

CHAPTER 1

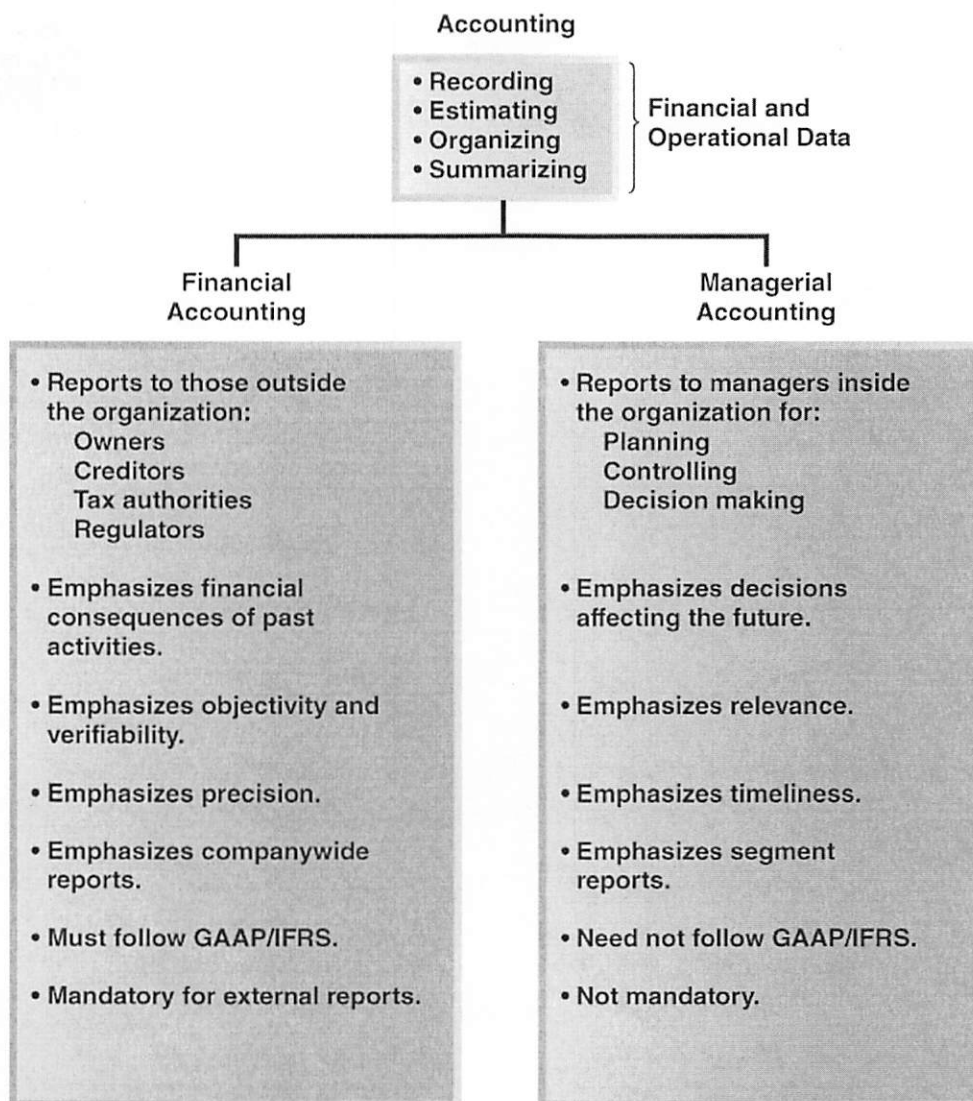
MANAGERIAL ACCOUNTING: AN OVERVIEW

AGENDA

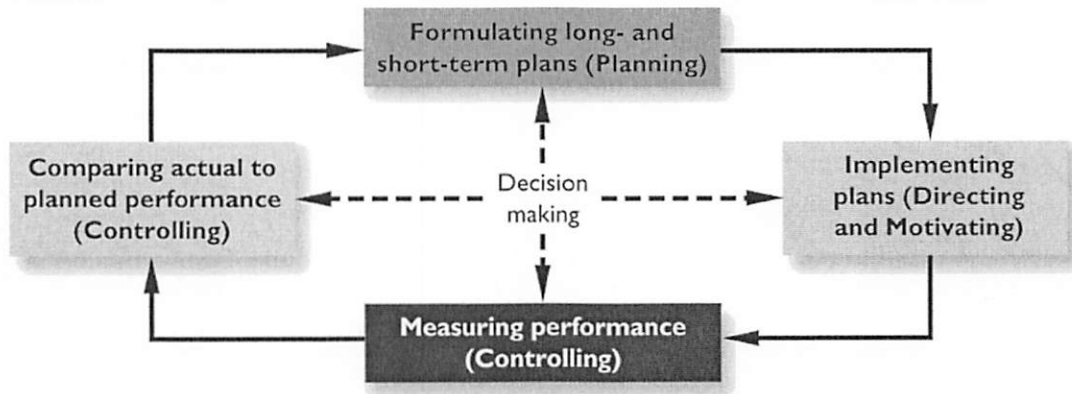
1. What is managerial accounting?
2. Value creation
3. Beyond the numbers
 - a. Ethics perspective
 - b. Corporate governance
 - c. Enterprise Risk Management Perspective
 - d. Corporate social responsibility

WHAT IS MANAGERIAL ACCOUNTING?

Comparison of Financial and Managerial Accounting



Planning, Directing and Motivating, Controlling, and Decision Making



Planning involves establishing goals and specifying how to achieve them.

- Plans are often accompanied by a budget.
- A budget is a detailed plan for the future that is usually expressed in formal quantitative terms.

Controlling involves gathering feedback to ensure that the plan is being properly executed or modified as circumstances change.

- Part of the control process includes preparing performance reports.
- A performance report compares budgeted data to actual data in an effort to identify and learn from excellent performance and to identify and eliminate sources of unsatisfactory performance.

