• What is accounting? How is accounting information used?
• What are career opportunities in accounting?
• What are the goals of generally accepted accounting principles?
• What are the key elements of the major financial statements?
• How can horizontal, vertical and ratio analysis provide insight into financial statements?
• How can managerial accounting help managers with product costing, incremental analysis, and budgeting?
### Accounting: Who Needs It?

<table>
<thead>
<tr>
<th>Managers</th>
<th>Stockholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees</td>
<td>Creditors</td>
</tr>
</tbody>
</table>

What other groups would be interested in accounting information?
The Accounting Profession: More Than Just Recording Transactions

What Accountants Do:

- Management Accountants (Private Accountants)
- Internal Auditors
- Public Accountants
- Government Accountants

Qualifications for Accounting Positions:

- Bachelor’s Degree
- Spreadsheet/Software Experience
- Certified Public Accountant (CPA)
- Certified Management Accountant (CMA)
- Master’s Degree – Preferred
In late 2008 federal authorities arrested Bernie Madoff on charges of perpetrating the biggest investment fraud in history. $50 billion dollars was gone…Where had it gone? Could any of it be recovered?

Forensic accountants follow money trails and untangle events and details. They may be:

- Certified Public Accountants
- Certified Fraud Examiners
- Law Enforcement Professionals

Many work for private companies

The FBI employs between 500-600 accounting specialists
The Role of the Financial Standards Accounting Board

**Generally Accepted Accounting Principles (GAAP)** – accounting standards that are used in the preparation of financial statements.

**Financial Accounting Standards Board (FASB)** – private self-regulated board that establishes and enforces GAAP.

Through GAAP, the FASB aims to ensure that financial statements are:

- Relevant
- Reliable
- Consistent
- Comparable
Will Going Global Zap GAAP?

- Many nations in Europe and Asia have adopted *International Reporting Standards (IFRS)*
- The SEC announced a suggested timeline for multinational U.S. firms to switch to the standards by 2016
- American firms will need to make significant changes as the criteria is different
Accounting scandals have shocked American business since the late 1990s

- Overstating earnings
- Hidden money and debt

The scandals have served as a wake-up call

- Laws have been changed
- Auditor independence enforced
Financial accounting includes three basic financial statements:

1. Balance Sheet
2. Income Statement

Corporations with publicly held stock must publish annual reports with all three statements.
**The Balance Sheet:**
What We Own and How We Got It

*Balance Sheet* – summarizes a firm’s financial position at a specific point in time

**Assets** – things of value that the firm owns

**Liabilities** – indicates what the firm owes to non-owners

**Owner’s Equity** – the claims owners have against their firm’s assets

Assets = Liabilities + Owner’s Equity
### EXHIBIT 8.1 The Balance Sheet for Bigbux

**Bigbux, Inc.**

**Balance Sheet**

**December 31, 201X**

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Stockholders' Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Assets</strong></td>
<td><strong>Current Liabilities</strong></td>
<td><strong>Total Liabilities</strong></td>
</tr>
<tr>
<td>Cash</td>
<td>Accounts payable</td>
<td><strong>Common Equity</strong></td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>Wages payable</td>
<td>Common stock</td>
</tr>
<tr>
<td>Inventory</td>
<td></td>
<td>Retained earnings</td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td><strong>Total current liabilities</strong></td>
<td><strong>Total Stockholders' Equity</strong></td>
</tr>
<tr>
<td>771,000</td>
<td>$220,000</td>
<td>$300,000</td>
</tr>
<tr>
<td><strong>Plant, Property and Equipment</strong></td>
<td><strong>Long-term Liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>Less: Accumulated depreciation</td>
<td>Long-term loan</td>
<td></td>
</tr>
<tr>
<td>Net plant, property and equipment</td>
<td></td>
<td>$504,000</td>
</tr>
<tr>
<td>$933,000</td>
<td>$380,000</td>
<td>$804,000</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>Total Liabilities</strong></td>
<td><strong>Total Liabilities and Stockholders' Equity</strong></td>
</tr>
<tr>
<td>$1,704,000</td>
<td>$1,704,000</td>
<td>$1,704,000</td>
</tr>
</tbody>
</table>

The balance sheet "balances," reflecting the equality expressed in the accounting equation.
Intangible Assets Take a Big Bite out of the Apple’s Balance Sheet

- On September 27, 2008 Apple Inc.’s balance sheet reported stockholder’s equity of $21.03 Billion

- The market value of outstanding common stock was more than $110.96 Billion

What accounts for the discrepancy?

