

# Financial vs. Managerial Accounting

## Introduction to Managerial Accounting

## Financial Accounting

1. Financial accounting provides information designed primarily for users who are not involved in the day to day management of the business.
  - Providers of capital - investors and creditors.
  - Government Regulators - SEC, FTC, etc.
2. Financial accounting information is provided through summarized general purpose financial statements prepared in accordance with GAAP.
3. Financial statements are subject to independent audit and public dissemination for publicly-held companies.
4. Financial statements provide information that is historical in its nature.

## Managerial Accounting

1. Managerial accounting provides information designed primarily for use by a company's officers, managers, and employees to improve the business operations.
2. Managerial accounting has no standardized information requirements.
3. Managerial accounting information typically includes more detailed information.
4. Managerial accounting information is not subject to independent audit or public dissemination.
5. Managerial accounting information commonly includes budgetary information and forecasts.

### Problem: Financial vs. Managerial

Given the following information needs, would managerial or financial accounting provide the best source of data to address the need:

- a. To better understand how individual product lines are selling in various geographic locations?
- b. To identify the % markup on cost on each of numerous products sold by a company?
- c. To identify the total gross margin % on all company sales over the last 12 months?
- d. To anticipate the amount of borrowings required to support operations over the next six months?
- e. To calculate the P/E ratio for the company's stock at a certain market price based on historical earnings?

### Problem: Financial vs. Managerial

Given the following information needs, would managerial or financial accounting provide the best source of data to address the need:

- f. To project how many units of sales are required to generate a 20% increase in gross margin for the next year?
- g. To determine the amount of bonuses due certain sales personnel based on the achievement of individual sales quotas?
- h. To understand how a company has generally been financed to date?
- i. To evaluate a company's overall liquidity as of the end of the last fiscal year?
- j. To determine and propose specific job terminations department by department in implementing a cost reduction plan?

### Solution: Financial vs. Managerial

**Given the following information needs, would managerial or financial accounting provide the best source of data to address the need:**

- a. To better understand how individual product lines are selling in various geographic locations?  
**Managerial**
- b. To identify the % markup on cost on each of numerous products sold by a company?  
**Managerial**
- c. To identify the total gross margin % on all company sales over the last 12 months?  
**Financial**
- d. To anticipate the amount of borrowings required to support operations over the next six months?  
**Managerial**

# Financial vs. Managerial Accounting

## Problem: Financial vs. Managerial

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Financial

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Managerial

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Managerial

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Financial

## Solution: Financial vs. Managerial

i. To evaluate a company's overall liquidity as of the end of the last fiscal year?

Financial

j. To determine and propose specific job terminations department by department in implementing a cost reduction plan?

Managerial

# Product vs Period Costs

## Understanding the Costs of Operating a Business

### Product Costs

Costs associated with the goods or services offered to customers.

### Period Costs

All other costs of operating a business. These costs are generally referred to as "operating expenses," or "selling and administrative expenses."

**All businesses (merchandising, manufacturing or service) have two kinds of operating costs: product or period costs.**

## Merchandising Business

**Product Costs:** The cost of inventory purchased for resale.

Inventory	xxx	xxx
Cash (A/P)		

When the inventory is sold the cost becomes an expense.

Cost of Goods Sold	xxx	xxx
Inventory		

**Period Costs:** Selling and administrative costs

Selling Expense	xxx	xxx
Cash or Payable		

## Balance Sheet

Current Assets:

Cash	\$ xxx
Accounts Receivable	xxx
Inventory	xxx

## Income Statement

Sales Revenues	\$ xxx
Cost of Goods Sold	(xxx)
Gross Margin	xxx
Operating Expenses	
Selling & Admin Expense	(xxx)
Operating Income	xxx

## Manufacturing Business

Product Costs: All costs of manufacturing the product to be sold by the business.

Product costs typically include:

1. Direct Material Costs
2. Direct Labor Costs
3. Manufacturing Overhead Costs



## Manufacturing Overhead Costs

1. Indirect Material Costs
  - Factory Maintenance Supplies
  - Production Supplies
2. Indirect Labor Costs
  - Manufacturing Supervisors
  - Quality Control Inspectors
  - Manufacturing Equipment and Factory Maintenance Personnel
  - Product Designers and Engineers
3. Other Overhead Costs
  - Factory Rent, Depreciation, Utilities, Insurance, Property Taxes, Depreciation of Equipment, etc.