Directing and Motivating involves overseeing day-to-day activities and keeping the organization functioning smoothly.

- Managers assign tasks to employees, arbitrate disputes, answer questions, solve on-the-spot problems, and make many decisions affecting customers and employees.

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

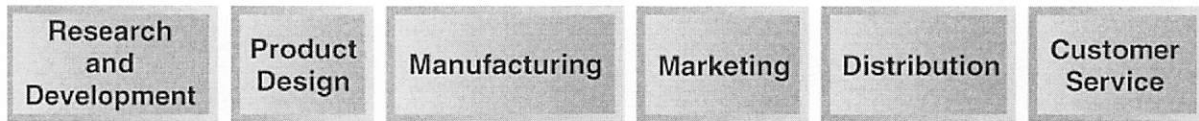
- Broadly speaking, many managerial decisions revolve around answering the following three questions:

What should we be selling?	Who should we be serving?	How should we execute?
What products and services should be the focus of our marketing efforts?	Who should be the focus of our marketing efforts?	How should we supply our parts and services?
What new products and services should we offer?	Who should we start serving?	How should we expand our capacity?
What prices should we charge for our products and services?	Who should pay price premiums or receive price discounts?	How should we reduce our capacity?
What products and services should we discontinue?	Who should we stop serving?	How should we improve our efficiency and effectiveness?

