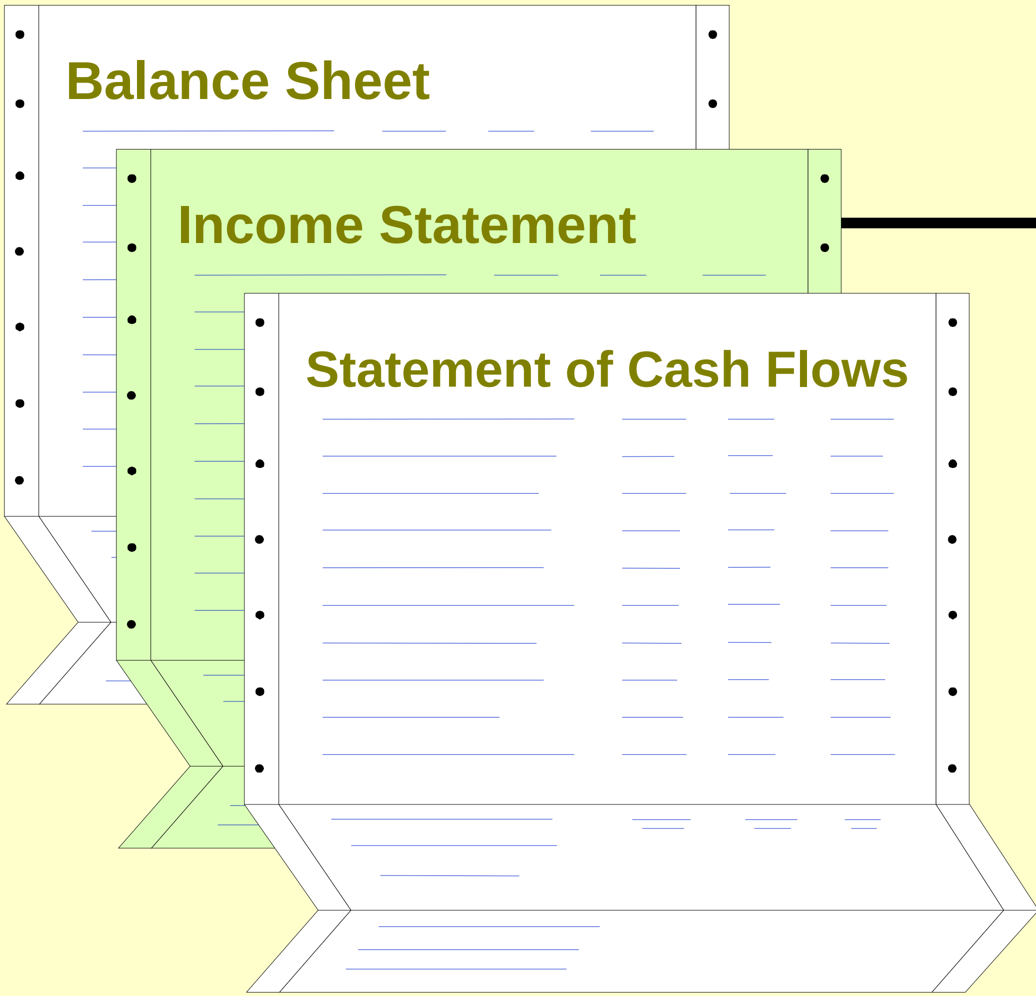
We will use a corporation to describe these statements.

Introduction to Financial Statements



Describes where the enterprise stands at a specific date.

Introduction to Financial Statements



Depicts the revenue and expenses for a designated period of time.

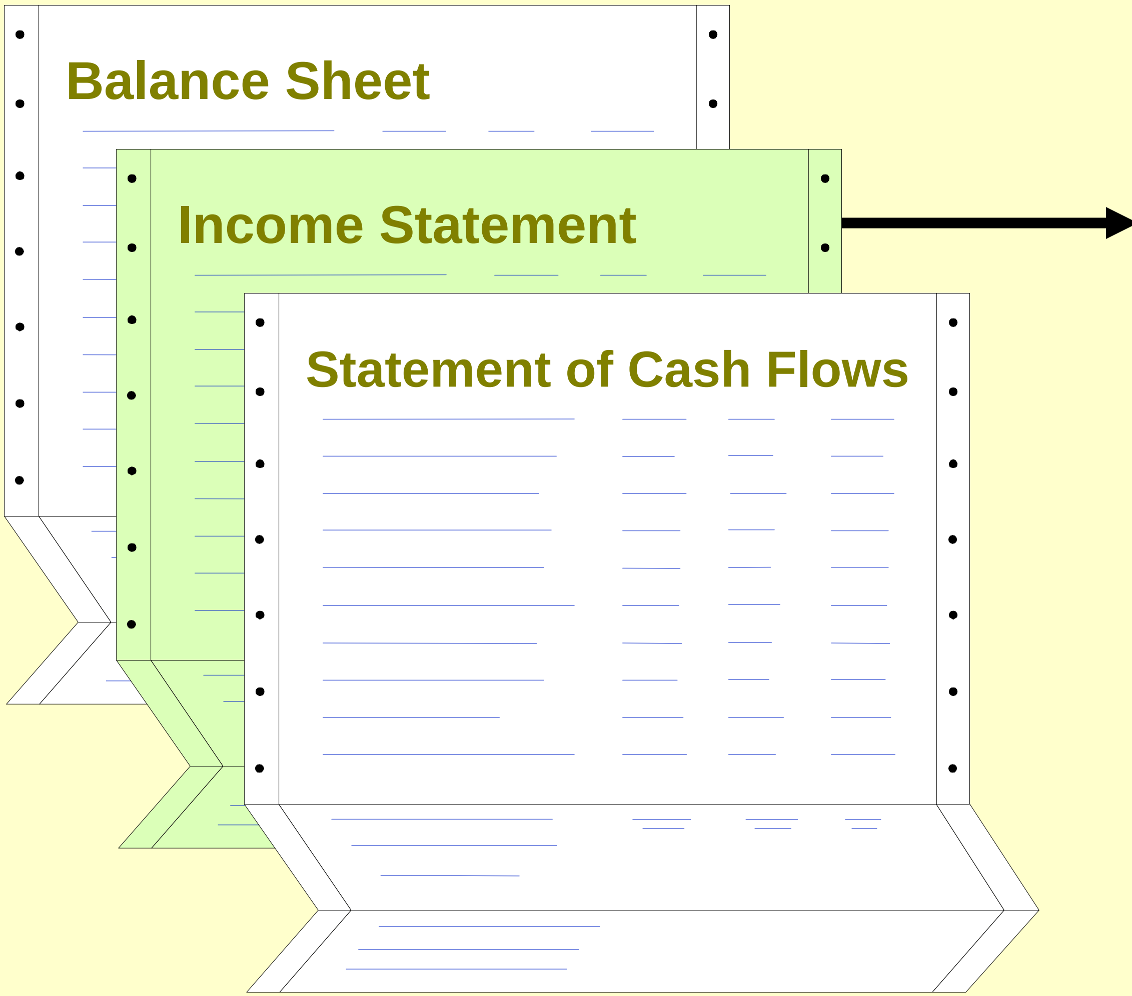
Introduction to Financial Statements

Revenues result in positive cash flow.

Expenses result in negative cash flow.

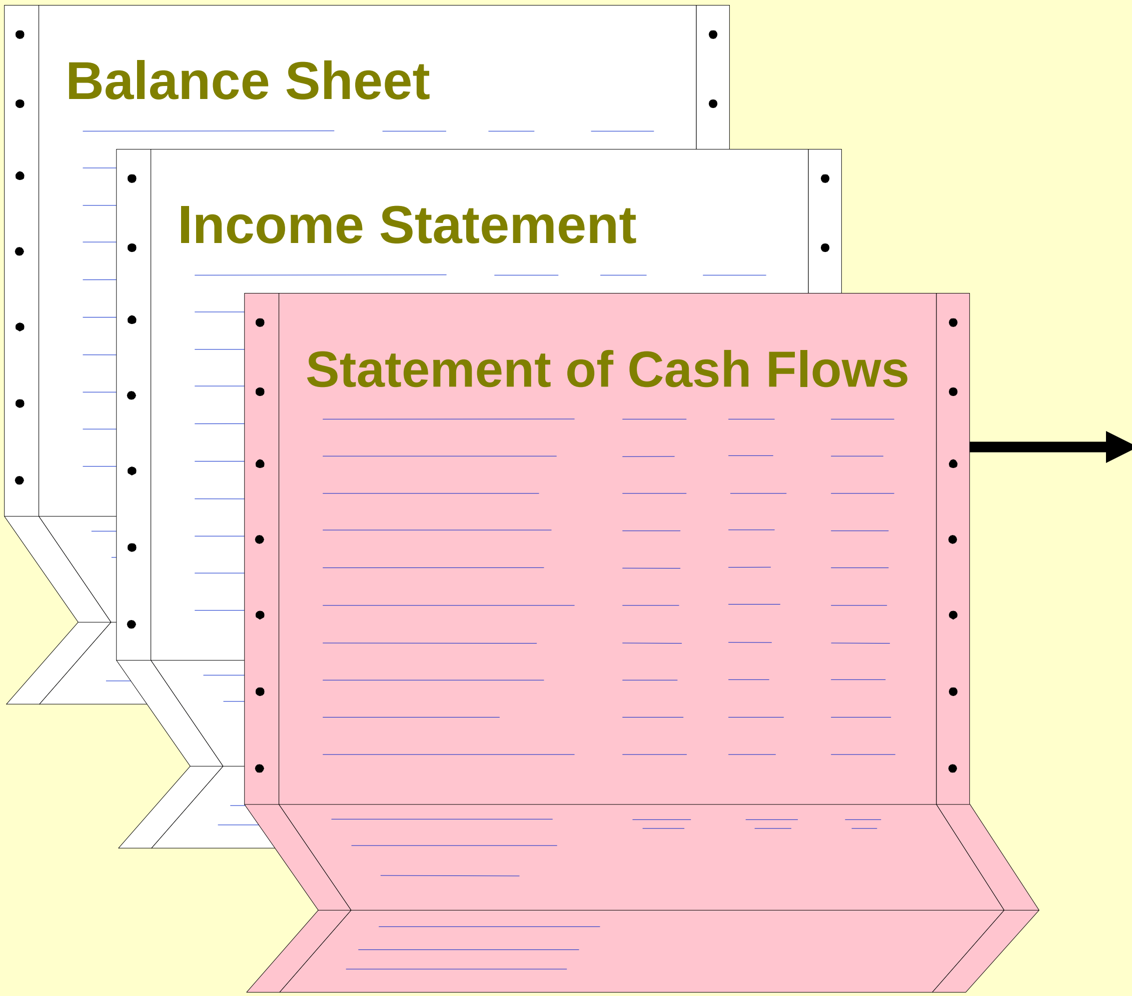
Either in the past, present, or future.

