**Financial Decisions Making**

Managerial Responsibilities:

Planning: Setting goals and objectives and how to achieve them.

Examples of planning

Generate more sales via opening new stores

Reduce labor costs by reducing store hours

Budgets

Directing: Overseeing company’s day-to-day operations

Examples Using daily/weekly sales reports to adjust marketing strategies

Using product cost reports to adjust raw  
material usage

Controlling: Evaluating results of operations against plans and making adjustments as needed.

Examples Comparing budgeted sales with actual sales to take corrective actions

Comparing budgeted product costs against actual product costs to take corrective actions

Diagram

Description automatically generated

Timeline

Description automatically generated

Diagram

Description automatically generated

Diagram

Description automatically generated

CEO, which stands for Chief Executive Officer, is **the highest-ranking individual in a company**. ... The Chief Executive Officer reports directly to, and is accountable to, the Board of Directors for the performance of a company.

The chief operating officer (COO) is **a senior executive tasked with overseeing the day-to-day administrative and operational functions of a business**. The COO typically reports directly to the chief executive officer (CEO) and is considered to be second in the chain of command.

The term chief financial officer (CFO) refers to **a senior executive responsible for managing the financial actions of a company**. The CFO's duties include tracking cash flow and financial planning as well as analyzing the company's financial strengths and weaknesses and proposing corrective actions.

Treasurer: a person appointed to administer or manage the financial assets and liabilities of a society, company, local authority, or other body.

Controller:  the controller is in charge of the accounting department,

Organizational Structure for audit team:

Audit committee:

Subcommittee of the board of directors and meet periodically

Oversees the internal audit function

Annual audit of the financial statements by independent CPA

Also report to a senior executive, such as CFO or CEO, for administrative matters

Also report to a senior executive, such as CFO or CEO, for administrative matters

Skills required for accounting management:

Diagram, timeline

Description automatically generated with medium confidence

Institute of Management Accountants (IMA)

* Professional association for management accountants
* IMA’s functions
  + - Certification (CMA)
    - Forum for research
    - Practice development
    - Education
    - Knowledge sharing
    - Ethical standards
    - Public education

Diagram

Description automatically generated

Ethical Behavior:

* Means doing the right thing, regardless of consequences
* Examples of unethical behavior
  + Allowing reimbursement of false expense reports
  + Manipulating income
  + Performing tasks not qualified to perform

Steps to Resolve Ethical Dilemmas

* Follow company’s policies for reporting unethical behavior
* If not resolved
  + Discuss with immediate supervisor
  + Discuss with objective advisor
  + Consult an attorney

Unethical vs. Illegal Behavior

Sarbanes-Oxley Act of 2002 (SOX)

* Restore trust in publicly traded corporations, management, financial statements, and auditors
* SOX enhances internal control and financial reporting requirements and establishes new regulatory requirement for publicly traded companies and tehir independent auditors.
* CEO /CFO requirements
  + Financial statements
  + Internal control structure
  + Annual assessment
* Independent audit committee
* CPA firms maintain independent from their client company
* Increases white-collar crime (e.g. Fraud) penalties

International Financial Reporting Standards (IFRS) are a set of accounting rules for the financial statements of public companies that are intended to make them consistent, transparent, and easily comparable around the world.

Extensible Business Reporting Language (XBRL): XBRL enables companies to release financial and business information in a format that can be *quickly*, *efficiently*, and *cost-effectively accessed*, *sorted*, and *analyzed* over the Internet.

Sustainability and Managerial Accounting: Definition: the ability to meet the needs of the present without compromising the ability of future generations to meet their own needs.

Three pillars:

Environmental, Social, and Economic

Triple bottom line

Profit, People, and Planet

Shifting Economy: Shift away from manufacturing toward service

Service companies: health care, communication, transportation, banking, and other important benefits to society.

* Managerial accounting has expanded

e.g., cost of servicing checking and saving accounts in the fees.

Competing in Global Marketplace

* Barriers to international trade have fallen
* How does it affect managerial accounting?

