

Managerial Accounting, the Business Organization, and Professional Ethics

OVERVIEW

This preview chapter emphasizes the partnership roles of managers and accountants in planning and controlling the operations of an organization. Our broad aim is to understand how accounting systems can aid management decisions. The chapter presents the three themes that govern the practice of management accounting: the concept of cost-benefit analysis, the behavioral focus, and adaptation to change. Your learning objectives for this chapter are to:

- I. Describe the major users and uses of accounting information
- II. Explain why ethics is important to management accountants
- III. Describe the cost-benefit and behavioral issues involved in designing an accounting system
- IV. Explain the role of budgets and performance reports in planning and control
- V. Discuss the role accountants play in the company's value-chain functions
- VI. Contrast the functions of controllers and treasurers
- VII. Explain why accounting is important in a variety of career paths
- VIII. Identify current trends in management accounting
- IX. Appreciate the importance of standards of ethical conduct to professional accountants

REVIEW OF KEY CONCEPTS

I. Describe the major users and uses of accounting information

- A. All accounting information is prepared to help someone make decisions. In many cases, accounting information is absolutely critical to making good decisions. Users of accounting information and their decisions include:
1. Internal managers making short-term planning and control decisions
 2. Internal managers making investment and long-term planning decisions
 3. External parties, such as investors who decide whether to invest in the company and government authorities who decide on various policy and regulatory matters
- B. Note how the primary users and decisions of accounting information are different:
1. The first two categories deal with the internal use of information by managers: this is *management accounting* and is the focus of this text and study guide.
 2. The third category is concerned mainly with the use of information by individuals who are external to the organization: this is *financial accounting*.
 3. Different needs and different users indicate either different accounting *systems* for each category or a complex, multi-purpose accounting *system* that serves all.
- Stop and Review**
See textbook Exhibit 1-1
- C. Income tax and other regulatory authorities set allowable accounting practices for external, financial accounting (e.g., GAAP). There are no similar constraints on management accounting.

Important Abbreviations

AICPA	American Institute of Certified Public Accountants
CMA	Certified Management Accountant
GAAP	Generally Accepted Accounting Principles
GAO	General Accounting Office
IMA	Institute of Management Accountants

Study Tip: Before going on to the next section, be sure that you understand the different users of accounting information and how different accounting systems provide information for their decision-making needs.

II. Explain why ethics is important to management accountants

- A. Ethical behavior is paramount in the accounting profession.
1. Companies rely on accurate reporting from accountants to make business decisions.
 2. Businesses run better when a high level of ethical integrity is established.

- B. The basic ideas of management accounting apply to service and nonprofit organizations as well as to manufacturing organizations.
1. Service organizations produce a service instead of a tangible product.
 - a. They include banks, insurance companies, railroads, theaters, and medical clinics.
 - b. Nearly all nonprofit organizations are engaged in service activities--for example, universities, public libraries, churches, charitable organizations, and government agencies.
 2. The main distinctive characteristics of service organizations are:
 - a. They are **labor-intensive** and not capital-intensive.
 - b. Their outputs are **difficult to define and measure**.
 - c. Their major inputs and outputs are **intangible** and therefore **cannot be stored**.
 3. The last two items are the reasons why management accounting in service organizations (1) is especially challenging and (2) may have the most opportunity for improving decision making.

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

- A. Three major themes govern the design of management accounting systems:
1. **Simplicity** – an overall watchword for systems design.
 2. The **cost-benefit** theme of choosing among accounting systems and methods:
 - a. All accounting information and systems are economic goods available at various *costs*.
 - b. More extensive management accounting information is desirable only if the *benefits* (through improved decision making) exceed the costs of the information.
 - c. Often it is easier to identify the costs of new information (e.g., computer hardware, software, and personnel) than the benefits.
 3. **Behavioral implications** of operating a management accounting system:
 - a. The use of budgets stimulates planning activities. This is a beneficial behavioral effect.
 - b. Individual motivations are strongly influenced by performance reports and incentives that are used to appraise both decisions and managers. This can be a favorable behavioral effect **if** the performance reports and incentives are designed properly. Otherwise, adverse behavioral effects may result.

Study Tip: *Can you explain the three major influences on management accounting systems?*

- B. Management decision making is composed of two basic functions:
1. **Planning:** deciding on objectives and ways to attain them.
 2. **Controlling:** evaluating performance through **feedback**, modifying plans if necessary, and implementing plans.

