**Chapter 1**

**Managerial Accounting, the Business**

Organization, and Professional Ethics

**LEARNING OBJECTIVES:**

When your students have finished studying this chapter, they should be able to:

1. Explain why accounting is essential for decision makers and managers.

2. Describe the major users and uses of accounting information.

3. Explain the role of budgets and performance reports in planning and control.

4. Describe the cost-benefit and behavioral issues involved in designing an accounting system.

5. Discuss the role accountants play in the company’s value-chain functions.

6. Identify current trends in management accounting.

7. Explain why ethics and standards of ethical conduct are important to accountants.

**CHAPTER 1: ASSIGNMENTS**

**CRITICAL THINKING EXERCISES**

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1. Accounting’s Position in the Organization: Controller and Treasurer

30. Marketing and Management Accounting

31. Production and Management Accounting

**EXERCISES**

32. Management Accounting and Financial Accounting

33. Planning and Control, Management by Exception

34. Line Versus Staff and Value Chain Responsibility

35. Microsoft’s Value Chain

1. Objectives of Management Accounting
2. Cost-Benefit of the Ethical Environment

38. Early Warning Signs of Ethical Conduct

**PROBLEMS**

1. Management and Financial Accounting
2. Use of Accounting Information in Hospitals
3. Costs and Benefits
4. Importance of Accounting
5. Changes in Accounting Systems
6. Value Chain
7. Role of Controller
8. The Accountant’s Role in an Organization
9. Ethics and Accounting Personnel
10. Ethical Issues
11. Hundred Best Corporate Citizens

**CASES**

50. Line and Staff Authority

51. Professional Ethics and Toxic Waste

52. Information in Nike’s 10k Report

**EXCEL APPLICATON EXERCISE**

53. Budgets and Performance Evaluation

**COLLABORATIVE LEARNING EXERCISE**

54. The Future Management Accountant

**INTERNET EXERCISE**

55. Institute of Management Accountants

(http://www.imanet.org)

**CHAPTER 1: OUTLINE**

**I. Accounting and Decision Making *{L. O. 1}***

**A. Users of Accounting Information**

In general, users of accounting information fall into two general categories.

1. Internal managerswho use information for day-to-day operating decisions and for long-range strategic decisions, and
2. External parties, such as investors and government authorities, who use the information for making decisions about the company.

The internal managers make use of **Management Accounting** information whereas the external parties make use of **Financial Accounting** information. See **EXHIBIT 1-1** for the major distinctions between these two types of accounting information.

**Accounting System—**a formal mechanism for gathering, organizing, and communicating information about an organization’s activities. A good accounting system helps an organization achieve its goals and objectives by helping to answer three types of questions.

1. **Scorecard Questions** (Am I doing well or poorly?)—accumulation and classification of data,

2. **Attention-Directing Questions** (Which problems should I look into?)—focuses on operating problems and opportunities, and

1. **Problem-Solving Questions** (Of the several ways of doing the job, which one is best?)—quantifies the likely results of possible courses of action for long-range planning.

**B. Influences on Accounting Systems**

An **accounting system** is a formal mechanism for gathering, organizing, and communicating information about an organization’s activities. Reports for external users are bound by **generally accepted accounting principles (GAAP)** and legal requirements. In the European Union and more than 100 countries worldwide, companies must comply with International Financial Reporting Standards (IFRS).

Internal accounting reports are not restricted by GAAP. Costs of developing and operating a system dictate an internal accounting system‘s design. Many organizations have an accounting system designed to meet external reporting requirements. Managers can create whatever kind of internal accounting system they want—provided they are willing to pay for it.

Because government agencies have legal power to order into evidence any internal document that they deem necessary, internal accounting systems may be affected by government regulation. An example is the manner in which universities and defense contractors must allocate their costs to government contracts.

**Foreign Corrupt Practices Act—**requires that accounting records be maintained in reasonable detail and accuracy, and that an appropriate system of internal accounting controls be maintained. The internal accounting controls must be documented by *management* rather than *external auditors*.

