

CHAPTER 1

MANAGERIAL ACCOUNTING: AN OVERVIEW

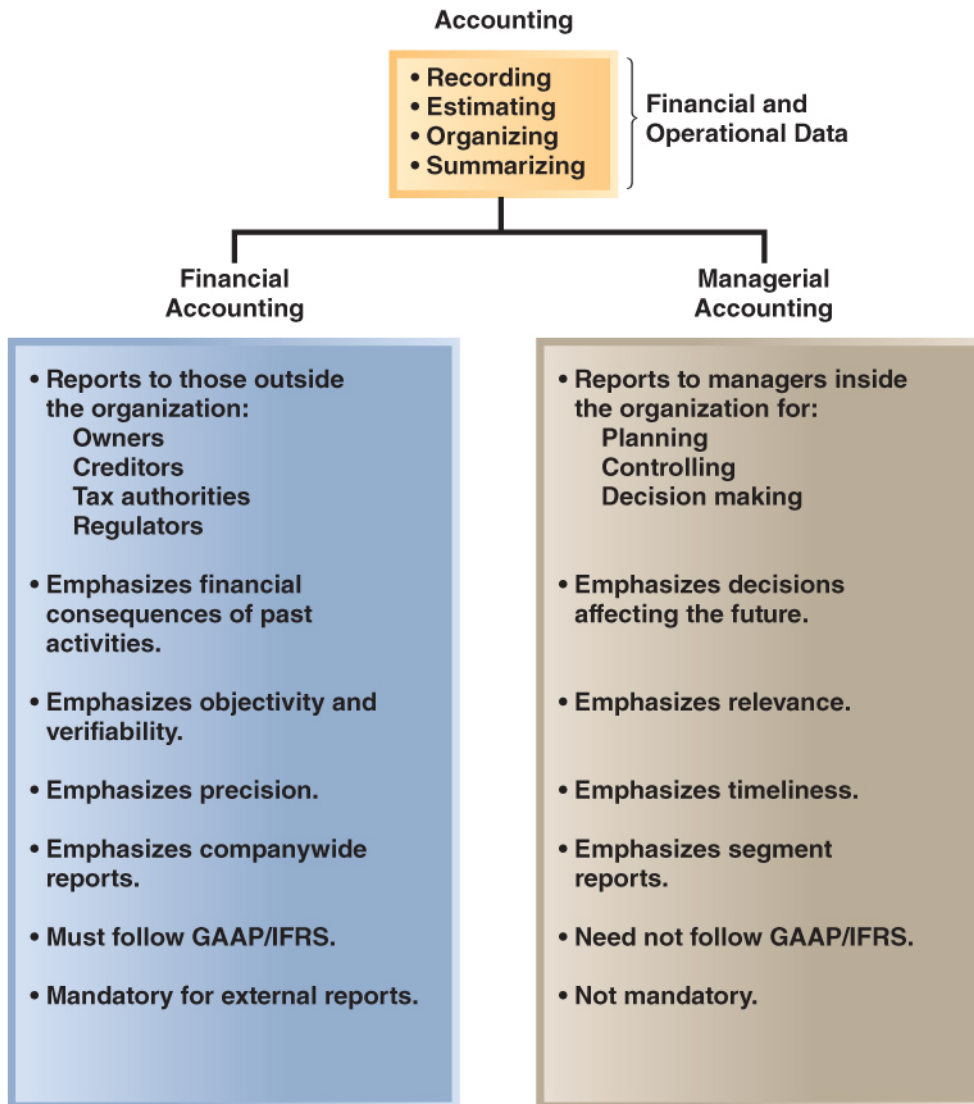
AGENDA

1. What is managerial accounting?
 - 1) Comparison of financial and managerial accounting
 - 2) Planning, controlling and decision making
 2. Why does managerial accounting matter to your career?
 - 1) Business majors
 - 2) Accounting majors
 3. What skills do managers need to succeed?
 - 1) Strategic management skills
 - 2) Enterprise risk management skills
 - 3) Process management skills
 - 4) Measurement skills
 - 5) Leadership skills
 4. The importance of ethics in business
 5. Corporate social responsibility
- Appendix 1A: Corporate governance
- 1) The Sarbanes-Oxley Act of 2002
 - 2) Internal controls