Stop and Review

See textbook Exhibit 1-2

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

- A. **Budgets** are the main type of planning information. A **budget** is a quantitative expression of a plan of action. It is also an aid in coordinating and implementing the plan.
- B. **Performance reports** are the main type of controlling information that compares results with plans and highlights deviations from plans.
- C. **Management by exception** means focusing attention and effort on the more significant deviations from expected results. In accounting these deviations are called **variances**.

Stop and Review

See textbook Exhibit 1-3

***Study Tip:** Before going on, be sure that you understand the different types of information that accounting systems provide and how this information is consistent with the management process.*

- D. Many management decisions relate to a single good or service, or to a group of related products.
 - 1. It is the responsibility of accountants to plan for and control the production of these goods and services. To do this effectively, accountants and managers often consider the **product's life cycle**.
 - 2. A **product's life cycle** refers to the stages that a product goes through, from development and introduction to the market, to maturation, and, eventually, withdrawal from the market.
- E. The development stage of the product life cycle determines most of the costs of products and programs.
 - 1. During the production or delivery stages, typical accounting systems do not report past development costs or future phase-out costs.
 - 2. Thus, product costs over the entire life cycle may be understated by ignoring development and phase-out costs.
 - 3. Proper decision making for current products (and importantly for planning future products) requires that managers consider the costs over the entire product life cycle.

Stop and Review

See textbook Exhibit 1-4

V. Discuss the role accountants play in a company's value-chain functions

- A. All businesses must assess and design activities to meet needs and values of their customers.
 - 1. The linked functions that a business uses to meet these needs and values together are called a **value chain**.
 - 2. Businesses must assess whether functions really add value to the products or services of an organization.

Stop and Review

See textbook Exhibit 1-5

- B. Accountants play a key role in all **value-chain functions**. Accountants affect each step of the product life cycle.
1. Providing estimated revenue during research and development
 2. Giving feedback as to cost reductions that can be made long before any commitments must be made
 3. Tracking the effects of continuous improvement programs during development
 4. Planning for efficient distribution of the product (direct retail vs. wholesale; shipping and transportation)
 5. Providing cost data for customer service activities (warranty and repair costs, cost of returned goods)

VI. Contrast the functions of controllers and treasurers

- A. The chief accounting executive, or chief management accountant, is often called the **controller** (or **comptroller** in government organizations).
1. The controller's authority is basically of the **staff type**, that is, giving advice and service to other departments.
 2. The **controller** has direct control, called **line authority**, only over subordinates, such as staff accountants (sometimes called financial analysts), internal auditors, cost clerks, and the general ledger bookkeeper.
- Staff authority**, however, may be exerted to an equal, superior, or subordinate. This is the authority to advise not command.

Stop and Review

See textbook Exhibit 1-6

3. The main functions of the controller are preparing information for planning and reporting and interpreting and evaluating information in consultation with other managers.
- D. In contrast to the controller's functions, the **treasurer** of a company is concerned mainly with such financial activities as investor relations, banking, long- and short-term borrowing, and investments.

Controllership

1. Planning for control
2. Reporting and interpreting
3. Evaluating and consulting
4. Tax administration
5. Government reporting
6. Protection of assets
7. Economic appraisal

Treasurership

1. Provision of capital
2. Investor relations
3. Short-term financing
4. Banking and custody
5. Credits and collections
6. Investments
7. Risk management (insurance)

VII. Explain why accounting is important in a variety of career paths

- A. There are many types and levels of career opportunities available in the field of accounting.
 - 1. Certified public accountants (CPAs) in the U.S., or chartered accountants (CAs) in many other nations, work externally ensuring the reliability of companies' published financial statements.
 - 2. Certified management accountants (CMAs) are internal employees of companies. The CMA program is overseen by the Institute of Management Accountants (IMA).
- B. Entry-level accounting positions are springboards into the world of business. By learning about all aspects of business, accountants make themselves prime candidates for management positions.

VIII. Identify current trends in management accounting

- A. External environments and internal decision making change over time.
- B. Management accounting systems will provide useful information in the future only if they evolve along with the environment and the organization. Many accountants, managers, and academics have criticized accounting systems for not evolving and, therefore, for impeding good decision making.
- C. Current changes include:
 - 1. Increased emphasis on service
 - 2. Increased global competition
 - 3. Advances in technology and electronic commerce
 - 4. Changes in business processes (e.g. JIT and CIM)
- D. Management accountants themselves must be willing and able to learn and evolve.