1) More accurate and timely information needed

2) Whether to expand sales and/or production into foreign countries

3) Aware of regulations and laws in other countries

4) Learn new management techniques by observing their international competitors

ERP: System that integrates a company’s functions, departments, and data

* Advantages
  + Streamline operations
  + Respond quickly to changes
  + Replace separate software
  + systems
* Disadvantage: expensive

Lean Operations: A philosophy and business strategy of manufacturing without waste

Example: Toyota- “just-in-time (JIT)”

* + Lowers costs: storage costs (warehousing and security, utilities etc. )
  + Throughput time: the time between buying raw materials and selling finished products, while still maintain high quality
  + Increases competitive position

TQM is one key to succeeding in global economy

Total quality management is a managerial accounting concept where an organization strives to produce higher quality products with few defects being shipped to customers

Goal to provide customers with superior products and services

Continuously set higher goals for quality

International Organization for Standardization (ISO)–ISO 9001:2008

Commitment to continuous quality improvement

Chapter2:

1) Service

2) Merchandisers

1. Manufacturers

Service Companies

Sell and provide intangible services

No inventory

Other costs: services, develop new services, advertise etc.

Examples

Advertising agencies

Banks

Law firms

Insurance companies

Merchandisers

* Resell products purchased from suppliers
* One inventory account
* Examples
  + Walmart
  + Best Buy
  + Amazon.com
* Retailers vs. Wholesalers

Manufacturers

* Use labor, plant, and equipment to convert raw materials into finished products
* Examples
  + Procter & Gamble
  + General Mills
  + Dell Computer
  + Toyota
* Three inventory accounts
* Three inventory accounts

Raw materials: Steel, Rubber, Glass

Work in process: Partially completed vehicles

Finished goods: Completed goods that have not yet been sold

Value Chain

* Activities that add value to products and services and cost money.
* Research and Development (R&D)
* Design
* Production or Purchase
* Marketing
* Distribution
* Customer Service

Direct cost: A cost can be traced to the cost object

e.g.: cost of steel, cost of tires etc.

Indirect cost: A cost that relates to the cost object but cannot be traced to it.

e.g.: warehouse utilities

* Manufacturing Overhead: Indirect costs related to *manufacturing* that are not direct materials or direct labor
  + Indirect materials

e.g., cleaning suppliers, oil and lubricant

* + Indirect labor

e.g., salaries, wage, benefits of forklift operators, securities

* + Other indirect manufacturing costs

e.g., depreciation expense of PP&E, insurance, maintenance fee

* Assign direct and indirect costs to cost object:
* **Trace:** direct costs to cost objects

*Amount of cost assigned to the cost object is very precise*

* **Allocate:** indirect costs to cost objects

*Amount of cost assigned to the cost object is less precise*

* **Total costs:** used internally only (we will see this in later chapters- Chp8)

e.g., The total cost for Prius is to research, design, manufacture, market, distribute, and service.

* **Inventoriable product costs:** Used for external reporting
* **Period costs:** All costs incurred in the other stages of the value chain must be expensed in the period in which they are incurred

Manufacturing overhead

* Indirect costs related to *manufacturing* that are not direct materials or direct labor
  + Indirect materials