Introduction to Financial Statements



Net income (or net loss) is simply the difference between revenues and expenses.

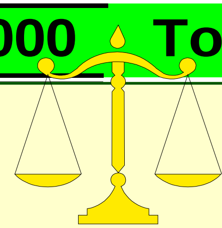
Introduction to Financial Statements



Depicts the ways cash has changed during a designated period of time.

A Starting Point: Statement of Financial Position

Vagabond Travel Agency Balance Sheet December 31, 2005			
Assets		**Liabilities & Owners' Equity**	
Cash	$ 22,500	Liabilities:	
Notes receivable	10,000	Notes payable	$ 41,000
Accounts receivable	60,500	Accounts payable	36,000
Supplies	2,000	Salaries payable	3,000
Land	100,000	Total liabilities	$ 80,000
Building	90,000	Owners' Equity:	
Office equipment	15,000	Capital stock	150,000
		Retained earnings	70,000
Total	**$ 300,000**	**Total**	**$ 300,000**



The Concept of the Business Entity

A **business entity** is separate from the personal affairs of its owner.

Assets

Vagabond Travel Agency Balance Sheet December 31, 2005	
Assets	
Cash	$ 22,500
Notes receivable	10,000
Accounts receivable	60,500
Supplies	2,000
Land	100,000
Building	90,000
Office equipment	15,000
Total	$ 300,000

Assets are economic resources that are owned by the business and are expected to provide positive future cash flows.

Assets

Cost Principle

Stable-Dollar Assumption

These accounting principles support cost as the basis for asset valuation.

Going-Concern Assumption

Objectivity Principle

Liabilities

Liabilities are debts that represent negative future cash flows for the enterprise.

Vagabond Travel Agency Balance Sheet December 31, 2005			
		Liabilities & Owners' Equity	
		Liabilities:	
		Notes payable	$ 41,000
		Accounts payable	36,000
		Salaries payable	3,000
		Total liabilities	$ 80,000
		Owners' Equity:	
		Capital stock	150,000
		Retained earnings	70,000
Total	$ 300,000	**Total**	$ 300,000

Owners' Equity

Owners' equity represents the owners' claims to the assets of the business.

Vagabond Travel Agency Balance Sheet December 31, 2005			
		Liabilities & Owners' Equity	
		Liabilities:	
		Notes payable	$ 41,000
		Accounts payable	36,000
		Salaries payable	3,000
		Total liabilities	$ 80,000
		Owners' Equity:	
		Capital stock	150,000
		Retained earnings	70,000
Total	$ 300,000	**Total**	$ 300,000

Owners' Equity

Changes in Owners' Equity

- Owners' Investments
- Business Earnings

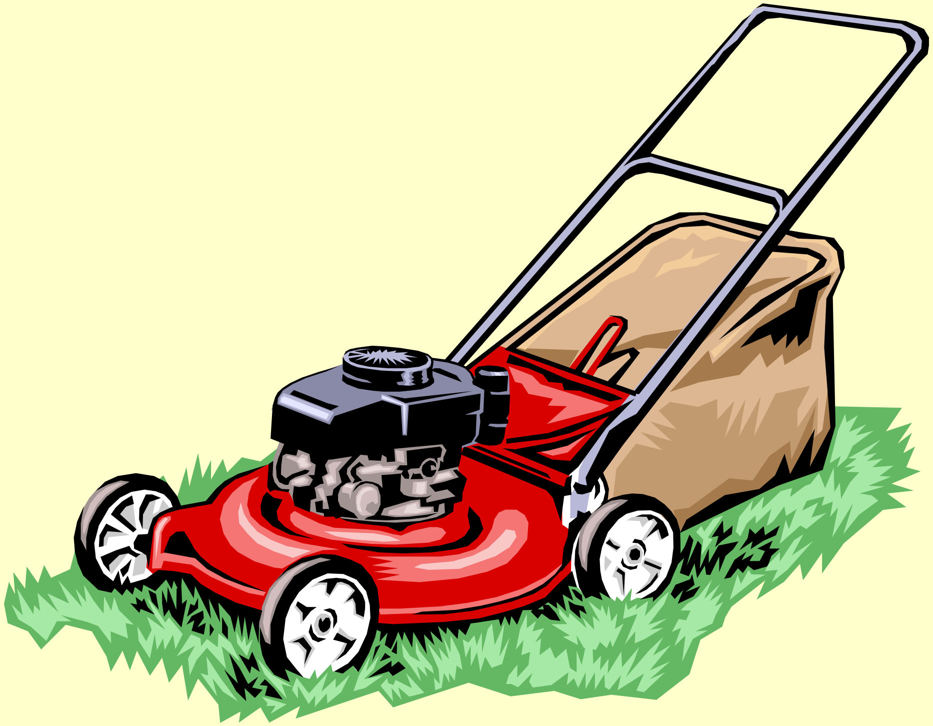
- Payments to Owners
- Business Losses

The Accounting Equation

Assets = Liabilities + Owners' Equity

$300,000 = $80,000 + $220,000

			uity
Cash	$ 22,500	Liabilities:	
Notes receivable	10,000	Notes payable	$ 41,000
Accounts receivable	60,500	Accounts payable	36,000
Supplies	2,000	Salaries payable	3,000
Land	100,000	Total liabilities	$ 80,000
Building	90,000	Owners' Equity	
Office equipment	15,000	Capital stock	150,000
		Retained earnings	70,000
Total	$ 300,000	Total	$ 300,000



Let's analyze some transactions for JJ's Lawn Care Service.

On May 1, 2005, Jill Jones and her family invested $8,000 in JJ's Lawn Care Service and received 800 shares of stock.

JJ's Lawn Care Service Balance Sheet May 1, 2005					
Assets			Owners' Equity		
Cash	$	8,000	Capital Stock	$	8,000
Total	$	8,000	Total	$	8,000

On May 2, JJ's purchased a riding lawn mower for $2,500 cash.

JJ's Lawn Care Service Balance Sheet May 2, 2005					
Assets			**Owners' Equity**		
Cash	$	5,500	Capital Stock	$	8,000
Tools & Equipment		2,500			
Total	$	8,000	Total	$	8,000

On May 8, JJ's purchased a $15,000 truck.

JJ's paid $2,000 down in cash and issued a note payable for the remaining $13,000.

JJ's Lawn Care Service
Balance Sheet
May 8, 2005

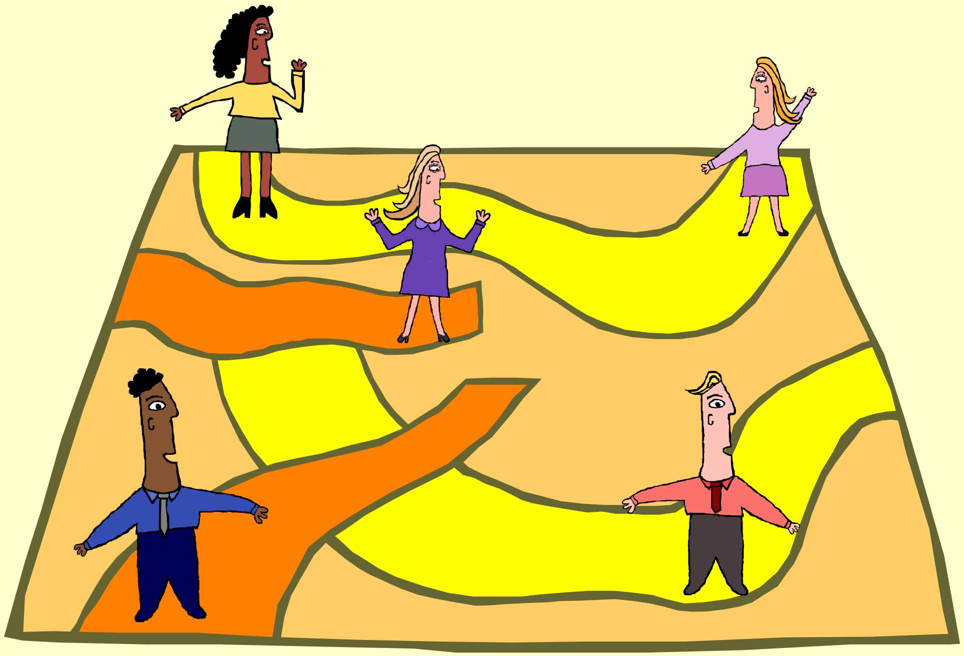
Assets		Liabilities and Owners' Equity	
Cash	$ 3,500	Liabilities:	
Tools & Equipment	2,500	Notes Payable	$ 13,000
Truck	15,000	Owners' Equity:	
		Capital Stock	8,000
Total	$ 21,000	Total	$ 21,000

On May 11, JJ's purchased some repair parts for $300 on account.

JJ's Lawn Care Service
Balance Sheet
May 11, 2005

Assets		Liabilities and Owners' Equity	
Cash	$ 3,500	Liabilities:	
Tools & Equipment	2,800	Notes Payable	$ 13,000
Truck	15,000	Accounts Payable	300
		Total Liabilities	$ 13,300
		Owners' Equity:	
		Capital Stock	8,000
Total	$ 21,300	Total	$ 21,300

End of Part (2)



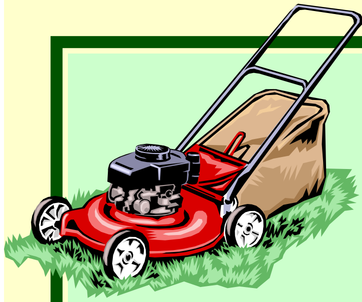
Part (3)

ACCOUNTING REPORTING of FINANCIAL RESULTS

JJ's Lawn Care Service Adjusted Trial Balance May 31, 2005		
Cash	$ 3,925	
Accounts receivable	75	
Tools & equipment	2,650	
Accum. depreciation: tools & eq.		$ 50
Truck	15,000	
Accum. depreciation: truck		250
Notes payable		13,000
Accounts payable		150
Capital stock		8,000
Dividends	200	
Sales revenue		750
Gasoline expense	50	
Depreciation exp.: tools & eq.	50	
Depreciation exp.: truck	250	
Total	$ 22,200	$ 22,200

This is the Adjusted Trial Balance for JJ's.

Now, let's prepare the financial statements for JJ's Lawn Care Service for May.