VALUE CREATION

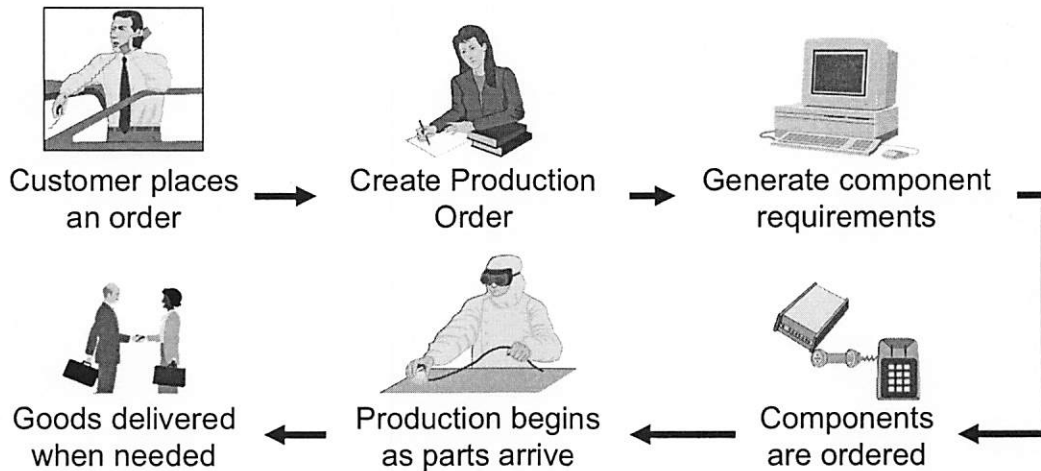
Value creation is the principle underlying all that organizations do to create value for their stakeholders.

A value chain consists of the major business functions that add value to a company's products and services.



Lean Production

- 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.
- The term just-in-time (JIT) production is often used because products are only manufactured in response to customer orders and they are completed just-in-time to be shipped to customers.



- The lean approach results in fewer defects, less wasted effort, and quicker customer response times than traditional production methods.

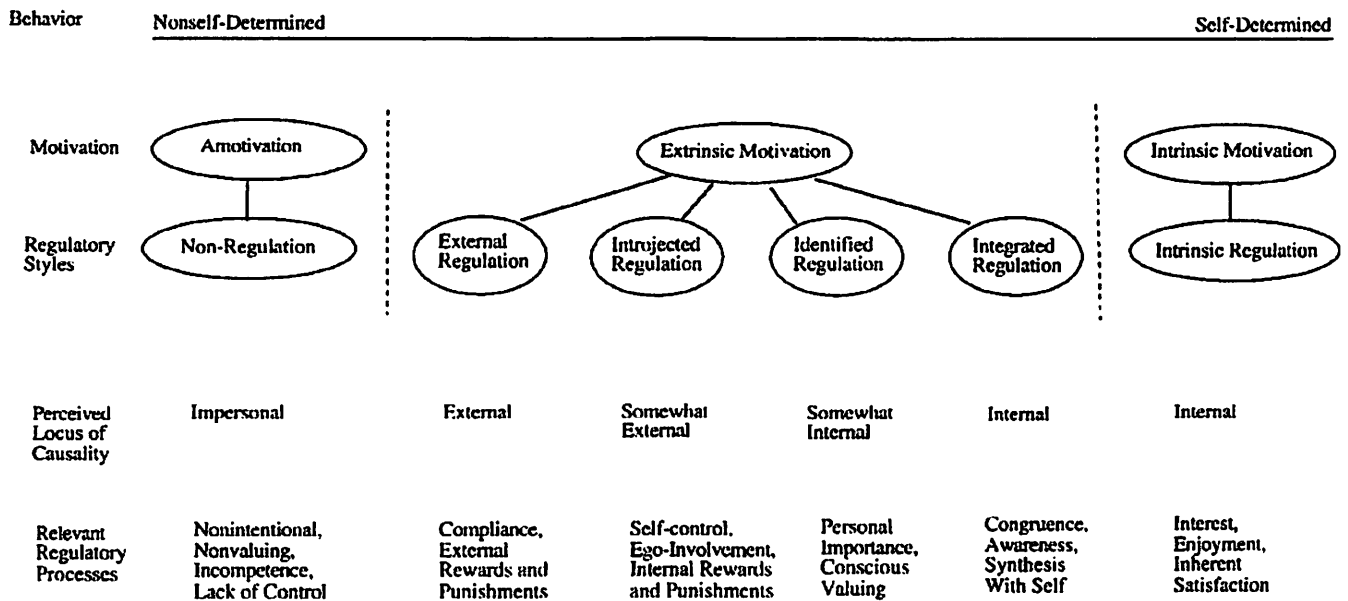
Leadership Perspective

Leaders need to understand how intrinsic motivation, extrinsic motivation, and cognitive bias influence human behavior.