IX. Appreciate the importance of standards of ethical conduct to professional accountants

- A. High standards of ethical conduct are essential to the practice of management accounting.
 - 1. Without acknowledged ethical behavior, accountants and their information are not credible.
 - 2. The public recognizes accountants as adhering to high ethical standards.
 - 3. To a large degree, the accounting profession's ethical reputation is responsible for its high social status.
 - 4. The Institute of Management Accountants has developed standards of ethical behavior that address:
 - a. **Competence** - Maintain a high level of competence through ongoing development of knowledge and skills.
 - Perform professional duties in accordance with relevant laws, regulations, and technical standards.
 - Prepare complete and clear recommendations after appropriate analysis of relevant and reliable information.
 - b. **Confidentiality** - Do not disclose any confidential information unless authorized to do so.
 - Inform subordinates appropriately of the confidentiality of the information and monitor their activities in order to maintain confidentiality.
 - Do not use, or appear to use, confidential information in an unethical or illegal manner.

- c. Integrity**
- Avoid conflicts of interest.
 - Engage in no activity that would affect the company's ability to function ethically.
 - Refuse any favor that may influence or appear to influence the company's actions.
 - Do not subvert the company's attainment of ethical objectives.
 - Communicate professional limitations.
 - Communicate professional opinions and information, favorable as well as unfavorable.
 - Refrain from engaging in or supporting any activity that may discredit the profession.
- d. Objectivity**
- Communicate fairly and objectively.
 - Disclose all relevant information that could influence user actions.

Stop and Review

See textbook Exhibit 1-7

Study Tip: *The previous sections described the organizational and professional roles of management accountants. Can you describe the practice and profession of management accounting?*

PRACTICE TEST QUESTIONS AND PROBLEMS

This section will help you find out how well you have absorbed the content of the textbook. Try to answer all of these questions and problems *with your textbook closed*. Then, check your answers with the *solutions that immediately follow this practice test*. In this way, you can determine which parts of the textbook chapter to restudy.

True or False Statements

Determine whether each of the following statements is True (T) or False (F) and enter your answer in the space provided.

- ____ 1. Management control refers primarily to the setting of maximum limits on expenditures.
- ____ 2. The treasurer of a company is concerned mainly with planning, reporting, evaluating, and interpreting.
- ____ 3. Compared with the typical management accounting reports, financial accounting reports are more likely to focus only on the actual results of the preceding period.
- ____ 4. One feature common to both financial and managerial accounting is that the methods and practices of both are strictly constrained by external authorities.
- ____ 5. There are essentially no conceptual differences between management accounting for service and for manufacturing organizations.
- ____ 6. Management by exception refers to assigning the most difficult management control tasks only to exceptional managers, who are identified by accounting performance reports.
- ____ 7. It is important to understand a product's life cycle so that costs from one stage of the cycle are not mixed with costs from another stage.
- ____ 8. The controller of an organization exercises both line and staff authority.
- ____ 9. Risk management is one of the usual duties of the controller.
- ____ 10. One of the objectives of the IMA's code of ethics is to establish management accounting as a recognized profession.

Multiple-Choice Questions

For the following multiple-choice questions, select the best answer(s), and enter identification letters in the spaces provided.

- ____ 1. Management accounting for an organization is aimed mainly at the decision needs of: (a) its stockholders, (b) its creditors, (c) government regulators, (d) internal managers.
- ____ 2. Analyzing variances from the budget of the cost of materials used in making a particular product should be classified as: (a) problem solving, (b) attention directing, (c) scorekeeping, (d) financial auditing.
- ____ 3. Controlling is done by: (a) accountants, (b) managers, (c) internal auditors, (d) accounting systems.
- ____ 4. The controller has direct line authority over: (a) line departments, (b) staff accountants, (c) staff departments, (d) executives.
- ____ 5. The management controlling function includes which of the following? (a) formulating plans, (b) implementing plans, (c) evaluating results, (d) providing feedback.
- ____ 6. What two functions do performance reports serve? (a) the planning function, (b) the evaluation function, (c) the feedback function, (d) the audit function.
- ____ 7. Budgets primarily serve: (a) the financial reporting function, (b) the feedback function, (c) the planning function, (d) the controlling function.
- ____ 8. Unique difficulties of management accounting in service organizations *do not* include: (a) labor intensity, (b) diverse output, (c) ill-defined output, (d) perishability of output.
- ____ 9. The effective restrictions on measurements that can be reported by a management accounting system *do not* include: (a) GAAP, (b) the cost-benefit philosophy, (c) behavioral impacts, (d) adaptation to change.
- ____ 10. The most useful scorekeeping information is the evaluation of performance made by comparing actual results for a month with: (a) the budget for that month, (b) actual results of the preceding month, (c) actual results of the same month a year ago, (d) actual results with results of a competitor.

Completion

Complete each of the following statements by filling in the blanks:

1. The two basic functions of the management process are _____ and _____.
2. The three main types of useful information that the management accountant should supply are:
_____-keeping information,
_____-directing information, and
_____-solving information.