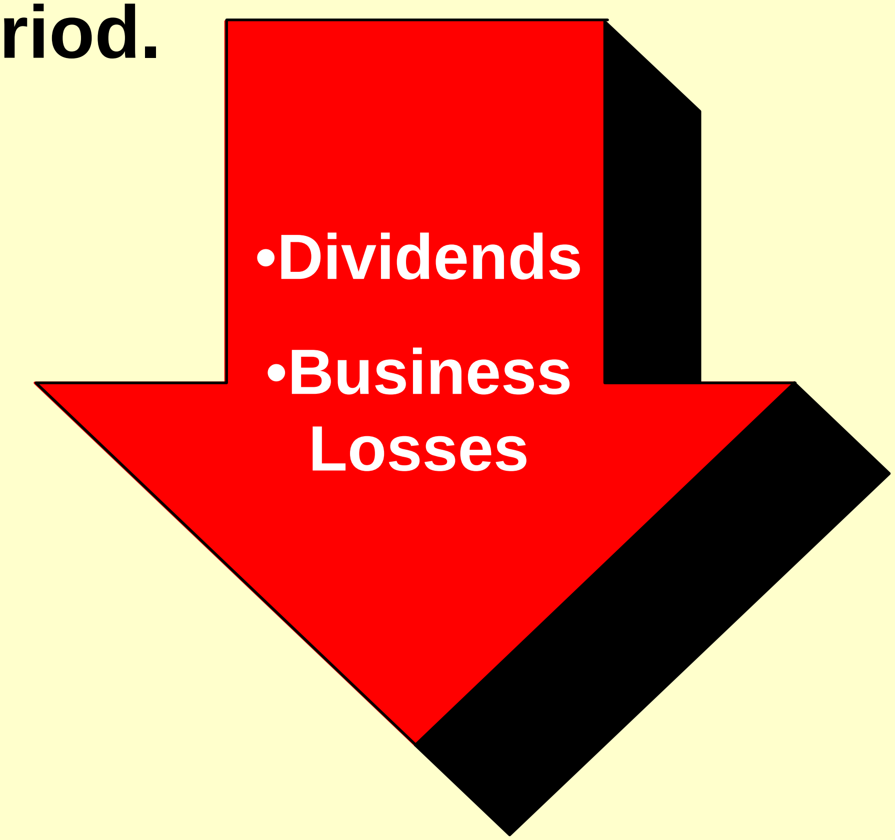
JJ's Lawn Care Service
Income Statement
For the month ending May 31, 2005

Sales revenue		**$ 750**
Operating expenses:		
Gasoline expense	**$ 50**	
Depr. exp.: tools & eq.	**50**	
Depr. exp.: truck	**250**	**350**
Net income		**$ 400**

Net income also appears on the Statement of Retained Earnings.

Statement of Retained Earnings

This statement summarizes the increases and decreases in Retained Earnings during the period.



JJ's Lawn Care Service
Statement of Retained Earnings
For the Month Ended May 31, 2005

Retained earnings, May 1	$	-
Add: Net income		400
Subtotal	$	400
Less: Dividends		200
Retained earnings, May 31	$	200

Now, let's prepare the Balance Sheet.

JJ's Lawn Care Service
Balance Sheet
May 31, 2005

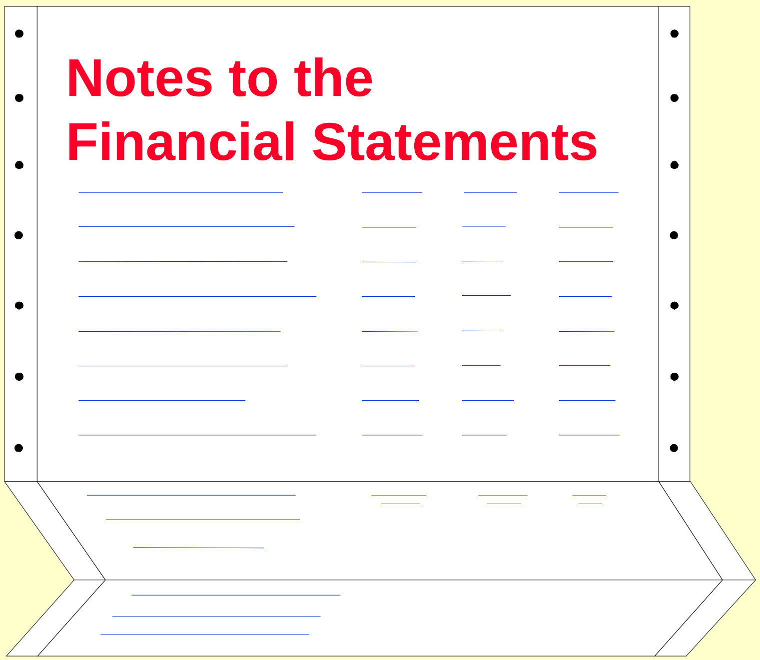
Assets		
Cash		$ 3,925
Accounts receivable		75
Tools & equipment	$ 2,650	
Less: Accum. depr.: tools & eq.	50	2,600
Truck	$ 15,000	
Less: Accum. depr.: truck	250	14,750
Total assets		$ 21,350
Liabilities & Stockholders' Equity		
Liabilities:		
Notes payable		$ 13,000
Accounts payable		150
Total liabilities		$ 13,150
Stockholders' equity:		
Capital stock	$ 8,000	
Retained earnings	200	
Total stockholders' equity		8,200
Total liabilities & stockholders' equity		$ 21,350

Next, let's prepare the Statement of Cash Flows for JJ's Lawn Care Service for May.

JJ's Lawn Care Service
Statement of Cash Flows
For the Month Ended May 31, 2005

Cash flows from operating activities:		
Cash received from revenue transactions	$ 750	
Cash paid for expenses	(50)	
Net cash provided by operating activities		$ 700
Cash flows from investing activities:		
Purchase of lawn mower	$ (2,500)	
Purchase of truck	(2,000)	
Collection for sale of repair parts	75	
Payment for repair parts	(150)	
Net cash used by investing activities		(4,575)
Cash flows from financing activities:		
Investment by owners	$ 8,000	
Dividends	(200)	
Net cash provided by financing activities		7,800
Increase in cash for month		$ 3,925
Cash balance, May 1, 2005		-
Cash balance, May 31, 2005		$ 3,925

Drafting Notes to the Financial Statements



<u>Examples of Items Disclosed</u>

- **Lawsuits pending**
- **Scheduled plant closings**
- **Governmental investigations**
- **Significant events occurring after the balance sheet date**
- **Specific customers that account for a large portion of revenue**
- **Unusual transactions and related party transactions**

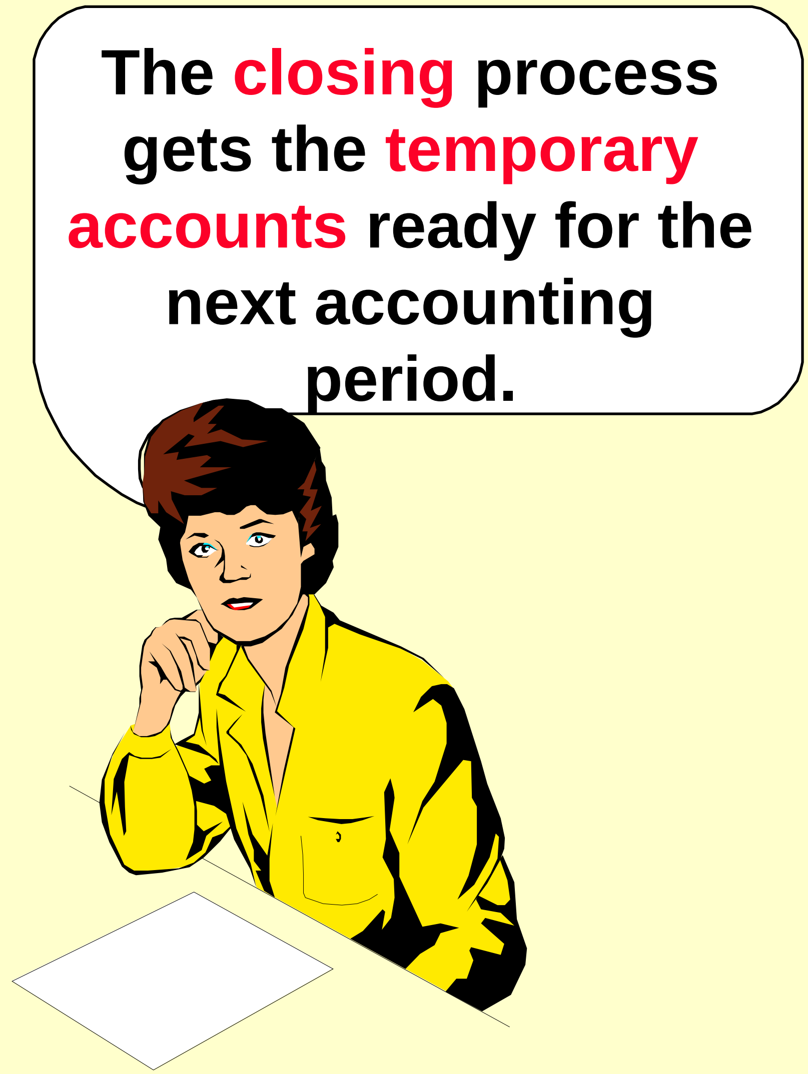
Closing the Temporary Equity Accounts

❶ **Close Revenue accounts to Income Summary.**

❷ **Close Expense accounts to Income Summary.**

❸ **Close Income Summary account to Retained Earnings.**

❹ **Close Dividends to Retained Earnings.**



Closing the Temporary Equity Accounts

JJ's Lawn Care Service Adjusted Trial Balance May 31, 2005		
Cash	$ 3,925	
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Tools & equipment	2,650	
Accum. depreciation: tools & eq.		$ 50
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Notes payable		13,000
Accounts payable		150
Capital stock		8,000
Dividends	200	
Sales revenue		750
Gasoline expense	50	
Depreciation exp.: tools & eq.	50	
Depreciation exp.: truck	250	
Total	$ 22,200	$ 22,200

Let's prepare the closing entries for JJ's Lawn Care Service.