(1) Intrinsic motivation

Ryan, R. M., & Deci, E. L. (2000). Self-determination theory and the facilitation of intrinsic motivation, social development, and well-being. *American Psychologist*, 55, 68-78

Figure 1
The Self-Determination Continuum Showing Types of Motivation With Their Regulatory Styles, Loci of Causality, and Corresponding Processes



(2) Extrinsic incentives

(3) Cognitive bias

Cultural Perspective

Hofstede's five dimensions of culture measures:

(1) Power distance

This dimension expresses the degree to which the less powerful members of a society accept and expect that power is distributed unequally. The fundamental issue here is how a society handles inequalities among people. People in societies exhibiting a large degree of Power Distance accept a hierarchical order in which everybody has a place and which needs no further justification. In societies with low Power Distance, people strive to equalise the distribution of power and demand justification for inequalities of power.

(2) Individualism

The high side of this dimension, called individualism, can be defined as a preference for a loosely-knit social framework in which individuals are expected to take care of only themselves and their immediate families. Its opposite, collectivism, represents a preference for a tightly-knit framework in society in which individuals can expect their relatives or members of a particular in-group to look after them in exchange for unquestioning loyalty. A society's position on this dimension is reflected in whether people's self-image is defined in terms of "I" or "we."

(3) Uncertainty avoidance

The Uncertainty Avoidance dimension expresses the degree to which the members of a society feel uncomfortable with uncertainty and ambiguity. The fundamental issue here is how a society deals with the fact that the future can never be known: should we try to control the future or just let it happen? Countries exhibiting strong UAI maintain rigid codes of belief and behaviour and are intolerant of unorthodox behaviour and ideas. Weak UAI societies maintain a more relaxed attitude in which practice counts more than principles.

(4) Masculinity

The Masculinity side of this dimension represents a preference in society for achievement, heroism, assertiveness and material rewards for success. Society at large is more competitive. Its opposite, femininity, stands for a preference for cooperation, modesty, caring for the weak and quality of life. Society at large is more consensus-oriented. In the business context Masculinity versus Femininity is sometimes also related to as "tough versus tender" cultures.

(5) Long-term orientation

Every society has to maintain some links with its own past while dealing with the challenges of the present and the future. Societies prioritize these two existential goals differently.

Societies who score low on this dimension, for example, prefer to maintain time-honoured traditions and norms while viewing societal change with suspicion. Those with a culture which scores high, on the other hand, take a more pragmatic approach: they encourage thrift and efforts in modern education as a way to prepare for the future.

BEYOND THE NUMBERS

Ethics in business

- Ethical standards in business are essential for a smooth functioning economy.
- Without ethical standards in business, the economy, and all of use who depend on it for jobs, goods, and services, would suffer.

IMA Statement of Ethical Professional Practice (adapted from IMA)

COMPETENCE

- Maintain professional expertise.
- Follow laws, regulations, and standards.
- Provide information and recommendations that are accurate, clear, concise, and timely.
- Recognize and communicate professional limitations.

CONFIDENTIALITY

- Do not disclose confidential information except when authorized or legally required.
- Ensure that subordinates do not disclose confidential information.
- Do not use confidential information for unethical or illegal advantage.

INTEGRITY

- Avoid actual or apparent conflicts of interest.
- Refrain from any conduct that would prejudice carrying out duties ethically.
- Refrain from actions that discredit the profession.

CREDIBILITY

- Communicate information fairly and objectively.
- Disclose all information that could be expected to influence a user's understanding.
- Disclose delays or deficiencies in information, processing, or internal controls.

Corporate governance

Corporate governance is the system by which a company is directed and controlled.

