

## Accounting for Decision Making and Control

## 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