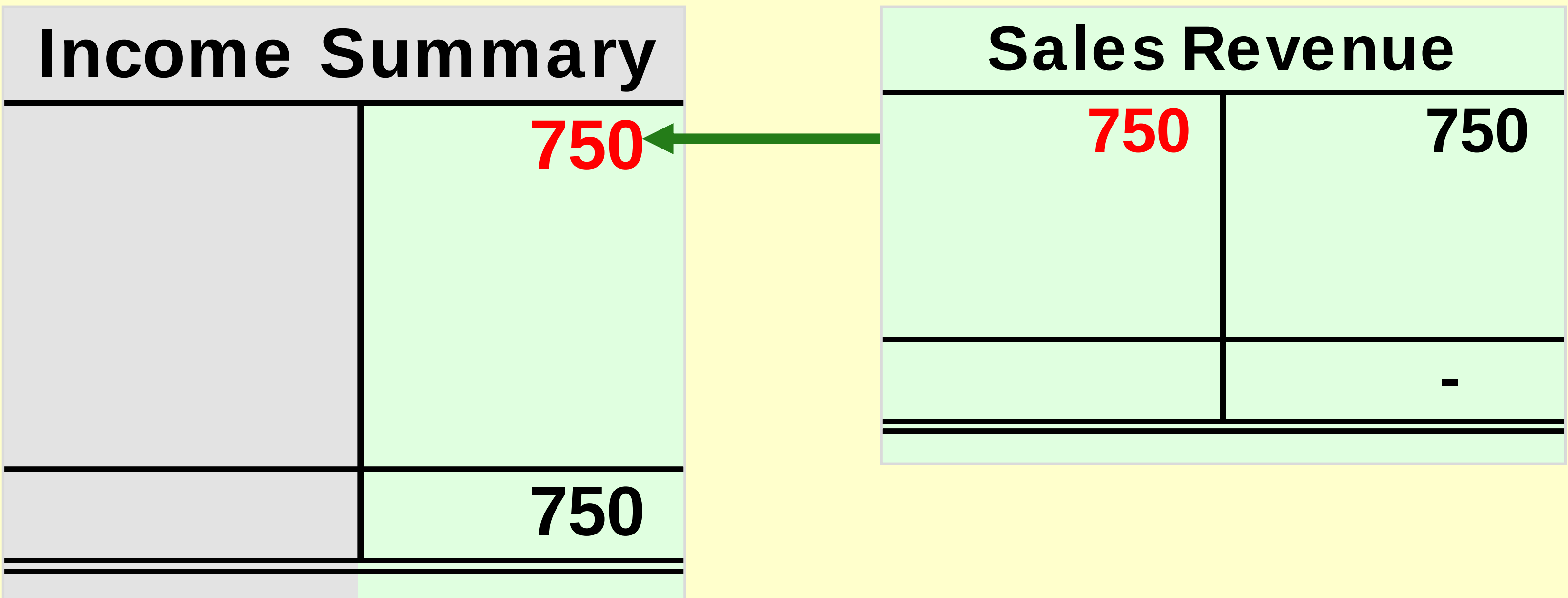
Closing Entries for Revenue Accounts

Since Sales Revenue has a credit balance, the closing entry requires a debit to the Sales Revenue account.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
May	31	Sales Reveune	750	
		Income Summary		750
		To close the revenue account.		

Closing Entries for Revenue Accounts



Closing Entries for Expense Accounts

Since expense accounts have a debit balance, the closing entry requires a credit to the expense accounts.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
May	31	Income Summary	350	
		Gasoline Expense		50
		Depreciation Exp.: Tools & Equipment		50
		Depreciation Exp.: Truck		250
		To close the expense accounts.		

Closing Entries for Expense Accounts

Gasoline Exp.

50	50
	-

Depr. Exp.: Tools & Equipment

50	50
	-

Depr. Exp.: Truck

250	250
	-

Income Summary

350	750
	400

Net Income

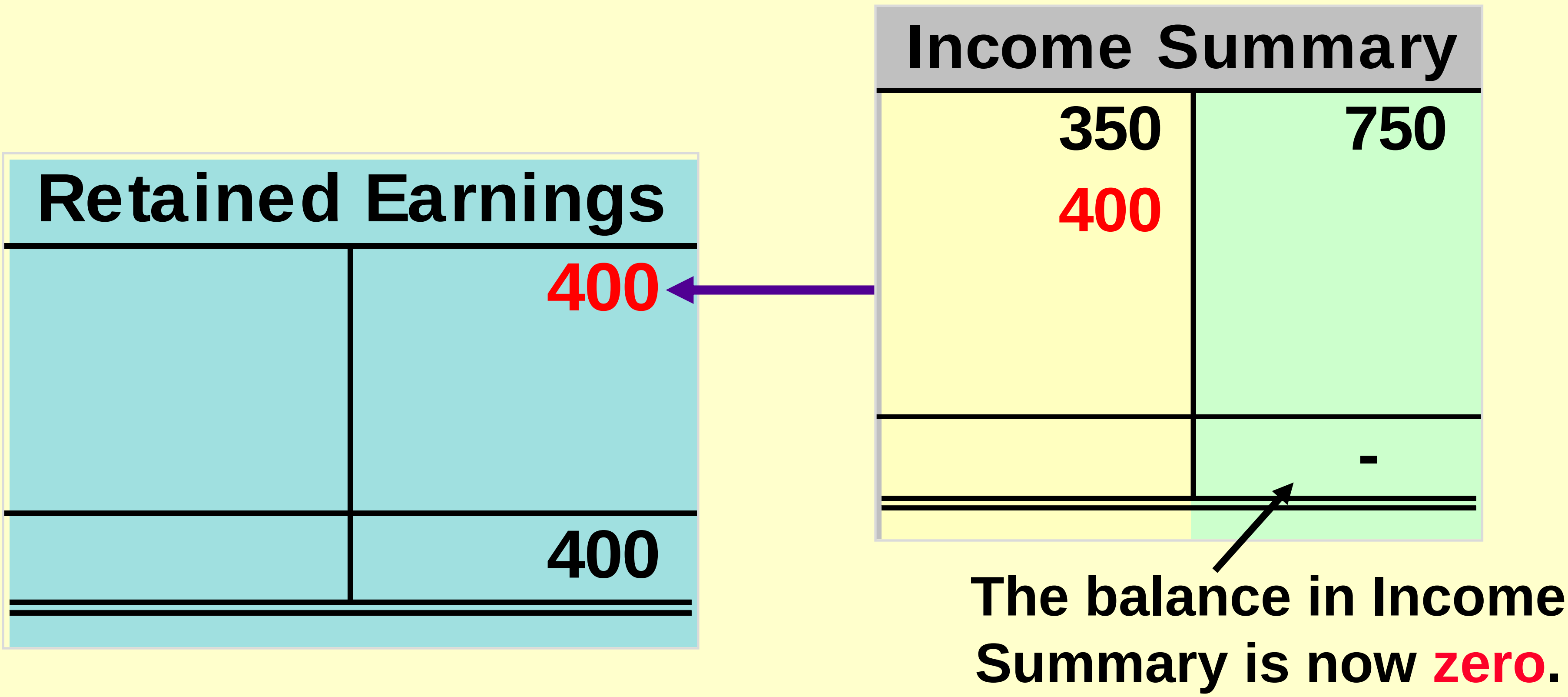
Closing the Income Summary Account

Since Income Summary has a $400 credit balance, the closing entry requires a debit to Income Summary.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
May	31	Income Summary	400	
		Retained Earnings		400
		To close Income Summary.		

Closing the Income Summary Account



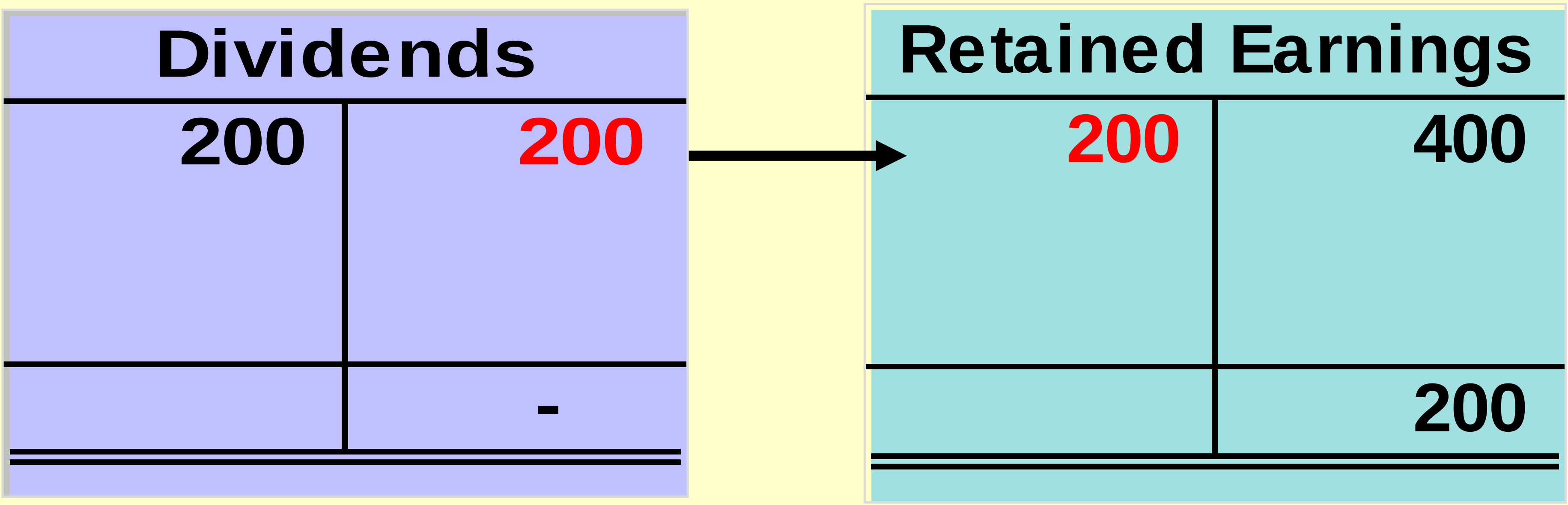
Closing the Dividends Account

Since the Dividends account has a debit balance, the closing entry requires a credit to the Dividends account.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
May	31	Retained Earnings	200	
		Dividends		200
		To close the Dividends account.		

Closing the Dividends Account



JJ's Lawn Care Service
After-Closing Trial Balance
May 31, 2005

Cash	$ 3,925	
Accounts receivable	75	
Tools & equipment	2,650	
Accum. depreciation: tools & eq.		$ 50
Truck	15,000	
Accum. depreciation: truck		250
Notes payable		13,000
Accounts payable		150
Capital stock		8,000
Retained earnings		200
Total	$ 21,650	$ 21,650

After all closing entries are made, JJ's After-Closing Trial Balance looks like this.

Evaluating the Business

Evaluating Profitability

Did the business earn a profit or loss in the current period?

What is the business's future potential for a profit?

Evaluating Liquidity

Does the business have assets available to pay debts as they become due?

