Chapter 1

Lecture Notes

Chapter theme: This chapter explains why managerial accounting is important to the future careers of all business students. It answers three questions: (1) What is managerial accounting? (2) Why does managerial accounting matter to your career? and (3) What skills do managers need to succeed? It also discusses the importance of ethics in business and corporate social responsibility.

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1. **What is managerial accounting?**

#### Financial and managerial accounting: seven key differences

* + 1. **Users**
       1. **Financial accounting** reports are prepared for **external parties**, whereas managerial accounting reports are prepared for **internal users**.
    2. **Emphasis on the future**

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* + - 1. Financial accounting summarizes **past activities**. Managerial accounting has a strong **future orientation**.
    1. **Relevance of data**
       1. Financial accounting data should be **objective and verifiable**. Managerial accountants focus on providing **relevant data** even if these data are not completely objective or verifiable.
    2. **Less emphasis on precision**
       1. Financial accounting focuses on **precision** when reporting to external parties. Managerial accounting aids decision makers by providing **good estimates** as soon as possible rather than waiting for precise data later.
    3. **Segments of an organization**
       1. Financial accounting is concerned with **companywide reports**. Managerial accounting focuses on **segment reports.** Examples of segments include:

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* + - * 1. Product lines, sales territories, divisions, departments, etc.
    1. **Managerial accounting – no externally imposed rules**
       1. Financial accounting **conforms to GAAP and IFRS**. Managerial accounting is **not bound by GAAP and IFRS**.
    2. **Managerial accounting – not mandatory**
       1. Financial accounting **is mandatory** because various outside parties require periodic financial statements. Managerial accounting **is not mandatory**.
  1. Managerial accounting helps managers carry out three main activities—**planning**, **controlling, and decision making**.

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* + 1. **Planning**
       1. Planning involves **establishing goals and specifying how to achieve them.**

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* + - 1. Plans are often accompanied by a **budget**.
         1. A budget is a detailed plan for the future that is usually expressed in **formal quantitative terms**.
    1. **Controlling**
       1. Controlling involves **gathering feedback** to ensure that the plan is being properly executed or modified as circumstances change.

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* + - 1. Part of the control process includes preparing performance reports.
         1. A **performance report** compares **budgeted** to **actual** results to improve future performance.
    1. **Decision making**

1. Decision making involves **selecting a course of action from competing alternatives**.

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2. Many managerial decisions revolve around answering three questions:

a. **What should we be selling**?

b. **Who should we be serving**?

c. **How should we execute**?

1. **Why does managerial accounting matter to your career?**
   1. Business majors
      1. **Marketing majors**
         1. **Planning**

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a. How much should we budget for TV, print, and internet advertising?

b. How many salespeople should we plan to hire to serve a new territory?

* + - 1. **Controlling**

a. Is the budgeted price cut increasing unit sales as expected?

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b. Are we accumulating too much inventory during the holiday shopping season?

* + - 1. **Decision making**

a. Should we sell our services as one bundle or sell them separately?

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b. Should we sell directly to customers or use a distributor?

* + 1. **Operations management majors**
       1. **Planning**

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a. How many units should we plan to produce next period?

b. How much should we budget for next period’s utility expense?

* + - 1. **Controlling**
         1. Did we spend more or less than expected for the units we actually produced?

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* + - * 1. Are we achieving our goal of reducing the number of defective units produced?

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3. **Decision making**

a. Should we buy a new piece of equipment or upgrade our existing machine?

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b. Should we redesign our manufacturing process to lower inventory levels?

* + 1. **Human resource management majors**
       1. **Planning**

a. How much should we plan to spend for occupational safety training?

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b. How much should we plan to spend on employee recruitment advertising?

* + - 1. **Controlling**
         1. Is our employee retention rate exceeding our goals?

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* + - * 1. Are we meeting our goal of completing timely performance appraisals?
      1. **Decision making**

a. Should we hire an on-site medical staff to lower our healthcare costs?

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b. Should we hire temporary workers or full-time employees?

* 1. **Accounting majors**
     1. The IMA estimates that more than **80%** of professional accountants in the United States work in **non-public accounting environments**.

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* + 1. If you are an accounting major there is a high likelihood that your future will involve working for a non-public accounting employer.
    2. This employer will expect you to have strong financial accounting skills, but more importantly, it will expect you to help **improve organizational performance** by applying the planning, controlling, and decision making skills that are the foundation of managerial accounting.

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* + 1. For accounting majors, the **Certified Management Accountant (CMA)** designation is a globally-respected credential that will increase your credibility, upward mobility, and compensation.

