Chapter 14 Outline – Mcgraw

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| Chapter Outline |
| **I. Managerial Accounting Basics**—*managerial accounting* provides financial and nonfinancial information to an organization’s managers.1. Purpose of Managerial Accounting—to provide useful information to aid in:

a. Determining the costs of an organization’s products and services. b. Planning future activities.c. Comparing actual results to planned results.Managerial accounting system collects cost information and assigns it to an organization’s products and services. Costs are important to managers because they impact the financial position and profitability of a business. They are also important for decisions such as product pricing, profitability analysis, and whether to make or buy a product.1. *Planning* is the process of setting goals and making plans to achieve them.1. *Strategic plans* usually set the *long-term* direction of a firm.
2. *Short-term action plans* include dollar amounts and are known as a *budget*.

2. *Control* is the process of monitoring and evaluating an organization's activities and employees. 1. Control feedback helps managers compare actual results with planned results and take corrective actions.
2. Nature of Managerial Accounting—illustrated by comparing the seven key differences between *managerial* and *financial*accounting:
3. Users of Accounting Information
4. In financial—investors, creditors and other users *external* to the organization.
5. In managerial—managers, executive employees *internal* to the organization.
6. Purpose of Information
7. In financial—assist external users in making investment, credit and other decisions.
8. In managerial—assist managers in making *planning*, and *control* decisions*.*
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| 3. Flexibility of Reporting1. In financial—structured and controlled by GAAP.
2. In managerial—relatively *flexible* (no GAAP rules). Useful for analyzing, planning, and control purposes.
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| 4. Timeliness of Information1. In financial—often available only after the audit is complete.
2. In managerial—available quickly without the need to wait for an audit.

5. Time Dimension1. In financial—focus on past performance using historical information.
2. In managerial—often includes real-time reports used to evaluate current performance, plan future activities, and make projections.
3. Focus of Information
4. In financial—emphasis on whole organization.
5. In managerial—emphasis on company’s projects, processes and divisions.
6. Nature of Information
7. In financial—monetary information.
8. In managerial—mostly monetary; but also some nonmonetary information such as customer and employee satisfaction data, product defect rates, etc.
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| C. Fraud and Ethics in Managerial Accounting—affects all business and is costly. 1. Three factors that push a person to commit fraud (called *the fraud triangle*):a. Opportunity – person must be able to commit fraud with low risk of getting caught.b. Pressure – person must feel pressure or have incentive to commit fraud.c. Rationalization – person justifies fraud or does not see its criminal nature. |
| 2. Implications for managerial accounting—key to stopping fraud is prevention. Less expensive and more effective to prevent than to detect fraud. To help prevent fraud, managers set up *internal control systems* to:a. Uphold company policies.b. Promote efficiency.c. Ensure reliable accounting.d. Protect assets.3. Ethics are beliefs that distinguish right from wrong. The IMA (Institute for Management Accountants) requires that management accountants be competent, maintain confidentiality, act with integrity, and communicate information in a fair and credible manner.4. Career Paths – managerial accounting skills are highly valued and useful in many careers including marketing, management, entrepreneurs, and decision making.1. **Cost Concepts**
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| 1. Direct vs. Indirect: a cost object is a product, process, department, or customer to which costs are assigned. Cost is classified as either *direct or indirect cost*. To classify must identify the cost object.
2. Direct costs—can be cost-effectively traced to a cost object. Consists of direct materials and direct labor.
3. Indirect costs—those that cannot be cost-effectively traced to a cost object. Includes salary of manufacturing supervisor and wages of maintenance department employees.
4. Manufacturing Costs
5. Direct Materials—materials that are crucial parts of a finished product. Direct material costs are the costs for direct materials that can be cost-effectively traced through the manufacturing process to finished goods.
6. Direct Labor—employees who directly convert materials into finished goods. Direct labor costs are the wages and benefits for direct labor that can be cost-effectively traced through the manufacturing process to finished products.
7. Factory Overhead (also called manufacturing overhead)—includes all manufacturing costs that are not direct materials or direct labor; costs cannot be cost-effectively traced to finished goods. Includes indirect materials, indirect labor and other indirect.
	1. Indirect Materials—used in manufacturing that cannot be cost-effectively traced to finished goods. Often direct materials can be classified as indirect when their costs are very low.
	2. Indirect Labor—labor needed in manufacturing that cannot be cost-effectively traced to finished goods. Includes costs of workers who assist in or supervise manufacturing.
	3. Other indirect costs include factory utilities, factory rent, factory depreciation, factory insurance, and factory property taxes.
8. Prime and Conversion Costs
	1. *Prime costs*—direct materials and direct labor.
	2. *Conversion costs--*direct labor and factory overhead costs *(*costs incurred in the process of converting raw materials to finished goods).
9. Product vs Period Costs:

1. Product costs—production costs necessary to create a product. Includes direct materials, direct labor, and factory overhead. Product costs are added to inventory, or capitalized, during manufacturing of products. When sold, these costs are expenses as cost of goods sold. |
| 1. Period costs—nonproduction costs linked to a time period (not to specific products). Expensed in period when incurred and reported on the income statement as either selling expenses or general and administrative expenses. Examples of selling expenses include selling expenses and advertising expenses, delivery expenses, and commissions. Examples of general and administrative expenses include office accounting expenses, office employee wages, and office rent. For a manufacturer, period costs are also called nonmanufacturing costs.
2. Reporting Product and Period Costs:
	1. Period costs go directly to the current income statement as expenses.
	2. Product costs are first assigned to inventory. They move to cost of goods sold when inventory is sold. Product costs assigned to inventory non sold are reported on the balance sheet. When sold, product costs are assigned to and reported as cost of goods sold on the income statement.
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| 1. Cost Concepts for Service Companies – cost concepts described also apply to service companies. Service companies can classify cost as direct materials, direct labor, overhead, selling, or general and administrative costs. Costs of services are not reported in inventory.
2. **Reporting—**financial statements for manufacturing companies have some unique features resulting from their activity of producing goods from materials and labor.
3. Reporting Inventory on the Balance Sheet
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| 1. Raw Materials Inventory—cost of materials a company acquires to use in making products Raw materials that can be cost-effectively traced to a product are called direct materials and included in raw materials inventory.
2. Work in Process Inventory*—* (goods in process inventory) consists of costs of direct materials, direct labor and overhead for partially completed products.
3. Finished Goods Inventory—consists of the costs of direct materials, direct labor and overhead of completed products ready for sale.
4. Manufacturer Balance Sheet - current assets section of the balance sheet for a merchandiser reports only merchandise inventory rather than three types of inventory. Service companies do not have any inventory held for sale.
5. Reporting Cost of Goods Sold on the Income Statement—the main difference between the income statement of a manufacturer and that of a merchandiser is the content of cost of goods sold.
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| 1. A Merchandiser computes cost of goods sold as:

 Beginning *merchandise* inventory+ cost of goods *purchased* Cost of goods available for Sale - Ending *merchandise* inventory Cost of Goods Sold |
| 1. A Manufacturer computes cost of goods sold as:

 Beginning *finished goods* inventory + cost of goods *manufactured\** Cost of goods available for Sale - Ending *finished goods* inventory Cost of Goods Sold1. *\*Cost of goods manufactured* is the sum *of direct materials, direct labor*, and *overhead costs* incurred in production.
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| 1. **Cost Flows and Cost of Goods Manufactured** —the three manufacturing activities are:
2. Materials Activity

 Raw materials inventory, beginning+ Raw materials Purchases Raw materials available for use in production- Raw materials inventory, ending Raw materials used in production1. Production ActivityBeginning work in process inventory—costs of partially complete products from prior period.
2. Sales Activity – manufacturers usually start a period with beginning finished goods inventory, which is the cost of finished goods from prior periods. Adding this to the cost of newly completed units equals total finished goods available for sale in the current period. Cost of finished goods sold is reported on the income statement. Cost of any finished goods not sold is reported as a current asset, finished goods inventory, on the balance sheet.
3. Schedule of Cost of Goods Manufactured (also called a manufacturing statement or a statement of cost of goods manufactured)– summarizes the types and amounts of costs incurred in the manufacturing process. Schedule is divided into four parts:
4. Compute direct materials used – beginning raw materials plus purchases minus ending raw materials.
5. Compute direct labor used –wages, payroll taxes, and employee benefits.
6. Compute factory overhead used – all indirect costs related to manufacturing activities.
7. Compute of cost of goods manufactured – direct materials, plus direct labor, plus overhead, plus beginning work in process minus ending work in process inventory.
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| 1. **Trends in Managerial Accounting**
2. Digital manufacturing – combines machines, computers, and human control to manufacture products. Humans use data analytics – process of analyzing data to identify meaningful relations and trends and data visualization – graphical depiction of data to help people interpret their meaning.
3. Customer orientation – increased emphasis on customers. Customer orientation means that managers and employees understand the changing needs of customers and align operations accordingly.
4. Global economy – expands competitive boundaries and provides customers more choices.
5. E-commerce – customers are increasingly interconnected via smartphones, text messaging, and other electronic applications and expect and demand to buy items electronically whenever and wherever they want.
6. Service economy – service companies include telecommunications and health care and constitute an ever-growing part of the economy.
7. Lean principles – goal is to eliminate waste while satisfying the customer and providing a positive return to the company. Includes total quality management (TQM) and just-in-time (JIT) manufacturing.
8. Value chain – series of activities that add value to a company’s products or services.
9. Corporate social responsibility – must consider demands of other stakeholders, including employees, suppliers, and society.
10. Triple bottom line – focuses on financial, social and environmental measures.
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| 1. **Raw materials inventory turnover and Days’ Sales in Raw Materials Inventory**
	* 1. Raw materials inventory turnover helps managers assess how effectively a company manages its raw materials inventory.
2. Computed as raw materials used divided by average raw materials inventory.
3. Reveals how many times a company turns over (uses in production) its raw materials inventory during a period.
4. High ratio is preferred.
	* 1. Days’ sales in raw materials inventory reveals how much raw materials inventory is available in terms of the number of days’ sales.
5. Computed as (ending raw materials inventory divided by raw materials used) x 365.
6. Measures how long it takes raw materials to be used in production.
7. Assuming production needs can be met, companies prefer a low number.
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