Outline of Chapter 1
Introduction
• Purposes of Managerial Accounting
  – Planning/Decision Making
  – Control
• Financial vs. Managerial Accounting
• Design of Accounting System
  – Design and Use of Systems
  – Evolution
• Example of Decision Making

Planning/Decision Making
• Choosing goals, predicting results under various alternatives, making the decision
• Examples:
  – Product Management: Add a new product, terminate an existing product line, accept/reject a special order
  – Pricing: Set selling price (profit or cash flow)
  – Cost control: Add equipment, change production process, make or buy (outsource)

Control
• Implementing the action
• Evaluating the performance of personnel and operations
• Goal: To ensure that the organization operates in the intended manner

Objectives of Managerial Accounting
• To provide information for decision making
• To assist in controlling operations
• To motivate employees toward achieving the organization’s goals
• To measure the performance of employees or subunits of the organization

Distinction Between Financial and Managerial Accounting
• Financial Accounting
  – Used by shareholders, bondholders, taxing authorities, regulatory bodies, etc.
  – Rule-oriented, general purpose reports
• Managerial Accounting
  – Used by managers - internal to firm
  – Focuses on the internal needs of managers (planning/decision making, performance evaluation)
Design - Foundation

• Economic perspective
• Assumptions
  – Self-interested employees - maximize their own self-interest
  – Owners want to maximize firm value
  – Maximizing profits maximizes firm value
• Goal: To design performance incentives based on accounting measures to motivate employees to take actions that maximize firm value

Design - Conflicting Goals

• Decision Making
  – Want to avoid distorted information
  – Desire estimates to plan future activities
• Control
  – Need incentives to motivate behavior changes
  – Tendency to ignore information not specifically included in the system
  – Desire to report “good” numbers to satisfy top management

Design - Evolution

• Economic Darwinism
  – Over the long term, systems survive in competitive markets when the benefits exceed or equal the costs of maintaining those systems.
• Survival does not imply optimality
  – Better systems may exist, but have not yet been discovered.

Quote - p.11: Different Costs for Different Purposes

• Points:
  – No single cost figure is superior to all others
  – All systems involve tradeoffs between decision making and control
  – Many decisions/choices are arbitrary - don’t be afraid to challenge/critique any systems that we’ve discussed.

Vortec Example

• Trade-off between decision management and decision control
• Beware of unit costs
• Use opportunity costs
• Supplement accounting data with other information
• Basing rewards on accounting information may be dangerous