**Management Audit—**a review performed by **internal auditors** of profit-seeking organizations and governmental agencies (through the General Accounting Office) to determine whether the policies and procedures specified by top management have been implemented.

**Sarbanes-Oxley Act**—passed in 2002 requiring more top-management oversight of a company’s accounting policies and procedures, which was driven by corporate bankruptcies (e.g., Enron, WorldCom, and Adelphia) blamed in part on accounting lapses.

**II. Cost-Benefit and Behavioral Considerations *{L. O. 2}***

**Cost-Benefit Balance—**weighing estimated costs against probable benefits. This is the primary consideration in choosing among accounting systems and methods. The value of a system must be seen as exceeding its cost.

**Behavioral Implications—**the accounting system’s effects on the behavior (decisions) of managers. A system that managers believe in and trust will be used more in making decisions than one they distrust.

**III. The Management Process and Accounting *{L. O. 3}***

**A. The Nature of Planning and Controlling**

The management process is a series of activities in a cycle of planning and control with **Decision Making—**the purposeful choice from among a set of alternative courses of action designed to achieve some objective, as the core. **Planning—**thesetting of objectives and outlining how they will be attained. **Controlling—**the *implementation* of plans and *using feedback* to attain objectives. Planning determines action, action generates feedback, and feedback influences further planning and possible corrective actions. See **EXHIBIT 1-2** for illustrations of these relationships utilizing a Starbucks store.

**B. Management by Exception**

A **budget** is a quantitative expression of a plan of action. Budgets are the chief devices for compelling and disciplining management planning.

**Performance Reports—**provide feedback by comparing results with plans and by highlighting **Variances** (i.e., deviations from plans). The accounting system records, measures, and classifies actions in order to produce *performance reports*. See **EXHIBIT 1-3** for an example of a performance report for a hypothetical store, the Mayfair Starbucks.

**Management by Exception—**concentrating on areas that need attention and ignoring areas that appear to be running smoothly. Managers use performance reports to investigate exceptions (i.e., items for which actual amounts differ significantly from budgeted amounts). Operations are then brought into conformity with plans, or the plans are revised.

**IV. Planning and Control for Product Life Cycles *{L. O. 4}***

**and the Value Chain**

**Product Life Cycle—**the various stages through which a product passes: from conception and development; introduction into the market; maturation; and, finally, withdrawal from the market. In the planning process, managers must determine revenues and costs over the entire life cycle. Accounting also needs to track actual costs and revenues throughout the life cycle. Periodic comparisons between planned costs and revenues and actual costs and revenues allow managers to assess the current profitability of a product, determine its current life-cycle stage, and make any needed changes in strategy. See **EXHIBIT 1-4** for a typical product life cycle.

**The Value Chain—**set of business functions that add value to the products or services of an organization. These functions, not of equal importance, include research and development, design of products or services, production, marketing, distribution, and customer service. See **EXHIBIT 1-5** for a depiction of business functions’ value chain.

**V. Accounting’s Position in the Organization**

**A. Line and Staff Authority**

**Line Authority**—authority extended downward over subordinates. **Staff Authority—**authority to advise but not command. It may be exerted downward, laterally, or upward. See **EXHIBIT 1-6** for the types of authority depicted in an organizational chart.

**Controller** (or **Comptroller** in a government organization) is the top accounting officer in an organization. This executive, like virtually everyone in an accounting function, fills a staff role, whereas sales and production executives and their subordinates fill line roles. **Line Departments** are those that are central to the mission of the organization, whereas **Staff Departments** lend support and service to the line department. See **EXHIBIT 1-6** for a partial organizational chart of a manufacturing company. Although controllers have a staff role, they are generally empowered by the firm’s president to approve, install, and oversee the organization’s accounting system to assure uniform accounting and reporting methods.

**B. Controller and Treasurer Functions**

**Controllers (Comptrollers)** are responsible for planning for control, reporting and interpreting, evaluating and consulting, tax administration, government reporting, protection of assets, and economic appraisal. The duties of **Treasurer** include provision of capital, investor relations, short-term financing, banking and custody, credits and collections, investments, and risk management (insurance). **Chief Financial Officer** (CFO) is a top executive who deals with all finance and accounting issues.