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* + 1. This slide summarizes the topics included in the two-part CMA exam. The CMA focuses on the **planning, controlling, and decision making skills** that are critically important to non-public accounting employers. It complements the CPA exam, which focuses on rule-based compliance—assurance standards, financial accounting standards, business law, and the tax code.

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* + 1. Information about becoming a CMA and the CMA program can be accessed on the IMA’s website at [www.imanet.org](http://www.imanet.org) or by calling 1-800-638-4427.

1. **What skills do managers need to succeed?**

#### Strategic management skills

* + 1. Definition

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1. A **strategy** is a “game plan” that enables a company to attract customers by distinguishing itself from competitors.

* + 1. **Customer value propositions**

1. Companies that adopt a **customer intimacy** strategy respond to individual customer needs better than competitors. Examples of companies that pursue this strategy include:

a. Ritz-Carlton, Nordstrom, and Virtuoso

2. Companies that adopt an **operational excellence** strategy strive to deliver products and services faster, more conveniently, and at a lower price than competitors. Examples of companies that pursue this strategy include:

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a. Southwest Airlines, Wal-Mart, and the Vanguard Group

3. Companies that adopt a **product leadership** strategy strive to offer higher quality products than competitors. Examples of companies that pursue this strategy include:

a. Apple, BMW, and Cisco Systems

#### Enterprise risk management

* + 1. **Enterprise risk management** is a process used by a company to proactively identify the risks that it faces and manage those risks.

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* + 1. Once a company identifies its risks, the most common risk management tactic is to **reduce risks by implementing specific controls**.
       1. This slide contains a subset of the business risks and controls shown in Exhibit 1-5 of the textbook. Collectively, these examples illustrate the diversity of risks that companies can face.

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#### Process management skills

* + 1. Key definitions
       1. A **business process** is a series of steps that are followed in order to carry out some task in a business.

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* + - 1. A **value chain** consists of the major business functions that add value to a company’s products and services.
    1. **Lean production** is a management approach that organizes resources such as people and machines around the flow of business processes and that only produces units in response to customer orders.

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* + - 1. Lean production is often called **just-in-time (JIT) production** because products are only made in response to customer orders and they are completed just-in-time to be shipped to customers.
      2. Traditional manufacturing methods organize work **departmentally** and encourage those departments to maximize their output even it exceeds customer demand and **bloats inventories**.

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* + - 1. Because lean thinking only allows production in response to customer orders, **the number of units produced tends to equal the number of units sold**.

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* + - 1. The lean approach also results in **fewer defects, less wasted effort, and quicker customer response times** than traditional production methods.
    1. **The Theory of Constraints (TOC)**
       1. A **constraint** (also called a **bottleneck**) is anything that prevents you from getting more of what you want.

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* + - * 1. The constraint in a system is determined by the step that has the **smallest capacity**.
      1. The **Theory of Constraints (TOC)** is based on the insight that **effectively managing the constraint** is the key to success.
         1. The goal is to manage the constraint with the intent of generating **more** business rather than **cutting** the workforce.

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3. The TOC offers a **four-step approach** to process improvement:

a. **First**, identify the weakest link in the chain, which is the constraint.

b. **Second**, do not place a greater strain on the system than the weakest link can handle – if you do, the chain will break.

c. **Third**, concentrate improvement efforts on strengthening the weakest link.

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d. **Fourth**, if the improvement efforts are successful, eventually the weakest link will improve to the point where it is no longer the weakest link. At this point, the new weakest link must be identified and the improvement process starts over again.

#### Measurement skills

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* + 1. The question you are trying to answer defines what you’ll measure and how you analyze it. For example:
       1. If the question you wish to answer is what net income should my company report to its stockholders, then you’ll be measuring and reporting **historical financial data** that complies with applicable **rules**.

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* + - 1. If you are trying to determine how your company is serving its customers, then you’ll be measuring and analyzing mostly **non-financial, process-oriented data**.

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* + - 1. If you want to predict whether your company will need to borrow money, then your measurement efforts will focus on estimating **future cash flows**.
    1. The primary purpose of this course is to teach you measurement skills that managers use every day to support their planning, controlling, and decision making activities.

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#### Leadership skills

* + 1. To be an effective leader, you’ll need to develop **six skills**:

1. You’ll need technical competence within your area of expertise and with respect to operations outside your functional area of expertise.

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2. You must be a person of high integrity.

3. You’ll need to understand how to implement organizational change.

4. You’ll need strong communication skills.

5. You’ll need to be capable of motivating and mentoring other people.

6. You’ll need to effectively manage team-based decision processes.

1. **The importance of ethics in business**

#### The IMA’s Statement of Ethical Professional Practice has two main parts – guidelines for ethical behavior and guidelines for resolution of an ethical conflict.

