Overview

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Introduction

- Undergraduate degree from Bucknell University
- 2 years at Price Waterhouse (CPA)
- 4 years at the Equitable
- Ph'd from Penn State
- Married with two children
- Research Interests
  – Accounting for Mergers and Acquisitions
  – Role of accounting information in financial contracts.
- Experience with managerial accounting

Course Overview - Objectives

1. Become familiar with what accounting information is typically used within the firm.
   - Strategic implications
   - Limitations

2. Develop an understanding of how accounting information is used by managers in the decision making process.

3. Consider how accounting information can be used to motivate members of the firm or as a mechanism to control their behavior.

Course Overview – Who should take this class

Are you going to be a manager?

Are you going to be a consultant?

Are you going to be an entrepreneur?

Course Overview - Requirements

This class is designed to allow you to develop an understanding of the concepts by applying the material covered to real life problems and cases. I have designed the grading system for this class to meet this objective.

Your grade will be computed as follows:

Group Case	20%
Individual Cases	40%
Take home Final	40%

Course Overview

Throughout the course we will develop an understanding of three basic concepts:

1. How costs behave

2. The nature of the firm

3. How accounting systems report costs

These building blocks will be used to gain insights on the role of accounting information in a variety of settings.

Managerial Accounting

What is managerial accounting?

The Smith Center

In 1992, State University committed to building the Smith Center (A 15,000 seat basketball Arena). The following projected financial information was available to the University prior to engaging in the project:

Costs:	
Building	$54 million
Parking	$ 2 million
Funding:	
Private Contributions	$23 million
State Funding	$33 million

The Smith Center

In the year after the Smith Center was built there were conflicting stories on the profitability of the Smith Center, and the profitability of the athletic department.

The state legislature reported that the athletic department made over 18 million and the basketball program made over 2.2 million.

The University reported a marginal profit for the basketball program, and breakeven results for the entire athletic department.

How can there be two different “profits” for the same economic entity?

The Smith Center

The following is a hypothetical scenario describing how these could be two different measurements of profit for the same economic entity. Lets first focus on the universities estimate.

The Smith Center

State University's estimates on Profitability of the Smith Center:

Revenue:	
Basketball Ticket Revenue	$2 million
Parking	$.5 million
Donations to Basketball program	$1 million
Television Revenue	$2.2 million
Allocated shared revenue	$.2 million
Costs	
Utilities	$1 million
Tuition cost of supporting a basketball team	$810,000
Cost of supporting coaches and administrators:	$700,000
Payroll Costs	$200,000
Allocation of shared expenses	$1 million

The Smith Center - Factors

What are allocated Costs?

- Orthopedic Surgeon
- Team Physicians
- Trainers
- Athlete medical Expenses
- Sports Information Department
- Academic Support Center

These cost total $23 million and are allocated equitably over the 23 varsity programs.

What would happen if the allocation were changed to a per athlete basis?

Does it matter?

The Smith Center - Factors

What are allocated revenues?

State University has a 4.2 million dollar endorsement contract with Pepsi. This revenue is also allocated equitably over the 23 Varsity programs.

Does an equitable allocation make sense?

What happens if the allocation is changed to sports which are broadcast to a national audience, or the number of national appearances?

Does it matter?

The Smith Center - Factors

What are the opportunity costs of providing $56 million of financing for the Smith Center?

Develop a school of information technology.

Expand the library.

Expand the football stadium

The Smith Center - Factors

How are utility costs assigned to the team?

In the Smith Center there are only 3 teams that use the facility, men’s and women’s basketball and wrestling. In Rec Hall 15 teams use the facilities.

Basketball and wrestling are winter sports, how are utility costs for the rest of the year assigned?

The Smith Center - Factors

Can State University generate additional revenue at the Smith Center?

- Concerts
- WWF
- Product Expo

Will State University use the facility for other purposes?

- Commencement
- Job Fair
- Tail gates etc…

The Smith Center - Factors

How do you allocate the costs of the 56 million dollars raised since there is no interest associated with raising these funds?

- Cost of Debt?

- Cost of Equity?

- Cost of next best available alternative?

The Smith Center

Should State University open the Smith Center?

Important considerations:

Summary

Important Concepts to take away from this class:

1. Opportunity Costs

2. Cost allocations are important in a wide variety of contexts.

3. Incremental cost analysis.

For tomorrows class, please read Main line vs Bassinger, it is on the web, and skim chapter 2 of the textbook. We will spend some time on problems: 2-16 (X Corporation Jet), 2-26 (University Parking), 2-41 (Amy's Boards).