



# Three Faces of Accounting

Learning how your organization is focused can help you get approvals for maintenance and engineering expenditures.

BY LEN MIDDLETON

**T**his column should help you to clarify some of the issues involved in communicating with finance and accounting departments. Just as maintenance and engineering have different disciplines or areas of specialization (e.g. mechanical, electrical), so does accounting. (Please note, I am not an accountant and thus this is my best understanding of the subject. However, I would like to thank Tom Wright, CA, for his input and assistance in reviewing this article.)

In Canada and the U.S.A., there are three major areas of accounting, each with its own intended audience, objectives, and rules or guidelines. They may all reside in the same department and wear multiple hats, and use the same systems for their multiple uses, but their objectives and perspectives can be significantly different, depending upon the area of accounting they are addressing. These accounting disciplines are financial accounting, tax, and management accounting (or cost accounting). Let's look at these individually and see how they might have an impact maintenance and engineering.

## Financial accounting

The intended audience for financial accounting is existing and potential owners (e.g. shareholders), investors and lenders to the organization. The objectives will depend upon the ownership structure and the owner's interests.

If the organization is privately or closely-held and expected to remain that way, then the financial accounting objectives may be focused on tax deferral. If the organization is publicly traded, or a privately or closely-held organization that is looking at selling all or part of the organization in the future (e.g. through an IPO — Initial Public Offering), then the focus may be on how the organization's financial performance looks to existing or potential investors or lenders.

How does this impact financial accounting decisions? As decisions made in financial accounting impact taxes, for *tax deferral* the organization would 'recognize' revenues as late as allowable, and recognize expenses as soon as allow-

able. Alternately, to make the *financial performance* look as good as possible, the organization would recognize revenues as soon as allowable, and recognize expenses as late as allowable. Once decisions have been made on how revenues and expenses are recognized, then they cannot be changed without revising past financial statements and notifying investors and regulators of the change.

One way of deferring recognition of expenditures is to capitalize them. The capital expenditure increases the value of the assets on the balance sheet, and the capital cost is allocated (through depreciation) over the economic lifetime of the asset. Therefore, decisions on capitalization can be very different based upon the organization's objectives. In financial accounting, as costs need to be allocated to the time period that the revenues occur, the use of depreciation allocates those capital costs to those periods.

To help protect the interests of those using the financial statements to make investment or lending decisions, financial accounting must comply with GAAP (Generally Accepted Accounting Principals — pronounced 'gap'). There are some differences between GAAP in Canada and the U.S.A., but overall I believe they are very similar. If senior management is compensated based upon share price (e.g. through stock options), then GAAP constrains what they can do to affect the share price. In many of the recent accounting scandals, it was violations of GAAP (e.g. bringing future revenues forward) that caused the problems.

## Tax

Of course the intended audience for taxes is the government, and the rules are the government's tax code. With governments there are political considerations, resulting in a trade-off between tax collection and the political objectives they are working to support. These objectives can include increasing employment, education/skill levels, capital investment, research and development, and support of selected industries or regions.

The tax collectors do not want to hear a different story than the one the organi-

zation is telling everyone else, so decisions made in financial accounting impact taxes. The one significant exception is that the tax collector has different rules than GAAP for capitalization and its allocation.

Tax does not talk about depreciation; it talks about CCA (Capital Cost Allowance). Capital assets are put into different CCA classes and their tax deduction value is based upon the class rate. Like depreciation, the asset value is reduced by the amount of the CCA allowed.

## Management accounting

As the name implies, the focus of management accounting is upon accounting to manage the operation of the business. Management accounting is looking into the organization, and using the tools deemed appropriate to manage the risk involved in the business operation. Some examples of managerial decisions would be 'make' (in-house) versus 'buy' (out-source/contract out), close a division, and taking on new (incremental) work.

While there are many different management accounting practices and systems (standard costing, ABC — Activity Based Costing, cash flow analysis, etc.), there is no regulated requirement. This enables the person designing the reports considerable freedom (ideally with input from the report users) in their design and content.

Management accounting would generally use the same standard financial accounting IS (Income Statement), BS (Balance Sheet), and CF (Cash Flow) reports to form a major part of internal managerial reporting.

As well as measuring financial performance of the organization, management accounting can be monitoring and reporting other measurements of performance (e.g. customer service measurements, productivity, OEE — Overall Equipment Effectiveness, etc.).

## Impact on maintenance and engineering

You may already know whether your part of the organization is focused upon how it is viewed from the outside or upon ensuring that operations are well

managed. It may be evident by the criteria used to evaluate investment in the business. The two approaches are not mutually exclusive, but there is likely to be a greater focus upon one perspective than the other.

Are financial ratios including ROA/RONA/ROE/EVA part of the evaluation criteria? Or are cash flow, working capital requirements, and ROI (Return On Investment) including NPV/IRR/discounted cash flow/payback period more involved in evaluation?

If you are looking at making changes, then you will need to understand senior management interests. Focus upon how your proposed changes support *their* organizational objectives. Otherwise you are not likely to get their attention and be able to make changes that involve significant resources (capital or human). There is a limit to what you can accomplish on your own through 'skunk works' projects.

Talk to your accounting group and see if they can help provide you with some insight to help focus your changes on the organizational objectives. They can also help you with the acronyms mentioned above.

*Next issue:* The next column will be about the business aspects of Executing Effective Projects.

MRO

Len Middleton of Asset Management Solutions of Toronto can be reached at [len@asset-management-solutions.com](mailto:len@asset-management-solutions.com).

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