Evaluating the Business

Evaluating Profitability

$$\text{Net Income Percentage} = \frac{\text{Net Income}}{\text{Total Revenue}}$$

$$\text{Return on Equity} = \frac{\text{Net Income}}{\text{Avg. Stockholders' Equity}}$$

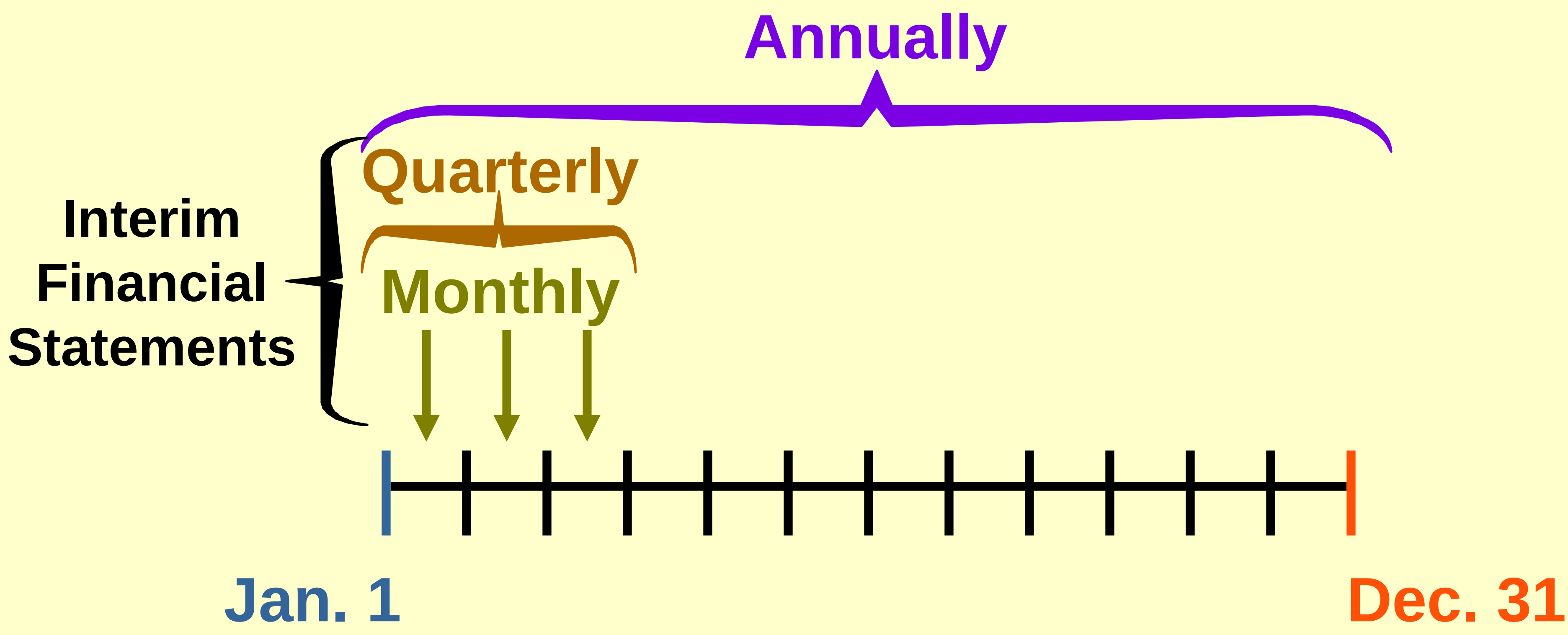
Evaluating Liquidity

Working Capital = Current Assets – Current Liabilities

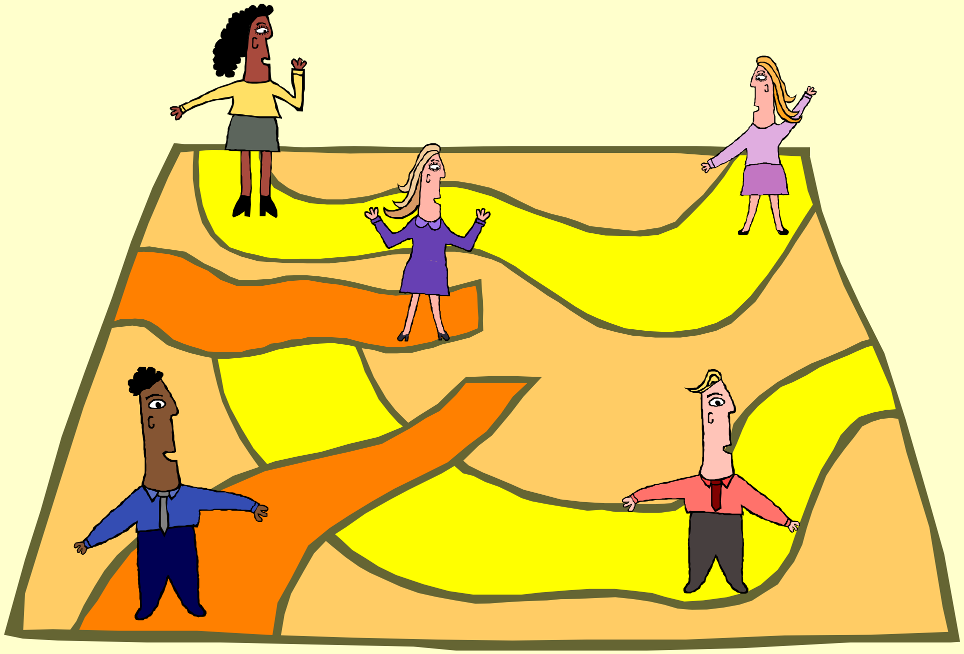
$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Preparing Financial Statements Covering Different Periods of Time

Many companies prepare financial statements at various points throughout the year.



End of Part (3)



Part (4)

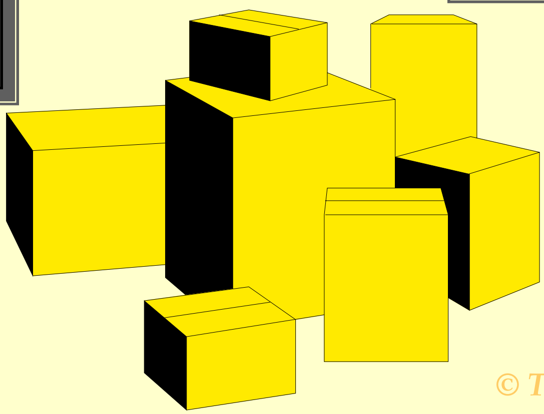
COST ACCOUNTING FOR MANAGEMENT

Inventory Defined

Inventory

Goods owned and held for sale to customers

Current asset



The Flow of Inventory Costs

As purchase cost (or manufacturing costs) are incurred

$

BALANCE SHEET

Current assets:
Inventory

$

as goods are sold

$

INCOME STATEMENT

Revenue
Cost of goods sold
Gross profit
Expenses
Net income

The Flow of Inventory Costs

In a perpetual inventory system, inventory entries parallel the flow of costs.

GENERAL JOURNAL				
Date		Account Titles and Explanation	Debit	Credit
		Entry on Purchase Date		
		Inventory	$$$$	
		Accounts Payable		$$$$
		Entry on Sale Date		
		Cost of Goods Sold	$$$$	
		Inventory		$$$$

Which Unit Did We Sell?

When identical units of inventory have different unit costs, a question naturally arises as to which of these costs should be used in recording a sale of inventory.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
		Entry on Sale Date		
		Cost of Goods Sold	$$$$	
		Inventory		$$$$

Inventory Subsidiary Ledger

A separate subsidiary account is maintained for each item in inventory.

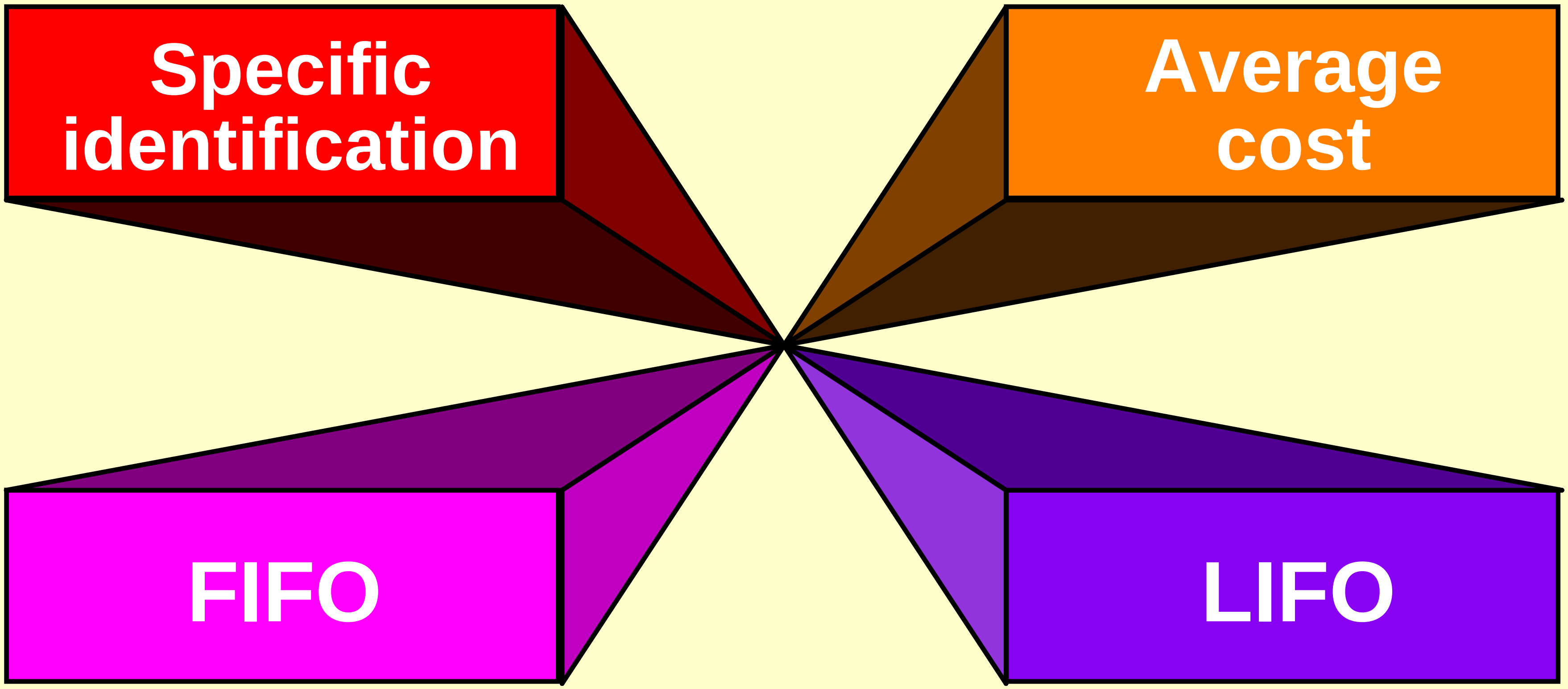
Item **LL002**	Primary supplier **Electronic City**
Description **Laser Light**	Secondary supplier **Electric Company**
Location **Storeroom 2**	Inventory level: Min: **25** Max: **200**

	Purchased			Sold			Balance		
Date	Units	Unit Cost	Total	Units	Unit Cost	Cost of Goods Sold	Units	Unit Cost	Total
Sept. 5	100	$ 30	$ 3,000				100	$ 30	$ 3,000
Sept. 9	75	50	3,750				100 75	30 50	3,000 3,750
Sept. 10				10	?	?	? ?	? ?	? ?

