Using Accounting Information for Decision Making

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WMBA 6050: ***Accounting for Management Decision Making***

Financial Information for Decision Making

Four Basic Financial Statements

In basic accounting there are four financial statements that paint a picture of the state of the corporation, to wit; the income statement, statement of stockholders' equity, statement of financial position, and statement of cash flows (Walden University, LLC., 2021). The income statement is the first of the four to be prepared because it provides the information necessary to generate the other financial statements. The income statement is a compilation of revenue and expenses and is often called a "profit and loss statement" because after subtracting expenses from revenue, the report can be used to quickly tell if the company was profitable over the reporting period, which is typically one calendar year (Walden University, LLC., 2021).

The next statement to be prepared is one that shows changes in equity and retained earnings, and is aptly called: The statement of stockholders' equity. In layman's terms, this statement itemizes and totals the value of all assets, and after doing the same for liabilities, subtracts the latter from the former (Fuscaldo, 2020). A company's stockholders own the equity in the company and this sheet calculates and documents the amount. Examples of equity include share capital, retained earnings, net income, and dividends (Fuscaldo, 2020).

The statement of financial position, or better known as the balance sheet, takes into account all liabilities and equity to ensure that these combine to equal the total of the firm's assets (Walden University, LLC., 2021). The balance sheet is a great document because it helps to ensure both sides are in balance. Little financial errors can often go unnoticed, but then can resurface on the balance sheet. Therefore, the balance sheet is extremely useful in finding these errors. Additionally, unlike the income statement which runs the span of a length of time such as one year and has a start and end date, the balance sheet takes a snapshot of assets, liabilities, and equity in the moment. If assisted by computational software, the balance sheet always begins at the formation of the organization and computes values current as of the date the statement is run. For managers who appreciate a "bottom-line" perspective, the balance sheet, or statement of financial position, provides that.

The statement of cash flows is useful in detailing the flow of 'cash', liquid assets, both in and out of the company over a specified period of time (Walden University, LLC., 2021). If ever we have heard someone ask "where did the money go", then this statement is the first they would desire to analyze. This is because the statement not only shows how money was received by the company from its various sources, including operations and investments, but it also shows how money was spent (Hayes, 2022). The financial statement does this by tracking three specific aspects of business, to wit; operations, investment, and financing. It then separates these into three distinct sections of the report (Hayes, 2022). When we arrive at the bottom line, either the statement is positive or negative. While being "cash flow negative" may sound like it is

signaling an overtly negative financial state, consideration must be given for certain circumstances, such as when the company is paying off debt, making dividend payments, or conducting a stock buy-back (Hayes, 2022). These are three activities that should be done with careful consideration and can affect this financial statement. I would like to take this opportunity to warn the reader that this statement is highly susceptible to manipulation and if the overseer viewing this statement is lacking the necessary and relevant information, he or she could quickly draw conclusions that are improper. For example, a new manager could suspend dividend payments (giving off a very negative signal to stakeholders) which would result in a suddenly positive cash flow statement by comparison to previous years, and the overseer or others could be misled to believe the company is just being more efficiently run by the new manager. Finally, it is crucial to understand that the above listed statements should be prepared in the order stated above because each requires information that the prior statement computes and provides (Walden University, LLC., 2021).

Comparing Strategic Planning, Budgeting, and Forecasting

Organizations use tools to guide them in formulating short-term and long-term plans, to anticipate future needs, and to determine the exact methods through which they will achieve their corporate vision (Walden University, 2021). Arguably, three of the most important tools to achieve these goals include strategic planning, budgeting, and forecasting. A strategic plan is the most long-term of the three and is a three to ten year corporate vision (Schiff, 2008). Conversely, a budget is a little more mid-term as financial models go and covers a set period of time. Annual budgets are most common and cover a 1-year period. Budgets document how capital is apportioned for departmental expenses to accomplish management’s stated operational needs (Shim et al, 2012). Forecasts are really neat tools because they are created mid-budget and allow management to quickly see if the individual departments are on target to meet their goals while staying within the budgetary constraints. Forecasts enable department heads to see how much money is left in the budget to be spent and what percentage has been spent versus how far along in the year (or budgetary period) they are so they can make adjustments (Schiff, 2008).