e.g., cleaning suppliers, oil and lubricant

* + Indirect labor

e.g., salaries, wage, benefits of forklift operators, securities

* + Other indirect manufacturing costs

e.g., depreciation expense of PP&E, insurance, maintenance fee

**Income Statement-**

+ Sales

– Cost of goods sold

= Gross profit

– Operating expenses

= Operating income

**Cost of Goods Sold Calculation:**

**Beginning inventory**

**+ Purchases**

**+ Import duties or tariffs**

**+ Freight-in**

**= Cost of goods available for sale**

**– Ending inventory**

**= Cost of goods sold**

**Direct Materials Used Calculation:**

**Beginning raw materials inventory**

**+ Purchases of raw materials**

**+ Freight in**

**= Materials available for use**

**– Ending raw materials inventory**

**= Direct materials used**

**Cost of Goods Sold**

**+ Beginning finished goods inventory**

**+ Cost of goods manufactured**

**= Cost of goods available for sale**

**– Ending finished goods inventory**

**= Cost of goods sold**

**Cost of Goods Manufactured**

**+ Beginning work in process inventory**

**+ Direct materials used**

**+ Direct labor**

**+ Manufacturing overhead**

**= Total manufacturing costs to account for**

**– Ending work in process inventory**

**= Cost of goods manufactured**

**Beginning inventory + Net purchases =**

**Cost of goods sold + Ending inventory**

**Cost of Goods Manufactured**

**Beginning work in process inventory**

**+ Direct materials used**

**+ Direct labor**

**+ Manufacturing overhead**

**= Total manufacturing costs to account for**

**– Ending work in process inventory**

**= Cost of goods manufactured**

**Cost of Goods Sold Calculation—**

**+ Beginning finished goods inventory**

**+ Cost of goods manufactured**

**= Cost of goods available for sale**

**– Ending finished goods inventory**

**= Cost of goods sold**

**Operating income**

**+ Sales**

**– Cost of goods sold**

**= Gross profit**

**– Operating expenses**

**= Operating income**

**Controllable and Uncontrollable Costs**

**Controllable cost: Management can influence or change cost**

**e.g., price paid for raw materials; research and development, design, and advertising**

**Uncontrollable cost: Management cannot change or influence cost in the short run**

**e.g., property tax and insurance costs of its existing plants**

**Relevant and Irrelevant Costs**

**Relevant cost: Differential costs, which are costs that differ between alternatives.**

**Irrelevant Cost: Costs that do not differ between alternatives**

***Variable Cost: Change in total cost in direct proportion to changes in volume.***

***Constant cost: Stay constant in total cost over a wide range of activity levels***

* ***Marginal Cost: Cost of making one more unit***

***For example: Toyota makes one more Prius unless the plant is operating at 100% capacity***

**Cost of Goods Manufactured Calculation—Manufacturer**

**+ Beginning work in process inventory**

**+ Direct materials used**

**+ Direct labor**

**+ Manufacturing overhead**

**= Total manufacturing costs to account for**

**– Ending work in process inventory**

**= Cost of goods manufactured**

**Chapter3:**

**Process Costing**

Process Costing

• Mass production

• Similar items

• Total costs are averaged over all units

• Examples – Paint manufacturers – Oil refineries – Cereal manufacturers

Job Costing:

Job Costing

• Unique, custom products or small batches

• Total costs are accumulated by job

• Examples – Hospitals – Custom home builders – Advertising agencies

Predetermined MOH rate= Total estimated mfg overhead costs

Total estimated amount of allocation base

Allocating Manufacturing Overhead (MOH) to Individual Jobs

**MOH allocated** Predetermined MOH **to a job =** rate **x** Actual amount of

allocation base used by the job

Process Costing

• Mass production

• Similar items

• Total costs are averaged over all units

• Examples – Paint manufacturers – Oil refineries – Cereal manufacturers

Job Costing

• Unique, custom products or small batches

• Total costs are accumulated by job

• Examples – Hospitals – Custom home builders – Advertising agencies

Reasons Why Management Needs Product Cost

1. Reduce future job costs

2. Assess and compare profitability of models

3. Pricing decisions

4. Discounts on high-volume sales

5. Bids for custom orders

6. Financial statement preparation

Sustainability and Job Costing

• Job cost record captures the essential resources required to manufacture a product • Job cost record can be enhanced with information about:

– Product/production’s effect on the environment – Employees involved in manufacturing process

– Future consumers – Future disposal

• Subcategories

• Extended Producer Responsibility (EPR)

Underallocated or Overallocated Manufacturing Overhead • Underallocated (undercosted) – Not enough allocated to jobs – Too little expense • Overallocated (overcosted) – Too much allocated to jobs – Too much expense

Underallocated or Overallocated Manufacturing Overhead • Why/How?

• Estimated manufacturing overhead costs were higher or lower than actual • Used more or less of the estimated allocation base than projected

• Two Solutions

• Adjust cost of goods sold or

• Prorate among Cost of Goods Sold, Work in Process Inventory, Finished Goods Inventory

**Chapter 4**

Predetermined MOH rate= Total estimated manufacturing overhead costs

Total estimated amount of the allocation base

The cost hierarchy is a classification system used in [activity-based costing](https://www.accountingtools.com/articles/2017/5/14/activity-based-costing) that designates activities based on how easily they can be traced to a product. In order of increasing order of traceability difficulty, the cost hierarchy is:

1. *Activities at the unit level*. These involve activities performed on each unit produced. If a unit is not produced, then this type of activity should not occur.
2. *Activities at the batch level*. These involve activities performed whenever a batch of units is processed. It does not matter how many units are in a batch, since the activities relate to the presence of a batch, not its size. Machine setup costs are considered to be at the batch level.
3. *Activities at the product level*. These involve activities targeted at a specific product or product line, such as the cost to process an [engineering change order](https://www.accountingtools.com/articles/2017/5/6/engineering-change-order).
4. *Activities at the facility level*. These involve activities carried out for an entire facility. For example, the [compensation](https://www.accountingtools.com/articles/2018/1/18/compensation) cost of the materials management staff is considered to be at the facility level.