**VI. Management Accounting and Your Career *{L. O. 5}***

**A. Certified Management Accountant**

Although financial accounting has long provided auditing positions that are typically staffed by **Certified Public Accountants (CPAs)**, accounting positions in corporations are increasingly calling for **Certified Management Accountants (CMAs).** The **Institute of Management Accountants (IMA)**, the largest U.S. professional organization of accountants whose major interest is management accounting, oversees the CMA program. CMAs must pass an examination covering: (1) financial planning, performance and control and (2) financial decision making. The **International Accounting Education Standards Board (IAESB)** is a part of the International Federation of Accountants and sets standards for auditors throughout the world.

**B. Training for Top Management Positions**

In addition to preparing you for a position in an accounting department, studying accounting, and working as a management accountant, can prepare you for the very highest levels of management, such as CEO.

**VII. Adaptation to Change *{L. O. 6}***

**A. Certified Management Accountant**

As decisions change, demands for information change. Accountants must adapt their systems to the changes in management practices and technology. Four major trends are influencing management accounting today:

1. Shift from a manufacturing to a service-based economy in the United States
2. Increased global competition
3. Advances in technology including **e-commerce**, **enterprise resource planning (ERP)**, and eXtensible Business Language Reporting (**XBRL)**
4. Changes in business process management

1. **Service Sector**

The characteristics of service organizations include the following:

* 1. Labor is a major component of costs
  2. Output is usually difficult to measure
  3. Service organizations cannot store their major inputs and outputs

1. **Global Competition**

There has been a shift in the balance of economic power in the world due to countries lowering tariffs and duties, and a trend toward deregulation.

1. **Advances in Technology**

The dominant influence on management accounting over the past decade has been technology change, affecting both the production and the use of accounting information. One of the more rapidly growing uses of technology is electronic commerce or e-commerce.

A major effect of technology on accounting systems has been the growing use of enterprise resource planning systems (ERP).

**VIII.** **Changes in Business Process Management**

Some companies implement sweeping changes in operations through **business process reengineering**, the fundamental rethinking and radical redesign of business processes to improve performance in areas such as cost, quality, service, and speed.

The most important recent change leading to increased efficiency in American factories has been the adoption of a **just-in-time (JIT) philosophy—**the elimination of waste by (1) reducing the time that a product spends in the production process and (2) eliminating the time that products spend on activities that do not add value (e.g., inspection and waiting time). Another step in gaining efficiency is **lean manufacturing**, which applies continuous process improvements to eliminate waste from the entire enterprise.

Companies can use computer-aided design (CAD) to design products that can be manufactured efficiently and computer-aided manufacturing (CAM) to produce a smoother, more efficient flow of production with fewer delays. The impact of both of these is to reduce processing time. **Computer-Integrated Manufacturing (CIM) Systems—**systems that use CAD and CAM together with robots and computer-controlled machines.

In the 1980s and 1990s, many companies undertook **Total Quality Management (TQM)** initiatives. TQM minimizes costs by maximizing quality. It focuses on continuous improvement in quality and has come to represent a focus on satisfying one’s customers.

Recently, the focus on quality has shifted to **Six Sigma**, a disciplined, data-driven approach to a continuous process improvement effort designed to reduce costs by improving quality and ensuring that internal processes are running as efficiently as possible.

**A. Implications of Process Changes for the Study of Management Accounting**

To adapt to changes, the student must understand why techniques are being used, not just how they are used. Students should develop their understanding of underlying concepts and principles, not just memorize rules and techniques.

**IX. Ethical Conduct for Professional Accountants *{L. O. 7}***

**A. Standards of Ethical Conduct**

Standards of ethical conduct have been adopted by professional accounting organizations because of the reliance by so many parties on the product of accountants. A **code of conduct** – a document specifying the ethical standards of an organization – is the centerpiece of most ethics programs. See **EXHIBIT 1-7** for the **IMA Statement of Ethical Professional Practice**. The standards are shown as responsibilities regarding competence, confidentiality, integrity, and objectivity.