How can we determine the unit cost for the Sept. 10 sale?

Inventory Cost Flows

We use one of these inventory valuation methods to determine cost of inventory sold.



Information for the Following Inventory Examples

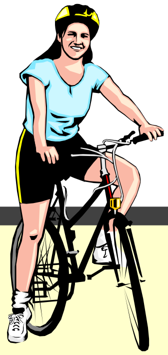
The Bike Company (TBC)

Cost of Goods Available for Sale

Aug.	1 Beg. Inventory	10 units @	$ 91	=	$	910
Aug.	3 Purchased	15 units @	$ 106	=	$	1,590
Aug.	17 Purchased	20 units @	$ 115	=	$	2,300
Aug.	28 Purchased	10 units @	$ 119	=	$	1,190

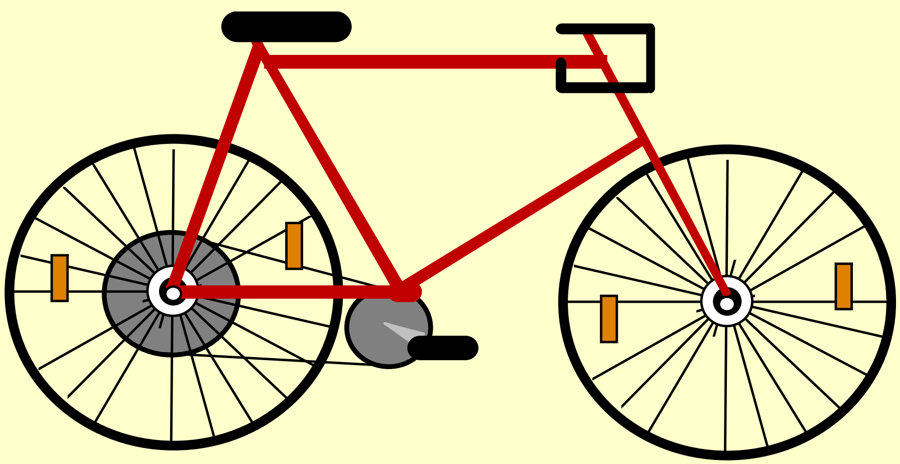
Retail Sales of Goods

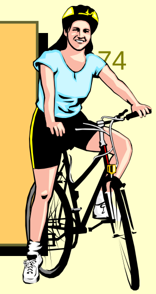
Aug.	14 Sales	20 units @	$ 130	=	$	2,600
Aug.	31 Sales	23 units @	$ 150	=	$	3,450



Specific Identification

When a unit is sold, the specific cost of the unit sold is added to cost of goods sold.





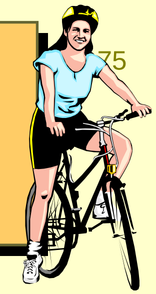
Specific Identification

Date	Purchases	Cost of Goods Sold	Inventory Balance
Aug. 1	**10 @ $ 91 = $ 910**		**$ 910**
Aug. 3	**15 @ $ 106 = $ 1,590**		**$ 2,500**

On August 14, TBC sold 20 bikes for $130 each.

Nine bikes originally cost $91 and 11 bikes originally cost $106.

Continue



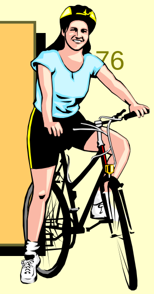
Specific Identification

Date	Purchases	Cost of Goods Sold	Inventory Balance
Aug. 1	**10 @ $ 91 = $ 910**		**$ 910**
Aug. 3	**15 @ $ 106 = $ 1,590**		**$ 2,500**
Aug. 14		**9 @ $ 91 = $ 819** **11 @ $ 106 = $ 1,166**	**$ 515**

The Cost of Goods Sold for the August 14 sale is $1,985, leaving $515 and 5 units in inventory.

Continue

Let's look at the entries for the Aug. 14 sale.



Specific Identification

GENERAL JOURNAL

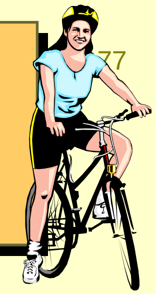
Date		Account Titles and Explanation	Debit	Credit
Aug.	14	Cash	2,600	
		Sales		2,600
	14	Cost of Goods Sold	1,985	
		Inventory		1,985

Retail

Cost

A similar entry is made after each sale.

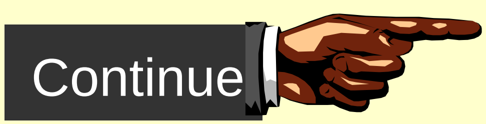
Continue



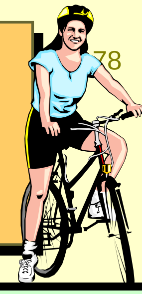
Specific Identification

Date		Cost of Goods Sold	Inventory Balance
Aug. 1			$ 910
Aug. 3			$ 2,500
Aug. 14		9 @ $ 91 = $ 819 11 @ $ 106 = $ 1,166	$ 515
Aug. 17			$ 2,815
Aug. 28			$ 4,005
Aug. 31		1 @ $ 91 = $ 91 3 @ $ 106 = $ 318 15 @ $ 115 = $ 1,725 4 @ $ 119 = $ 476	$ 1,395

Cost of Goods Sold for August 31 = $2,610



Specific Identification



Cost of Goods Sold	Inventory Balance
	$ 910
	$ 2,500
9 @ $ 91 = $ 819	
11 @ $ 106 = $ 1,166	$ 515
	$ 2,815
	$ 4,005
1 @ $ 91 = $ 91	
3 @ $ 106 = $ 318	
15 @ $ 115 = $ 1,725	
4 @ $ 119 = $ 476	$ 1,395

Income Statement

COGS = $4,595

Balance Sheet

Inventory = $1,395

1	@	$ 106	=	$	106
5	@	$ 115	=		575
6	@	$ 119	=		714
	End. Inv.				$1,395


Since specific identification is so easy, can't we use it all the time?
Not really. Specific identification is hard to use when we sell a lot of inventory that has lots of different costs.

Average-Cost Method

When a unit is sold,
the average cost of each unit
in inventory is assigned to
cost
of goods sold.

Cost of Goods Available for Sale ÷ Units on hand on the date of sale

First-In, First-Out Method (FIFO)

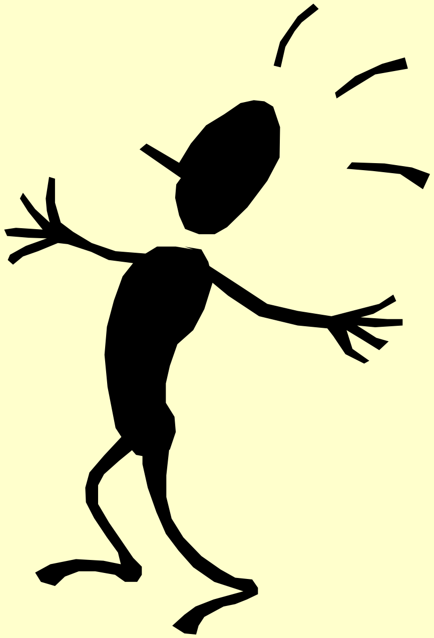
Oldest Costs → **Costs of Goods Sold**

Recent Costs → **Ending Inventory**

Last-In, First-Out Method (LIFO)

Recent Costs → **Costs of Goods Sold**

Oldest Costs → **Ending Inventory**



The Principle of Consistency

Once a company has adopted a particular accounting method, it should follow that method consistently, rather than switch methods from one year to the next.

Just-In-Time (JIT) Inventory Systems

This inventory arrived just in time for us to use it in the manufacturing process.

Periodic Inventory Systems

In a periodic inventory system, inventory entries are as follows.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
		Entry on Purchase Date		
		Purchases	$$$$	
		Accounts Payable		$$$$

Note that an entry is not made to inventory.

Periodic Inventory Systems

In a periodic inventory system, inventory entries are as follows.

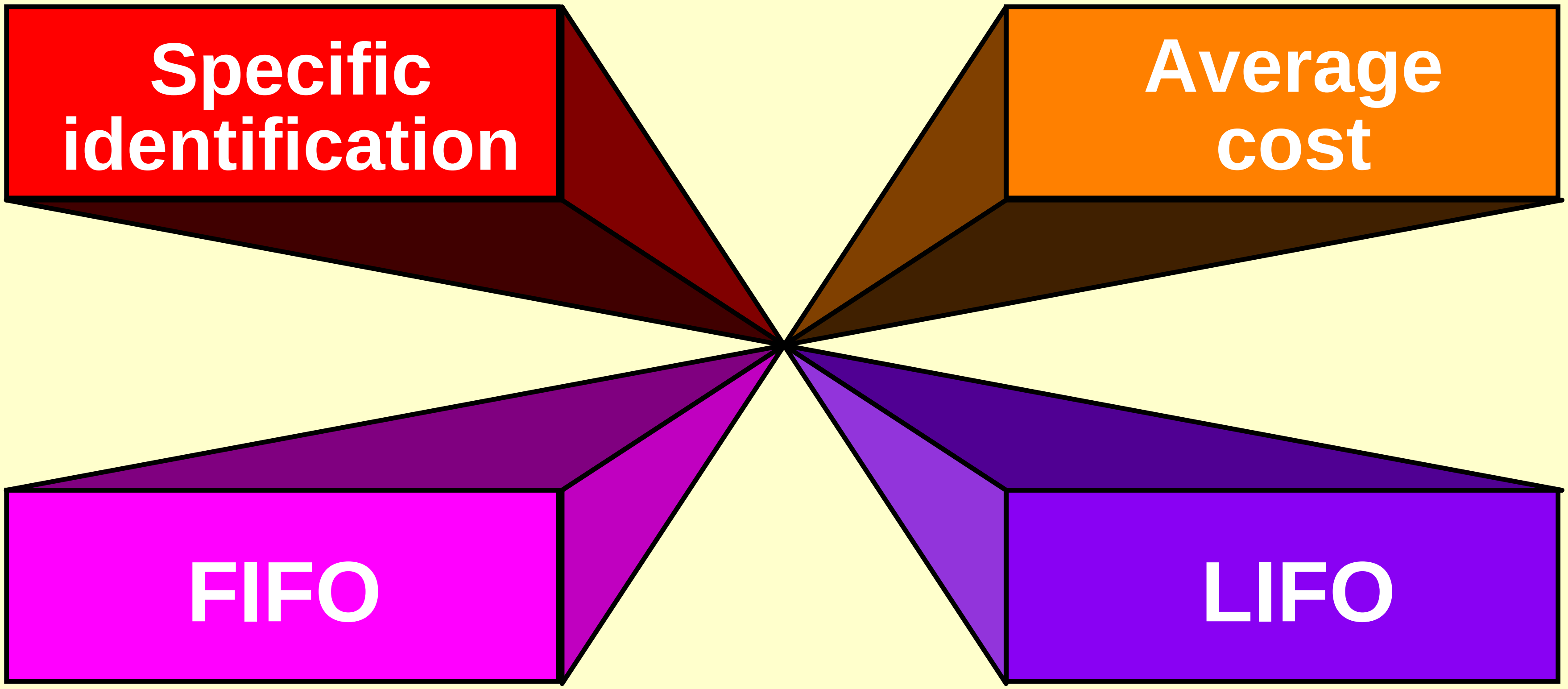
GENERAL JOURNAL				
Date		Account Titles and Explanation	Debit	Credit
		Entry on Sale Date		
		No entry to inventory.		
		Accounts Receivable	$$$$	
		Sales		$$$$

Periodic Inventory Systems

The inventory on hand and the cost of goods sold for the year are not determined until year-end.