- The Sarbanes-Oxley Act of 2002 was enacted to protect the interests of those who invest in publicly traded companies. Six key aspects of the legislation are as follows:
 - The Act requires the CEO and CFO to certify in writing that their company's financial statements and accompanying disclosures are fairly stated.
 - The Act establishes the Public Company Accounting Oversight Board to provide additional oversight over the audit profession.
 - The Act places the power to hire, compensate, and terminate a public accounting firm in the hands of the audit committee of the board of directors.
 - The Act places important restrictions on audit firms, particularly with respect to consulting services.
 - The Act requires that a company's annual report contain an internal control report.
 - The Act establishes severe penalties for destroying documents that may be used in an official proceeding or retaliating against a whistle-blower.

Enterprise risk management

Enterprise risk management (ERM) is a process used by a company to proactively identify and manage risk.

Once a company identifies its risks, perhaps the most common risk management tactic is to reduce risks by implementing specific controls.

Examples of Business Risks	Examples of Controls to Reduce Business Risks
<ul style="list-style-type: none"> • Intellectual assets being stolen from computer files • Products harming customers • Losing market share due to the unforeseen actions of competitors • Poor weather conditions shutting down operations • A website malfunctioning • A supplier strike halting the flow of raw materials • A poorly designed incentive compensation system causing employees to make bad decisions • Financial statements inaccurately reporting the value of inventory • An employee stealing assets • An employee accessing unauthorized information • Inaccurate budget estimates causing excessive or insufficient production • Failing to comply with equal employment opportunity laws 	<ul style="list-style-type: none"> • Create firewalls that prohibit computer hackers from corrupting or stealing intellectual property • Develop a formal and rigorous new product testing program • Develop an approach for legally gathering information about competitors' plans and practices • Develop contingency plans for overcoming weather-related disruptions • Thoroughly test the website before going "live" on the Internet • Establish a relationship with two companies capable of providing needed raw materials • Create a balanced set of performance measures that motivates the desired behavior • Count the physical inventory on hand to make sure that it agrees with the accounting records • Segregate duties so that the same employee does not have physical custody of an asset and the responsibility of accounting for it • Create password-protected barriers that prohibit employees from obtaining information not needed to do their jobs • Implement a rigorous budget review process • Create a report that tracks key metrics related to compliance with the laws

Corporate social responsibilities

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.

Examples of corporate social responsibilities:

Companies should provide *customers* with:

- Safe, high-quality products that are fairly priced.
- Competent, courteous, and rapid delivery of products and services.
- Full disclosure of product-related risks.
- Easy-to-use information systems for shopping and tracking orders.

Companies should provide *suppliers* with:

- Fair contract terms and prompt payments.
- Reasonable time to prepare orders.
- Hassle-free acceptance of timely and complete deliveries.
- Cooperative rather than unilateral actions.

Companies should provide *stockholders* with:

- Competent management.
- Easy access to complete and accurate financial information.
- Full disclosure of enterprise risks.
- Honest answers to knowledgeable questions.

Companies and their suppliers should provide *employees* with:

- Safe and humane working conditions.
- Nondiscriminatory treatment and the right to organize and file grievances.
- Fair compensation.
- Opportunities for training, promotion, and personal development.

Companies should provide *communities* with:

- Payment of fair taxes.
- Honest information about plans such as plant closings.
- Resources that support charities, schools, and civic activities.
- Reasonable access to media sources.

Companies should provide *environmental and human rights advocates* with:

- Greenhouse gas emissions data.
- Recycling and resource conservation data.
- Child labor transparency.
- Full disclosure of suppliers located in developing countries.

EXERCISE 1–1 The Roles of Managers and Management Accountants [LO1]

Six terms that relate to organizations, the work of management, and the role of managerial accounting are listed below:

Decentralization	Controller
Line	Organization chart
Staff	Chief financial officer

Choose the term above that most appropriately completes the following statements:

1. A position that is directly related to achieving the basic objectives of an organization is called a _____ position.
2. A diagram that shows how responsibility is divided among managers and shows the formal lines of reporting and communication is called an _____.
3. A _____ position provides service or assistance to other parts of the organization and does not directly achieve the basic objectives of the organization.
4. The delegation of decision-making authority throughout an organization by allowing managers at various operating levels to make key decisions relating to their area of responsibility is called _____.
5. The manager in charge of the accounting department is generally known as the _____.
6. The _____ is the member of the top management team who is responsible for providing timely and relevant data to support planning and control activities and for preparing financial statements for external users.