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* + 1. **Guidelines for ethical behavior**
       1. **Competence**
          1. Maintain professional competence.
          2. Follow applicable laws, regulations, and standards.

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* + - * 1. Provide accurate, clear, concise, and timely decision support information.
        2. Recognize and communicate professional limitations that preclude responsible judgment.
      1. **Confidentiality**
         1. Do not disclose confidential information unless legally obligated to do so.

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* + - * 1. Ensure that subordinates do not disclose confidential information.
        2. Do not use confidential information for unethical or illegal advantage.
      1. **Integrity**
         1. Mitigate conflicts of interest and advise others of potential conflicts.
         2. Refrain from conduct that would prejudice carrying out duties ethically.

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* + - * 1. Abstain from activities that might discredit the profession.
      1. **Credibility**

1. Communicate information fairly and objectively.
2. Disclose all relevant information that could influence a user’s understanding of reports and recommendations.

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1. Disclose delays or deficiencies in information timeliness, processing, or internal controls.
   * 1. **Guidelines for resolution of an ethical conflict**
        1. Follow the organization’s established policies for resolving ethical conflict. If this does not work, consider the following:
           1. Discuss the conflict with immediate supervisor or next highest uninvolved managerial level.

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* + - * 1. If immediate supervisor is the CEO, consider the board of directors or the audit committee.
        2. Contact above immediate supervisor should only be initiated with supervisor’s knowledge, assuming the supervisor is not involved.
        3. Except where legally prescribed, communication with individuals not employed by the organization is not appropriate.
        4. Clarify relevant ethical issues with an objective advisor, such as a member of the IMA’s Ethics Counseling Service.

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* + - * 1. Consult an attorney regarding your legal obligations.

#### Why have ethical standards?

* + 1. Ethical standards are motivated by a very practical consideration—**if the standards are not followed in business, then the economy and all of us would suffer**.

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* + 1. Abandoning ethical standards would lead to a **lower standard of living** with lower-quality goods and services, less to choose from, and higher prices.

1. **Corporate social responsibility**

#### Key definitions/concepts

* + 1. **Corporate social responsibility (CSR)** is a concept whereby organizations consider the needs of all stakeholders when making decisions. CSR extends beyond legal compliance to include voluntary actions that satisfy stakeholder expectations.

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* + 1. **Stakeholders** include groups, such as customers, employees, suppliers, communities, and envrionmental and human rights advocates, whose interests are tied to the company’s performance.
       1. This slide presents examples of corporate social responsibilities that are of interest to the six stakeholder groups just mentioned.

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1. **Appendix 1A: Corporate governance** (slide 43 is a title slide)

#### Key definitions/concepts

* + 1. **Corporate governance** is the system by which a company is directed and controlled.
       1. If properly implemented, the corporate governance system should provide incentives for the board of directors and top management to pursue objectives that are **in the interests of the company’s owners** and it should provide for effective monitoring of performance.

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#### The Sarbanes-Oxley Act of 2002

* + 1. **The Sarbanes-Oxley Act of 2002** was intended to protect the interests of those who invest in publicly-traded companies by improving the reliability and accuracy of corporate financial reports and disclosures. Six key aspects of the legislation include:
       1. The Act requires both the **CEO and CFO to certify in writing** that their company’s financial statements and disclosures fairly represent the results of operations.

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* + - 1. The Act establishes the **Public Company Accounting Oversight Board** to provide additional oversight to the audit profession.
      2. The Act places the power to **hire, compensate, and terminate public accounting firms in the hands of the audit committee**.
      3. The Act **places restrictions on audit firms**, such as prohibiting public accounting firms from providing a variety of non-audit services to an audit client.

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* + - 1. The Act requires a company’s auditor to issue an opinion on the effectiveness of the company’s internal control over financial reporting to accompany management’s assessment, and both are included in the company’s annual report.

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* + - 1. The Act establishes severe penalties for certain behaviors, such as:
         1. Up to 20 years in prison for altering or destroying any documents that may be used in an official proceeding.
         2. Up to 10 years in prison for retaliating against a “whistle blower.”

#### Internal control—A closer look

* + 1. **Internal control** is a process designed to provide reasonable assurance that objectives are being achieved.

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* + 1. A **preventive control** deters undesirable events from occurring. A **detective control** detects undesirable events that have already occurred.
    2. These two slides contain **seven examples** of internal controls for financial reporting. Each control is described and classified as preventive and/or detective.

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* + 1. Internal controls **cannot guarantee that objectives are achieved** because:

1. Even well-designed internal control systems can **break down**.

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2. Two employees may **collude** to circumvent the control system.

3. **Senior leaders may manipulate financial results** by intentionally overriding prescribed policies and procedures.