ABM refers to using activity-based cost information to make decisions that increase profits while satisfying customers’ needs.

• Using ABC information to make decisions

– Pricing and product mix

– Cost cutting

– Planning and control

Lean Thinking

Philosophy and a business strategy

• Primary goal: Eliminate waste and cost

• Focus of JIT

– Purchase raw materials just in time for production

– Finish goods just in time for delivery

Activity-Based Management (ABM)

• ABM refers to using activity-based cost information to make decisions that increase profits while satisfying customers’ needs.

• Using ABC information to make decisions – Pricing and product mix – Cost cutting – Planning and control

Pros to Lean Production Systems

• Defects: producing defective products or services cost time and money

• Overproduction: making more than product than needed or making product sooner than it needed

• Waiting: employees must often wait for parts, materials, information, or machine repairs before they can proceed with their tasks.

Pros to Lean Production Systems

• Not utilizing people to their full potential: wisdom of crowds

• Transportation: excess movement of parts, inventory, and paperwork e.g. caused by poor plant layout, large centralized storage cribs

• Inventory: too many inventories

• Movement: waste of transportation

• Excess processing: e.g. IKEA

Drawbacks to Lean Production Systems

• Vulnerable when problems strike suppliers or distributors

• Examples

– Delays in delivery

– Personnel problems

—union strikes

– Shortage of parts due to recalled products

– Weather related issues

Cost of Quality (COQ)

• Cost of quality reports categorize and list the costs incurred by the company related to quality.

• Four categories

Four Types of Quality Costs

1. Prevention costs—Avoid poor quality goods or services Caused: variability of the production process/ complexity of the product design
2. – Employee training
3. – Improved materials
4. – Preventive maintenance

2. Appraisal costs—Detect poor quality goods or services Appraisal costs are a specific category of quality control costs. Companies pay appraisal costs as part of the quality control process to ensure that their products and services meet customer expectations and regulatory requirements. These costs could include expenses for field tests and inspections. – Inspection throughout production – Inspection of final product – Product testing

3.Internal failure costs

—Avoid poor quality goods or services before delivery to customers

– Production loss caused by downtime

– Rejected product units

4..External failure costs

—Incurred after defective product is delivered

– Lost profits from lost customers

– Warranty costs

– Service costs at customer sites

– Sales returns due to quality problems

Conformance cost: all expenses incurred to ensure that a product meets the minimum quality standard Prevention Cost & Appraisal Costs

• Non-conformance cost: costs incurred because the product or service is defective Internal Failure Cost & External Failure Cost

Non-Manufacturing Costs of Quality

• Service firms and merchandising companies also incur costs of quality

• Prevention

– Professional training to their staff]

– Develop standardized service checklists

• Appraisal costs

– Review work continuously

– Inspect before releasing

Cost of Quality Report

• Identifies, categorizes, and quantifies all of the costs it incurs relating to quality.

• Calculate the percentage of total costs of quality that are incurred in each cost category • Use as a framework for decisions

Chapter 5

Process Costing Benefits

• Benefits –Cost trends –Budget to actual –Pricing –Financial statements Ending inventory and Cost of Goods Sold

Job and Process Costing Differences?

• Job cost systems

– Individual job cost records

– Direct material, direct labor, and manufacturing overhead assigned to individual jobs

– Cost of finished jobs flow into finished goods inventory

– Cost of sold jobs flow out of finished goods inventory into cost of goods sold

• Process cost systems

– Series of manufacturing processes

– Cost per process is accumulated and moved from one process to another process

– Costs transferred to finished goods inventory only from the work in process inventory of the LAST manufacturing process

– When units are sold, cost is transferred out of finished goods inventory into cost of goods sold

Process Costing

• Each process, there are separate work in process accounts.

• Each process has a material, wages, and overhead component.

• The costs are transferred to finished goods in the same manner as job costing.

• We accumulate the costs of each process and then assigning these costs to the units passing through the process.

Conversion costs (convert direct materials into new finished products) –

**Direct labor + manufacturing overhead**

• Equivalent units The amount of work done during a period in terms of fully completed units of output

**Number of equivalent units**

Number of physical units \* Percentage of completion = **Number of equivalent units**