- Much of Apple’s value includes their patents and loyal customers developed by their own design teams

- Although these items were written off as incurred expenses

- Investors recognize these intangible assets
**Income Statement** – summarizes a firm’s operations over a given period of time in terms of profit and loss

- **Revenue** – the increase in the amount of assets the firm earns
- **Expenses** – the cash the firm spends or other assets it uses to generate revenue
- **Net Income** – the profit or loss the firm earns

\[ \text{Revenue} - \text{Expenses} = \text{Net Income} \]
EXHIBIT 8.2 Income Statement for Bigbux

Bigbux, Inc.
Income Statement
For Year Ending December 31, 201X

Revenue: (What the firm earns)
- Sales Revenue: $890,000.00
- Cost of goods sold: $550,000.00
  Gross Profit: $340,000.00

Minus

Costs and Expenses (Cash spent and other resources used up)
- Operating Expenses
  - Selling expenses: $79,000.00
  - Administrative expenses: $86,000.00
  Total Operating Expenses: $165,000.00

Equals

Net Operating Income: $175,000.00
- Interest expense: $12,000.00
  Taxable Income: $163,000.00
- Taxes: $62,000.00
  Net Income: $101,000.00

Net Income (Profit if positive or loss if negative)
- Dividends: $55,000.00
  Transfer to Retained Earnings: $46,000.00
Stakeholders want to know if there is adequate cash to pay workers, creditors, suppliers and IRS.
**EXHIBIT 8.3** Bigbux’s Statement of Cash Flows

**Bigbux Corporation**

**Statement of Cash Flows**

**For Year Ended December 31, 201X**

**Operating Cash Flow**

- Cash payments from customers: $804,000
- Purchase of inventory: $(576,000)
- Cash operating expenses: $(155,000)

**Net Cash Provided from Operations**: $73,000

**Investing Cash Flow**

- Sale of land: $50,000
- Purchase of equipment: $(85,000)

**Net Cash Used by Investing**: $(35,000)

**Financing Cash Flow**

- Increase in long-term bank loans: $63,000
- Payments of cash dividends: $(55,000)

**Net Cash Provided from Financing**: $8,000

**Total Cash Flow**

- Cash at beginning of period: $142,000
- Cash at End of Period: $188,000

**Total Cash Flow**: $46,000
Other Statements

**Statement of Retained Earnings** – reports how retained earnings have changed

**Stockholder’s Equity Statement** – reports how net income and dividends affect retained earnings
It’s important to view financial statements and:

- The Independent Auditor’s Report
- Notes to Financial Statements
- Comparative Statements
The Independent Auditor’s Report: A Necessary Stamp of Approval

• Publicly traded corporations are required to have a CPA firm perform an external audit
  • *Is the information in the financial statements accurate?*

• The auditor will issue an *unqualified, qualified or adverse opinion*

• Auditors must be independent
| ✓ | Commonly referred to as SOX |
| ✓ | Banned relationships between CPA firms that might create conflict of interest |
| ✓ | Created Public Company Accounting Oversight Board (PCOAB) |
Additional information may be required to explain the numbers

- Lawsuits
- Employment Facts
- Mergers or acquisitions
- Health Insurance/Pension Funding
Comparative Statements: Trendy Analysis

• The SEC requires publicly traded companies to provide comparative financial statements
  ✓ 2-3 years of figures side-by-side
  ✓ Ability to view changes over a period of time
  ✓ Users can trace what has happened to key assets and liabilities

• Comparative analysis is a form of horizontal analysis
Managers rely on information to make decisions

- Accounting systems can provide competitive information
  - Product costs
  - Incremental analysis
  - Budgeting
- Many firms are empowering more employees with access to accounting information
### Managerial Accounting vs. Financial Accounting