1. **Ethical Dilemmas**

Ethical dilemmas exist when managers must choose an alternative and there

are (1) significant value conflicts among differing interests, (2) several

alternatives are justifiable, and (3) there are significant consequences for

stakeholders in the situation.

**C. Resolution of Ethical Conflicts**

Most often, you can bring the issue to the attention of your supervisor or a special ethics officer (often called an ombudsperson) in the organization. Ultimately, the board of directors, and even the Securities and Exchange Commission, may become involved.

**CHAPTER 1: Quiz/Demonstration Exercises**

**Learning Objective 1**

1. The major internal users of accounting information are \_\_\_\_\_.

a. managers who use information for day-to-day operating decisions

b. investors for investment decisions

c. government authorities

1. none of the above

2. In the European Union external reporting must comply with \_\_\_\_\_.

1. GAAP
2. IFRS
3. IRS
4. FASB

**Learning Objective 2**

3. Which of the following should be considered in the selection of an accounting system?

a. behavioral effects of the system on managers

b. costs of buying and operating the system

c. improved decision-making power resulting from the system

d. all of the above

**Learning Objective 3**

4. Concentrating on areas that need attention and ignoring areas that appear to be running smoothly is called \_\_\_\_\_.

1. variance analysis
2. management by exception
3. management smoothing
4. budget analysis

5. Which of the following is not an example of a special report?

a. cash flow report

b. customer survey

c. competitor analysis

d. advertising impact analysis

**Learning Objective 4**

6. The various stages through which a product passes are called:

1. planning cycle
2. control period
3. budget cycle
4. product life cycle

7. The focus on customers occurs in which functions of the value chain?

a. research and development

b. production

c. marketing

d. distribution

e. all of the above

8. The value-chain is a set of business functions that \_\_\_\_\_.

a. are of equal importance

b. are non-value added functions

1. c. are preferable functions
2. d. are value-added functions

e. are only related to distribution

9. The functions of planning for control, evaluating and consulting, and governmental reporting are typically assumed within organizations by \_\_\_\_\_.

a. the company treasurer

b. the company controller

c. the company vice president of marketing

d. external auditors

1. The treasurer function includes \_\_\_\_\_.
2. tax administration
3. evaluating and consulting
4. investor relations
5. economic appraisal

**Learning Objective 5**

1. The CMAs must pass an exam that includes \_\_\_\_\_.
2. financial control
3. financial decision making
4. financial planning
5. all of the above
6. Which designation is the internal accountant’s counterpart to the CPA?
7. CA
8. CMA
9. CFP
10. none of the above

**Learning Objective 6**

13. Trends that are causing changes in management accounting today include:

1. advances in technology
2. increased global competition
3. a shift from a manufacturing to a service-based economy
4. A and B
5. A, B, and C
6. A step in changes in business process management to gain efficiency by continuous process improvement to eliminate waste from the entire enterprise is called \_\_\_\_\_.
7. just in time
8. lean manufacturing
9. waste management
10. none of the above

**Learning Objective 7**

15. Ethical obligations of management accountants are governed by the **IMA Statement of Ethical Professional Practice,** which outlines responsibilities regarding \_\_\_\_\_.

1. incompetence, full disclosure of all information, moral decay, and partisanship
2. assisting in maximizing profits regardless of the means necessary
3. competence, confidentiality, integrity, and objectivity
4. none of these
5. In the **IMA’s Statement of Ethical Professional Practice**, which of the following is not an example of Competence?
6. provide decision support information and recommendations that are accurate
7. avoid actual or apparent conflicts of interest
8. maintain an appropriate level of professional expertise
9. perform professional duties in accordance with relevant laws

**CHAPTER 1: Solutions to Quiz/Demonstration Exercises**

**1. *[a]***

**2. *[b]***

**3. *[d]***

**4. *[b]***

**5. *[a]***

**6. *[d]***

**7. *[e]***

**8. *[d]***

**9. *[b]***

**10. *[c]***

**11. *[d]***

**12. *[b]***

**13. *[e]***

**14. *[b]***

**15. *[c]***

**16. *[b]***