These three concepts are distinct, yet interrelated. As an example, upper management may establish the corporate vision and develop a strategic plan which covers the next 5-years. Meanwhile, department heads will individually develop annual budgets that require annual renewal and approval by higher-ups. While the budgets may serve as the guiding force for each department moving forward, the managers will use forecasts to see whether they are on track or not and to aid in making adjustments moving forward. Forecasts can be drafted at any interval within the budgetary period to ensure departments stay on track. Some departments may find that they have need to forecast more frequently than others.

Responsibility Centers

In review of the three goals above, it would be wise to note that department heads and managers should only be held responsible for areas over which they have control (Franklin et al., 2019). This concept is broadly termed, responsibility accounting. Responsibility accounting places the corporation or entity into one of three responsibility centers, to wit; cost centers, profit centers, and investment centers. A cost center is a form of responsibility accounting where specific managers are individually held responsible for costs expended within the department directly under their individual control (Franklin et al., 2019). This is the most common of the three since it is grounded in an elemental form of financial stewardship whereby managers are held accountable for the use of budgeted company funds under their care.

A profit center is another center of responsibility that places the manager responsible for both the revenues and costs (Franklin et al., 2019). An example of this would be a corporation with multiple locations where the kind of strict financial oversight required of upper management in a cost center would be infeasible or impractical. A profit center responsibility accounting structure can be great because all of the numbers on financial statements can be converted to percentages and then multiple locations of a corporation can be compared and analyzed as to metrics such as efficiency and profitability while giving the individual locations more autonomy and giving control to local management.

Cost center responsibility is great for a corporation with a single location and profit center responsibility is great for a corporation with multiple locations within a similar geographic region, but when companies expand across geographic regions, such as into non-adjoining counties or states, they begin to take on a different set of needs. Investment center responsibility seeks to resolve this. Within investment center responsibility, corporations entrust regional managers with the responsibility of managing their own investments to improve the business' value, customer experience, or customer loyalty (Franklin et al., 2019). Within this type of responsibility accounting, a corporation's disparate locations within diverse regions can perform their own market research and make investment decisions that will yield localized results to boost value and ultimately revenue for their location.

Decision Rights

As corporations grow, so does their hierarchy of management, and with this comes delegation of responsibilities. As discussed above, responsibility should only be placed to the extent that the manager has control over the area he or she is to be responsible over. Decision rights have to do with setting clear roles and determining the extent to which a manager will be held accountable (Bain and Company, 2017). There are many circumstances where multiple individuals would need to share responsibility and control over a given department or aspects of the corporation. There are five distinct decision rights which upper management can assign, to wit; recommend rights,

agree, perform, input, and decide (Bain and Company, 2017). Recommend rights seem fairly self-explanatory, it is the responsibility to recommend decisions to those who will ultimately make the decisions (Bain and Company, 2017). These individuals will collect information and assess facts for relevance, and gather input from others where appropriate, for the purpose of ultimately making a specific recommendation (Bain and Company, 2017). Those with 'agree' rights, serve to either fast-track decisions or delay them if they believe additional work or research to be required (Bain and Company, 2017). Those with 'perform' rights receive tasks within a corporation and are expected to execute on those directives. Performers have many challenges, usually relative to the degree of freedom with which they are given to decide unknown variables or unexpected circumstances as they come up. Depending on the situation, perform rights may work best for task-oriented individuals where particulars are given, or may work best for visionaries when little actual direction or details for completion are actually provided. Input rights are assigned when managers need input from individuals with actual experience in the areas that require decision-making (Bain and Company, 2017). When input rights are given, individuals add their experience and salt facts with their personal judgment to add input to recommendations. Decide rights are given to individuals who will ultimately make decisions (Bain and Company, 2017). Decide rights are best bestowed on 'big-picture' people who are good at taking a look at the organization as a whole and making decisions that will obligate the firm to a given decision path.

More decision rights are given to profit centers than cost centers, and even more decision rights are given to investment centers than profit centers. This has to do with the size of the organization, the geographical separation of locations, and the regional differences where locations are located. Investment centers will undoubtedly employ all five decision rights while cost centers will employ perhaps just perform and recommend rights, reserving ultimate decision making, the ability to delay decisions, and to provide direction. Profit centers may always assign perform and recommend rights and may add or remove 'agree' and 'input' rights where appropriate. Additionally, decision rights may be shared between managers when it is not feasible or practical to split a department completely in two but when a department requires multiple managers to improve efficiency.

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