EXERCISE 1–2 The Business Environment [LO2]

A number of terms are listed below:

Six Sigma	value chain	enterprise risk management
customer value proposition	stakeholders	The Sarbanes-Oxley Act of 2002
lean thinking model	pulls	nonconstraint
supply chain management	business process	constraint
Theory of Constraints	corporate governance	corporate social responsibility
non-value-added activity	strategy	manufacturing cell

Required:

Choose the term or terms from the above list that most appropriately completes each of the following statements:

1. A(n) _____ is a game plan that enables a company to attract customers by distinguishing itself from competitors.
2. _____ is a method that relies on customer feedback and objective data gathering and analysis techniques to drive process improvement.
3. A(n) _____ is a series of steps that are followed to carry out some task in a business.
4. The system by which a company is directed and controlled is called _____.
5. The process used by a company to help identify the risks that it faces and to develop responses to those risks so that the company is reasonably assured of meeting its goals is known as _____.
6. A _____ is a work space that takes employees and equipment from departments that were previously separated from one another and places them side-by-side.
7. The various groups of people, such as employees, customers, and suppliers, whose interests are tied to a company's performance are called _____.
8. A(n) _____ is anything that prevents an organization or individual from getting more of what it wants.
9. Increasing the rate of output of a(n) _____ as the result of an improvement effort is unlikely to have much effect on profits.
10. A(n) _____ consists of business functions that add value to a company's products and services such as research and development, product design, manufacturing, marketing, distribution, and customer service.
11. _____ is a concept whereby organizations consider the needs of all stakeholders when making decisions.
12. A management approach that coordinates business processes across companies to better serve end consumers is known as _____.
13. The _____ is a five-step management approach that organizes resources around the flow of business processes and that _____ units through those processes in response to customer orders.
14. A company can only succeed if it creates a reason for customers to choose it over a competitor; in short, a _____.
15. _____ was enacted to protect the interests of those who invest in publicly traded companies.
16. A(n) _____ consumes resources but does not add value for which customers are willing to pay.
17. The management approach that emphasizes the importance of managing constraints is known as the _____.

**EXERCISE 1-7 Ethics in Business**

Consumers and attorney generals in more than 40 states accused a prominent nationwide chain of auto repair shops of misleading customers and selling them unnecessary parts and services, from brake jobs to front-end alignments. Lynn Sharpe Paine reported the situation as follows in “Managing for Organizational Integrity,” *Harvard Business Review*, Volume 72 Issue 3:

In the face of declining revenues, shrinking market share, and an increasingly competitive market . . . management attempted to spur performance of its auto centers. . . . The automotive service advisers were given product-specific sales quotas—sell so many springs, shock absorbers, alignments, or brake jobs per shift—and paid a commission based on sales. . . . [F]ailure to meet quotas could lead to a transfer or a reduction in work hours. Some employees spoke of the “pressure, pressure, pressure” to bring in sales.

This pressure-cooker atmosphere created conditions under which employees felt that the only way to satisfy top management was by selling products and services to customers that they didn’t really need.

Suppose all automotive repair businesses routinely followed the practice of attempting to sell customers unnecessary parts and services.

Required:

1. How would this behavior affect customers? How might customers attempt to protect themselves against this behavior?
2. How would this behavior probably affect profits and employment in the automotive service industry?

EXERCISE 1-8 Cognitive Bias

In the 1970s, one million college-bound students were surveyed and asked to compare themselves to their peers. Some of the key findings of the survey were as follows:

- a. 70% of the students rated themselves as above average in leadership ability, while only 2% rated themselves as below average in this regard.
- b. With respect to athletic skills, 60% of the students rated their skills as above the median and only 6% of students rated themselves as below the median.
- c. 60% of the students rated themselves in the top 10% in terms of their ability to get along with others, while 25% of the students felt that they were in the top 1% in terms of this interpersonal skill.