Periodic Inventory Systems

We use one of these inventory valuation methods in a periodic inventory system.




For interim financial statements, we may need to estimate ending inventory and cost of goods sold.

The Gross Profit Method

❶ Determine cost of goods available for sale.

❷ Estimate cost of goods sold by multiplying the net sales by the cost ratio.

❸ Deduct cost of goods sold from cost of goods available for sale to determine ending inventory.

The Gross Profit Method

In March of 2005, ChemCo's inventory was destroyed by fire. ChemCo's normal gross profit ratio is 30% of net sales. At the time of the fire, ChemCo showed the following balances:

Sales	**$ 31,500**
Sales returns	**1,500**
Beginning Inventory	**12,000**
Net cost of goods purchased	**20,500**

The Retail Method

The retail method of estimating inventory requires that management determine the value of ending inventory at retail prices.

In March of 2005, ChemCo's inventory was destroyed by fire. At the time of the fire, ChemCo's management collected the following information:

Information for ChemCo The Retail Method	
Goods available for sale at cost	$ 32,500
Goods available for sale at retail	50,000
Physical count of ending inventory priced at retail	22,000

Financial Analysis

Measures how quickly a company sells its merchandise inventory.

$$\text{Inventory Turnover Rate} = \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$$

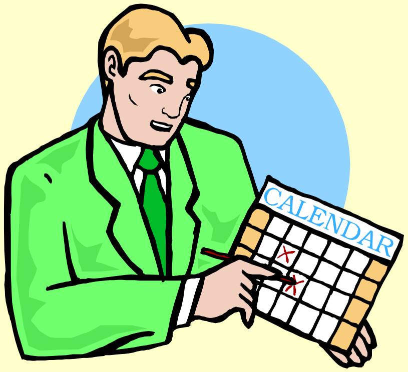
Average Inventory = (Beg. Inv. + End. Inv.) ÷ 2

A ratio that is low compared to competitors suggests inefficient use of assets.

Financial Analysis

Avg. Number of Days to Sell Inventory	=	$\dfrac{\text{Days in the Year}}{\text{Inventory Turnover}}$

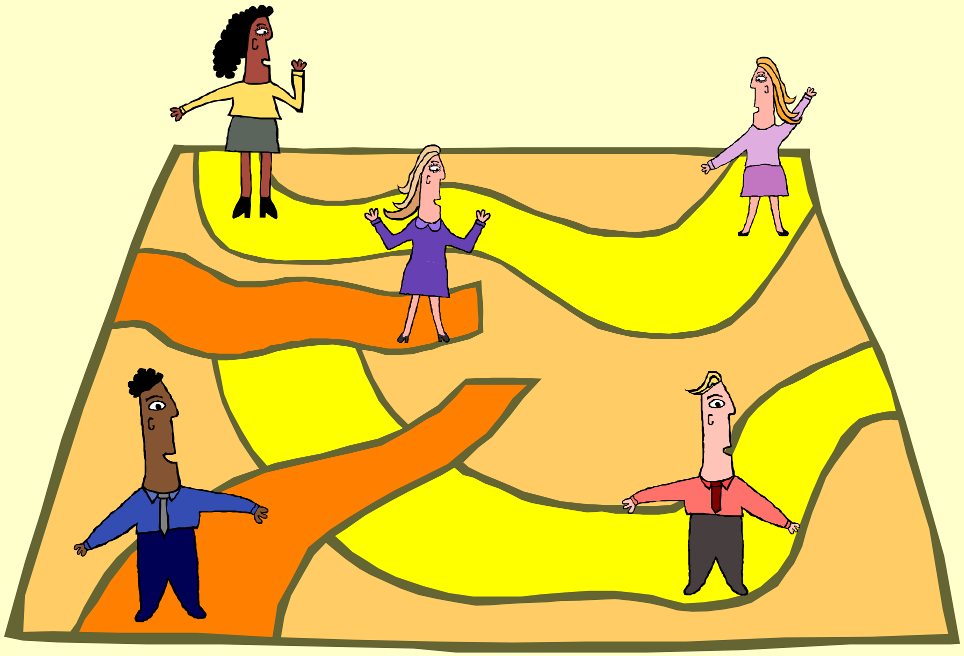
Measures how many days on average it takes to sell its inventory.



Accounting Methods Can Affect Financial Ratios

Remember that identical companies that use different inventory methods (e.g., FIFO and LIFO) will have different inventory turnover ratios.

End of Part (4)



Part (5)

MANAGEMENT ACCOUNTING

Management Accounting: Basic Framework

Management accounting and assigning decision-making authority.

- **Accounting systems help to identify who has authority over assets.**
- **Accounting information supports planning and decision-making.**
- **Accounting reports provide a means of monitoring, evaluating, and rewarding performance.**

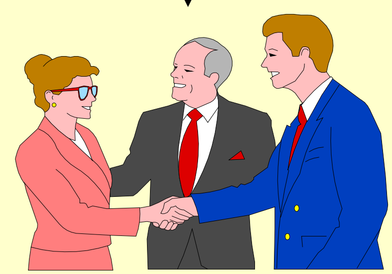
Management Accounting Systems Framework

Top Management

Budget: Future Plans

Actual Results: Current

Performance Evaluation: Past



Assign Decision-Making

Support Decision-Making

Evaluate Decision-Making

Comparing Financial Accounting and Management Accounting

	Financial Accounting	Management Accounting
Purpose	Provide information about the financial position and performance of the company.	Provide information for planning, evaluating, and rewarding performance.
Types of Reports	Balance sheet, income statement, and statement of cash flows.	Various, non-standard reports.
Standards	GAAP	None
Reporting Entity	Usually, the company taken as a whole.	A component of the company's value chain.
Time Periods	Usually a year, quarter, or a month.	Any period.
Users	Investors, creditors, and other external parties.	Management, customers, and others in the value chain.

Accounting for Manufacturing Operations

The cost to produce a unit of product includes:

- **Direct material**
- **Direct labor**
- **Manufacturing overhead**

Direct Materials

Raw materials & component parts that become an integral part of finished products.

Can be traced directly and conveniently to products.

If materials cannot be traced directly to products, the materials are considered indirect and are part of manufacturing overhead.

Direct Labor

Includes the payroll cost of direct workers.

Direct labor hours × Wage rate

Those employees who work directly on the goods being manufactured.

The cost of employees who do not work directly on the goods is considered indirect labor and is part of manufacturing overhead.

Manufacturing Overhead

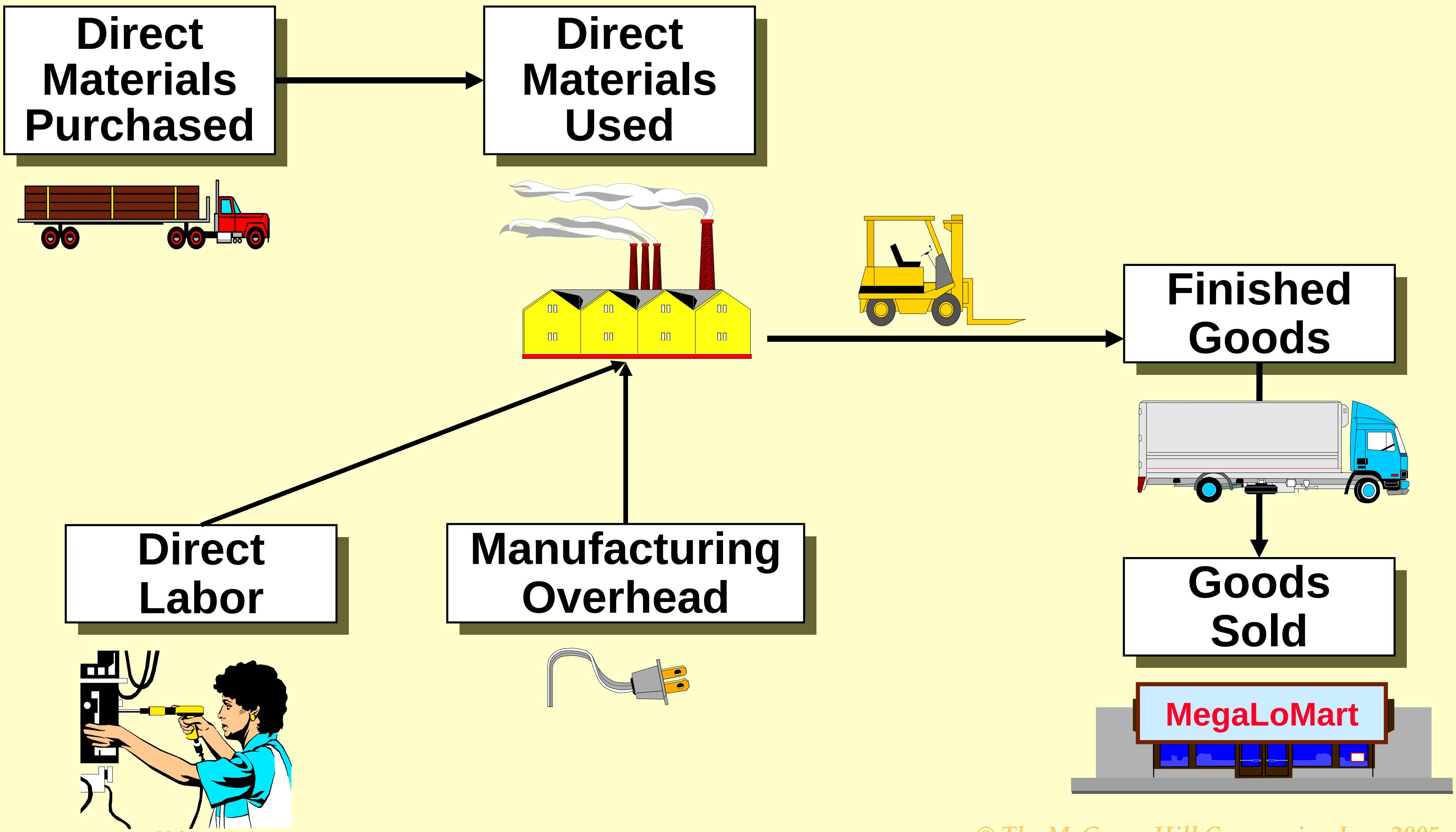
All manufacturing costs other than direct materials and direct labor.