These product costs are accounted for as part of the cost of "Inventory" until the product is sold, at which time the costs are expensed as "Cost of Goods Sold". There are three categories or phases of inventory in a manufacturing business:

**Raw Materials Inventory**



**Work in Process Inventory (WIP)**



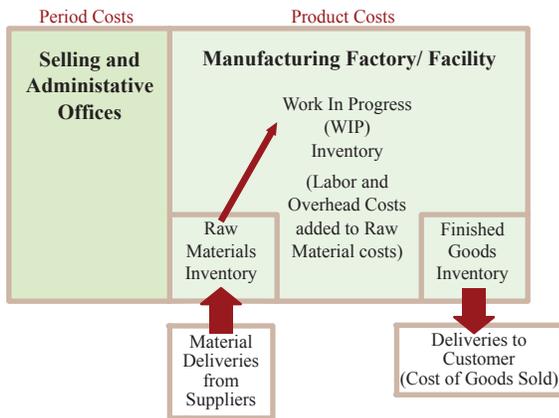
**Finished Goods Inventory**



**Cost of Goods Sold**

# Product vs Period Costs

## Overhead View of a Manufacturing Facility



## Balance Sheet

### Current Assets:

Cash	\$ xxx
Accounts Receivable	xxx
Inventory:	xxx
Raw Materials	xxx
Work in Process	xxx
Finished Goods	xxx

## Income Statement

Sales Revenues	\$ xxx
Less: Cost of Goods Sold	<u>(xxx)</u>
Gross Margin	xxx
Less: Operating Expenses-	
Selling & Admin Expenses	<u>(xxx)</u>
Net Income	xxx

### Problem: Product vs. Period Costs

Identify the following as either product or period costs. In the case of product costs note whether the cost would be classified as either a direct material, direct labor or manufacturing overhead cost and at what point that cost would be added to inventory; at the raw material, work in process or finished goods stage?

- Salaries of sales secretarial staff
- Direct materials used in manufacturing
- Janitorial supplies for the administrative office space
- Solvents used to clean manufacturing equipment
- Building rent (80% of building space is used for manufacturing and 20% for selling and administrative offices)

### Problem: Product vs. Period Costs

- Depreciation of administrative and office furniture
- Depreciation of manufacturing equipment
- Product quality control inspector's salary
- Factory production line worker's wage
- CEO salary
- Cost accountant salary
- Manufacturing vice president bonus
- Property taxes on manufacturing equipment
- Copy machine costs in sales department
- Building utility costs
- Manufacturing supervisor salaries

### Solution: Product vs. Period Costs

Identify the following as either product or period costs. In the case of product costs note whether the cost would be classified as either a direct material, direct labor or manufacturing overhead cost and at what point that cost would be added to inventory; at the raw material, work in process or finished goods stage.

- Salaries of sales secretarial staff  
**Period Cost**
- Direct materials used in manufacturing  
**Product Cost, Direct Materials, Raw Materials Inventory**
- Janitorial supplies for the administrative office space  
**Period Cost**

## Product vs Period Costs

### Solution: Product vs. Period Costs

- d. Solvents used to clean manufacturing equipment  
**Product Cost, Manufacturing Overhead, Raw Materials Inventory**
- e. Building rent (80% of building space is used for manufacturing and 20% for selling and administrative offices)  
**Period (20%) and Product (80%) Cost, Manufacturing Overhead, WIP Inventory**
- f. Depreciation of administrative and office furniture  
**Period Cost**
- g. Depreciation of manufacturing equipment  
**Product Cost, Manufacturing Overhead, WIP Inventory**

### Solution: Product vs. Period Costs

- h. Product quality control inspector's salary  
**Product Cost, Manufacturing Overhead, WIP Inventory**
- i. Factory production line worker's wage  
**Product Cost, Direct Labor, WIP Inventory**
- j. CEO salary  
**Period Cost**
- k. Cost accountant salary  
**It depends on whether the job would be eliminated if the company purchased rather than manufactured its product.**

### Solution: Product vs. Period Costs

- l. Manufacturing vice president bonus  
**Product Cost, Manufacturing Overhead, WIP Inventory**
- m. Property taxes on manufacturing equipment  
**Product Cost, Manufacturing Overhead, WIP Inventory**
- n. Copy machine costs in sales department  
**Period Cost**
- o. Building utility costs  
**Period and Product Cost based on some method of allocation**
- p. Manufacturing supervisor salaries  
**Product Cost, Manufacturing Overhead, WIP Inventory**