Required:

What type of cognitive bias reveals itself in the data mentioned above? How might this cognitive bias adversely influence a manager’s planning, controlling, and decision-making activities? What steps could managers take to reduce the possibility that this cognitive bias would adversely influence their actions?

Source: Dan Lovallo and Daniel Kahneman, “Delusions of Success: How Optimism Undermines Executives’ Decisions,” *Harvard Business Review*, July 2003, pp. 56–63.

EXERCISE 1-9 Ethics and Decision Making

Assume that you are the chairman of the Department of Accountancy at Mountain State University. One of the accounting professors in your department, Dr. Candler, has been consistently and uniformly regarded by students as an awful teacher for more than 10 years. Other accounting professors within your department have observed Dr. Candler’s classroom teaching and they concur that his teaching skills are very poor. However, Dr. Candler was granted tenure 12 years ago, thereby ensuring him life-long job security at Mountain State University.

Much to your surprise, today you received a phone from an accounting professor at Oregon Coastal University. During this phone call you are informed that Oregon Coastal University is on the verge of making a job offer to Dr. Candler. However, before extending the job offer, the faculty at Oregon Coastal wants your input regarding Dr. Candler’s teaching effectiveness while at Mountain State University.

Required:

How would you respond to the professor from Oregon Coastal University? What would you say about Dr. Candler’s teaching ability? Would you describe your answer to this inquiry as being ethical? Why?

EXERCISE 1–10 Corporate Social Responsibility

In his book *Capitalism and Freedom*, economist Milton Friedman wrote on page 133: “There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it . . . engages in open and free competition, without deception or fraud.”

Required:

Explain why you agree or disagree with this quote.

EXERCISE 1–11 Intrinsic Motivation and Extrinsic Incentives

In a *Harvard Business Review* article titled “Why Incentive Plans Cannot Work,” (Volume 71, Issue 5) author Alfie Kohn wrote: “Research suggests that, by and large, rewards succeed at securing one thing only: temporary compliance. When it comes to producing lasting change in attitudes and behavior, however, rewards, like punishment, are strikingly ineffective. Once the rewards run out, people revert to their old behaviors. . . . Incentives, a version of what psychologists call extrinsic motivators, do not alter the attitudes that underlie our behaviors. They do not create an enduring *commitment* to any value or action. Rather, incentives merely—and temporarily—change what we do.”

Required:

1. Do you agree with this quote? Why?
2. As a manager, how would you seek to motivate your employees?
3. As a manager, would you use financial incentives to compensate your employees? If so, what would be the keys to using them effectively? If not, then how would you compensate your employees?

EXERCISE 1–12 Cognitive Bias and Decision Making

During World War II, the U.S. military was studying its combat-tested fighter planes to determine the parts of the plane that were most vulnerable to enemy fire. The purpose of the study was to identify the most vulnerable sections of each plane and then take steps to reinforce those sections to improve pilot safety and airplane durability. The data gathered by the U.S. military showed that certain sections of its combat-tested fighter planes were consistently hit more often with enemy fire than other sections of the plane.

Required:

1. Would you recommend reinforcing the sections of the plane that were hit most often by enemy fire, or would you reinforce the sections that were hit less frequently by enemy fire? Why?
2. Do you think cognitive bias had the potential to influence the U.S. military’s decision-making process with respect to reinforcing its fighter planes?

Source: Jerker Denrell, “Selection Bias and the Perils of Benchmarking,” *Harvard Business Review*, Volume 83, Issue 4, pp. 114–119.

EXERCISE 1–13 Ethics and Decision Making

Assume that you just completed a December weekend vacation to a casino within the United States. During your trip you won \$10,000 gambling. When the casino exchanged your chips for cash they did not record any personal information, such as your driver’s license number or social security number. Four months later while preparing your tax returns for the prior year, you stop to contemplate the fact that the Internal Revenue Service requires taxpayers to report all gambling winnings on Form 1040.

Required:

Would you report your gambling winnings to the Internal Revenue Service so that you could pay federal income taxes on those winnings? Do you believe that your actions are ethical? Why?