Includes:

- **Indirect materials.**
- **Indirect labor.**
- **Machinery and equipment costs.**
- **Cost of regulatory compliance.**

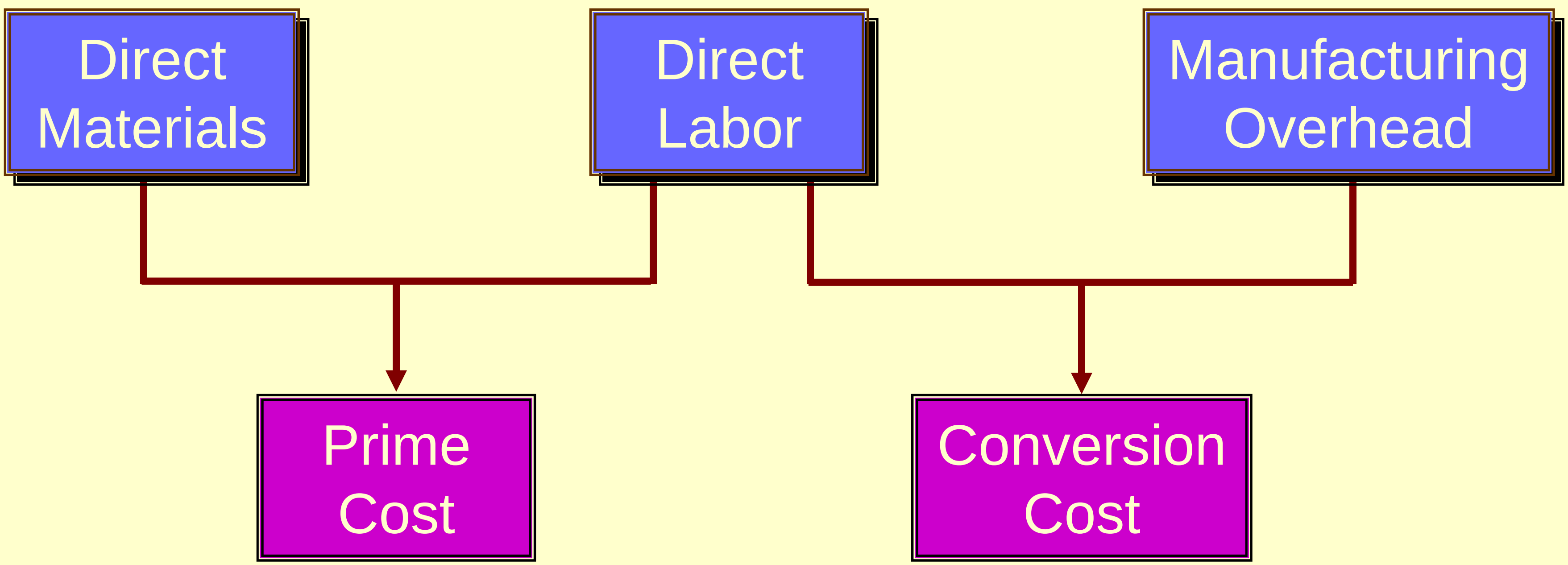
Does not include selling or general and administrative expenses.

Flow of Physical Goods in Production



Accounting for Manufacturing Operations

Manufacturing costs are often combined as follows:



Product Costs Versus Period Costs

Product Costs
(manufacturing
costs**)**

as
incurred

Balance Sheet

Current assets and inventory

When goods are sold.

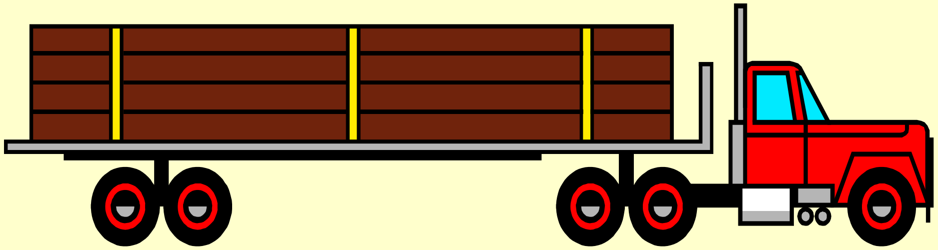
Income Statement

Revenue
COGS
Gross profit
Expenses
Net income.

Period Costs
(operating
expenses and
income taxes.**)**

as
incurred

Inventories of a Manufacturing Business

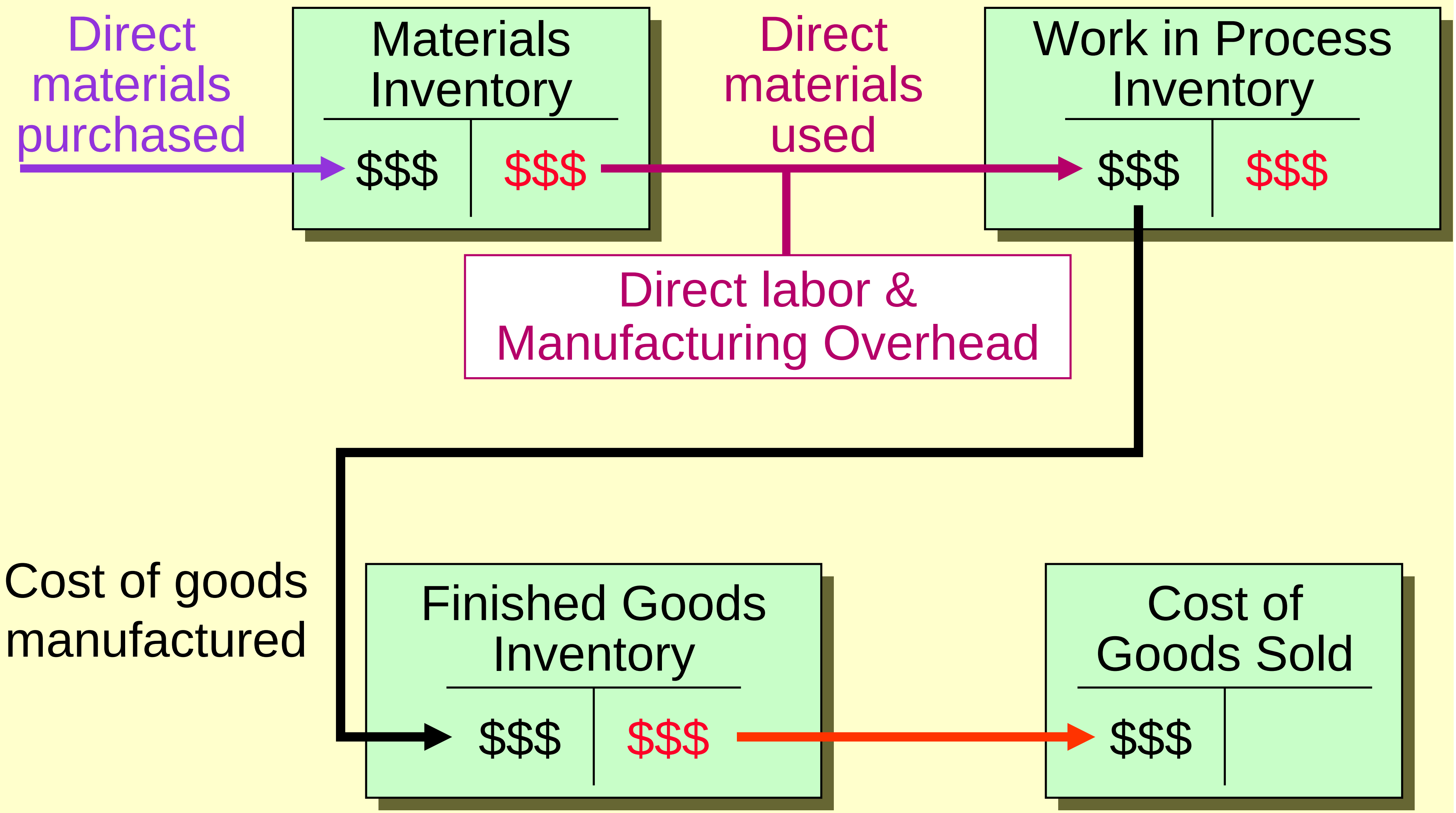


Raw materials - inventory on hand and available for use.

Work in process - partially completed goods.

Finished goods- completed goods awaiting sale.

Flow of Costs Associated With Production



Flow of Costs Associated With Production

Pure-Ice Inc. had $52,000 of inventory in direct materials inventory on January 1, 2005. During the year, Pure-Ice purchased $586,000 of additional direct materials. At December 31, 2005, $78,000 of the direct materials were still on hand.

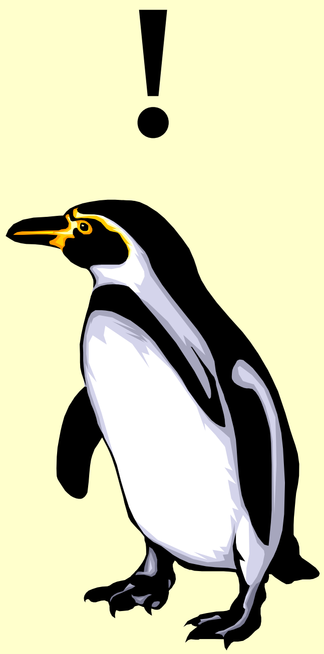
How much direct material was placed into production during 2005?

Flow of Costs Associated With Production

	Beginning materials inventory	$ 52,000
+	Materials purchased	586,000
=	Materials available to be placed into production	638,000
–	Materials placed into production	?
=	Ending materials inventory	$ 78,000

Flow of Costs Associated With Production

	Beginning materials inventory	$	52,000
+	Materials purchased		586,000
=	Materials available to be placed into production		638,000
–	Materials placed into production		560,000
=	Ending materials inventory	$	78,000



End of Part (5)