**EXHIBIT 8.4** Comparison of Financial and Managerial Accounting

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Financial Accounting</th>
<th>Managerial Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purpose</td>
<td>Primarily intended to provide information to external stakeholders, such as stockholders, creditors, and government regulators. Information provided by financial accounting is available to the general public.</td>
<td>Primarily intended to provide information to internal stakeholders, such as the managers of specific divisions or departments. This information is proprietary—meaning that it isn’t available to the general public.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Type of information presented</th>
<th>Focuses almost exclusively on financial information.</th>
<th>Provides both financial and nonfinancial information.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Nature of reports</th>
<th>Financial Accounting</th>
<th>Managerial Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nature of reports</td>
<td>Prepares a standard set of financial statements.</td>
<td>Prepares customized reports to deal with specific problems or issues.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Timing of reports</th>
<th>Financial Accounting</th>
<th>Managerial Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Timing of reports</td>
<td>Presents financial statements on a pre-determined schedule (usually quarterly and annually).</td>
<td>Creates reports upon request by management rather than according to a predetermined schedule.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Adherence to accounting standards?</th>
<th>Financial Accounting</th>
<th>Managerial Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adherence to accounting standards?</td>
<td>Governed by a set of generally accepted accounting principles (GAAP).</td>
<td>Uses procedures developed internally that are not required to follow GAAP.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Time period focus</th>
<th>Financial Accounting</th>
<th>Managerial Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time period focus</td>
<td>Summarizes past performance and its impact on the firm’s present condition.</td>
<td>Provides reports dealing with past performance, but also involves making projections about the future when dealing with planning issues.</td>
</tr>
</tbody>
</table>
• Without good information on cost, managers are operating in the dark

• Some costs like direct labor and direct material costs are easy to identify and measure

• Costs like overhead can be challenging to trace

• Activity-based costing (ABC) aids in allocating costs

• ABC is difficult to implement but it provides meaningful results
Environmental Management Accounting: The Rise of “Green” Bean Counters

• Managers need relevant and accurate measures of the costs and benefits of environmental decisions

• Environmental management accounting (EMA) is:

“the management of environmental and economic performance through development and implementation of appropriate environment-related systems and practices”

• The practice is very new—techniques and tools are still evolving
Evaluates the financial impact of different alternatives in a decision-making situation

- Make parts or buy from supplier?
- Repair equipment or buy new?
- Perform repairs or outsource?
- Eliminate or sell product line/business?
An electronics firm produces high definition LCD televisions at a rate of 10,000 per month. It currently makes its own digital tuners for the televisions.

A supplier offers to sell the firm similar tuners at a cost of $25 per television. The firm could lower costs by buying the speakers, $25 is less than $30. Right?
### EXHIBIT 8.6 Incremental Analysis: Make or Buy Tuners?

<table>
<thead>
<tr>
<th>Type of Cost</th>
<th>Make</th>
<th>Buy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct labor costs</td>
<td>$140,000</td>
<td>$0</td>
</tr>
<tr>
<td>Direct materials costs</td>
<td>$85,000</td>
<td>$0</td>
</tr>
<tr>
<td>Manufacturing overhead</td>
<td>$75,000</td>
<td>$65,000</td>
</tr>
<tr>
<td>Cost of purchasing speakers ($25 \times 10,000 units)</td>
<td>$0</td>
<td>$250,000</td>
</tr>
<tr>
<td>Total monthly cost</td>
<td>$300,000</td>
<td>$315,000</td>
</tr>
</tbody>
</table>
Budget: Planning for Accountability

- Outline how resources will be used to meet goals
- Communication and coordination among managers and employees
- Motivate achievement of goals
- Monitor progress
Preparing the Budget: Top-Down or Bottom-Up?

Top-down budgeting – top management prepares the budget with little or no input from middle and supervisory managers

Bottom-up or participatory budgeting - allows middle and supervisory managers to actively participate in the creation of the budget
Developing the Key Budget Components: One Step at a Time

Operating Budgets identify sales and production goals.

- Sales Budget
- Production Budget
- Direct Labor Budget

Financial Budgets focus on the firm’s financial objectives.

- Cash Budget
- Capital Budget

Master Budget – brings together all of the budgets to represent the overall plan.
EXHIBIT 8.7 Development of the Master Budget

Operating Budgets:
- Sales Budget
- Production Budget
- Selling and Administrative Expense Budget
- Direct Labor Budget
- Direct Materials Budget
- Overhead Costs Budget

Financial Budgets:
- Cash Budget
- Capital Budget
- Budgeted Balance Sheet

Budgeted Income Statement
Looking Back

- What is accounting? How is accounting information used?
- What are career opportunities in accounting?
- What are the goals of generally accepted accounting principles?
- What are the key elements of the major financial statements?
- How can horizontal, vertical and ratio analysis provide insight into financial statements?
- How can managerial accounting help managers with product costing, incremental analysis, and budgeting?