3. Concentrating on areas that deviate from the plan and ignoring smooth-running areas is called _____.
4. The three distinctive features of service organizations are:
(a) _____
(b) _____
(c) _____
5. The chief accounting executive, or chief management accountant, is often called the _____.
6. Interpreting and evaluating information in consultation with operating managers is an example of the exercise of the controller's _____ authority.
7. Comparison of this year's actual results with this year's budget is an example of a _____.
8. Write out in full the words for each of the following initials:
(a) CMA: _____
(b) GAAP: _____
(c) IMA: _____
9. The major areas of responsibility for ethical conduct by management accountants are:
(a) _____
(b) _____
(c) _____
(d) _____

Exercises

1. Identify each of the following features as being *more* identified with management accounting (MA) or with financial accounting (FA):
 - _____ 1. Measuring actual performance against actual results of preceding period
 - _____ 2. Less freedom in choosing measurement methods and principles
 - _____ 3. Flexible timespan
 - _____ 4. Detailed reports on subunits of an organization
 - _____ 5. Stronger orientation to investors
 - _____ 6. Constrained by GAAP
 - _____ 7. Affects employees' daily behavior
 - _____ 8. Focus on prior period's results

2. For each of the following activities within a company, identify the main function that is being performed: SK = scorekeeping; PS = problem solving; AD = attention directing.
 - _____ 1. Preparing the variance of actual dollar sales from budgeted sales by type of product and by name of salesperson
 - _____ 2. Tabulating spoiled rejected product units at the end of a manufacturing process
 - _____ 3. Entering checks in the cash disbursement journal
 - _____ 4. Estimating future cash inflows and cash outflows relating to the contemplated acquisition of specialized manufacturing machinery
 - _____ 5. Computing and recording end-of-year adjustments for accrued wages and salaries

3. For each of the following pairs, use the code shown below to indicate the usual type of authority of the first-named party over the second-named party: L = line authority; S = staff authority; N = no authority
 - _____ 1. controller/payroll clerks
 - _____ 2. production superintendent/accounts payable bookkeeper
 - _____ 3. engineering vice president/storekeeper
 - _____ 4. controller/production superintendent
 - _____ 5. president/chairman of the board
 - _____ 6. manufacturing vice president/receiving clerk
 - _____ 7. assistant controller/accounts receivable bookkeeper
 - _____ 8. controller/purchasing officer
 - _____ 9. internal auditor/assistant controller

Problems

Prepare solutions for each of the following problems in the spaces provided.

1. The Parent Teacher Organization (PTO) of Eisenhower Elementary School held a fund-raising fair in the school gymnasium. The PTO president had prepared the following budget assuming 200 attendees who spend an average of \$20 each and donations of all other resources:

Revenues	\$4,000
Costs:	
Food and beverages	800
Prizes	500
Supplies	300
Custodial services	<u>200</u>
Total costs	<u>\$1,800</u>
Income	<u>\$2,200</u>

Afterwards, the PTO treasurer (the PTO has no controller) determined that 150 people had attended the fair, and total revenues were \$2,250. Cost of food and beverages was \$750. All prizes were awarded. Supplies cost \$180, and custodial services were \$500 due to damage to the gymnasium floor.

Prepare a performance report that shows how actual results differ from budgeted results. Which variances deserve further examination?

<u>Item</u>	<u>Actual results</u>	<u>Budgeted results</u>	<u>Variance</u>	<u>Explanation</u>
Revenues		\$4,000		
Costs:				
Food and beverages		800		
Prizes		500		
Supplies		300		
Custodial services		<u>200</u>		
Total costs		<u>\$1,800</u>		
Income		<u>\$2,200</u>		

2. The Evergreen Chamber of Commerce prepared the following budget for its annual Fourth of July concert and fireworks show:

Sources of revenue:

Merchant donations	\$10,000
Public donations	<u>5,000</u>
Total revenue	<u>\$15,000</u>

Costs:

Fireworks	\$12,000
Rentals (band tent, audio equipment, portable toilets, barricades)	2,000
Police and fire protection services	<u>3,000</u>
Total costs	<u>\$17,000</u>
Budgeted loss	<u>\$ (2,000)</u>

Donations totaled \$13,000. Due to an unusually wet first week of July, police and fire protection services cost \$1,000 less than expected. Some fireworks did not ignite, and the distributor issued a \$500 refund. One of the portable toilets was destroyed by members of the public and had to be replaced for \$400.

Prepare a performance report that shows how actual results differ from budgeted results. Which variances deserve further examination?