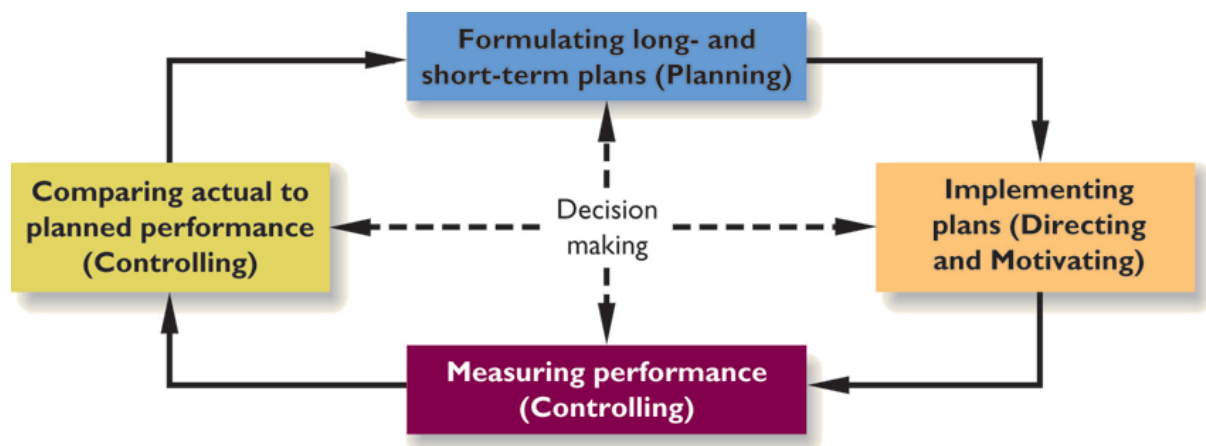
I. WHAT IS MANAGERIAL ACCOUNTING?

Comparison of Financial and Managerial Accounting

Seven Key Differences



Planning, 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.

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?

II. WHY DOES MANAGERIAL ACCOUNTING MATTER TO YOUR CAREER?

Relating Managerial Accounting to Three Business Majors

	Marketing	Operations Management	Human Resource Management
Planning	How much should we budget for TV, print, and Internet advertising?	How many units should we plan to produce next period?	How much should we plan to spend for occupational safety training?
	How many salespeople should we plan to hire to serve a new territory?	How much should we budget for next period's utility expense?	How much should we plan to spend on employee recruitment advertising?
Controlling	Is the budgeted price cut increasing unit sales as expected?	Did we spend more or less than expected for the units we actually produced?	Is our employee retention rate exceeding our goals?
	Are we accumulating too much inventory during the holiday shopping season?	Are we achieving our goal of reducing the number of defective units produced?	Are we meeting our goal of completing timely performance appraisals?
Decision Making	Should we sell our services as one bundle or sell them separately?	Should we buy a new piece of equipment or upgrade our existing machine?	Should we hire an on-site medical staff to lower our health care costs?
	Should we sell directly to customers or use a distributor?	Should we redesign our manufacturing process to lower inventory levels?	Should we hire temporary workers or full-time employees?

The Importance of Managerial Accounting to Accounting Majors

- The IMA estimates that 80% of professional accountants in the United States work in non-public accounting environments.
- The Certified Management Accountant (CMA) designation is a globally-respected credential that will increase your credibility, upward mobility, and compensation.
- The CMA exam emphasizes the planning, controlling, and decision making skills that are critically important to non-public accounting employers. The exam content specifications are as follows:

<i>Part 1</i>	<i>Financial Planning, Performance, and Control</i> Planning, budgeting, and forecasting Performance management Cost management Internal controls Professional ethics
<i>Part 2</i>	<i>Financial Decision Making</i> Financial statement analysis Corporate finance Decision analysis and risk management Investment decisions Professional ethics

III. WHAT SKILLS DO MANAGERS NEED TO SUCCEED?

Strategic Management Skills

- A strategy should include a plan for attracting customers.
- A *customer value proposition* is a reason for customers to choose a company over its competitors. Successful customer value propositions include:
 - *Customer intimacy*. “You should choose us because we understand and respond to your individual needs better than our competitors.”
 - *Operational excellence*. “You should choose us because we can deliver products and services faster, more conveniently, and at a lower price than our competitors.”
 - *Product leadership*. “You should choose us because we offer higher quality products than our competitors.”

Enterprise Risk Management Skills

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

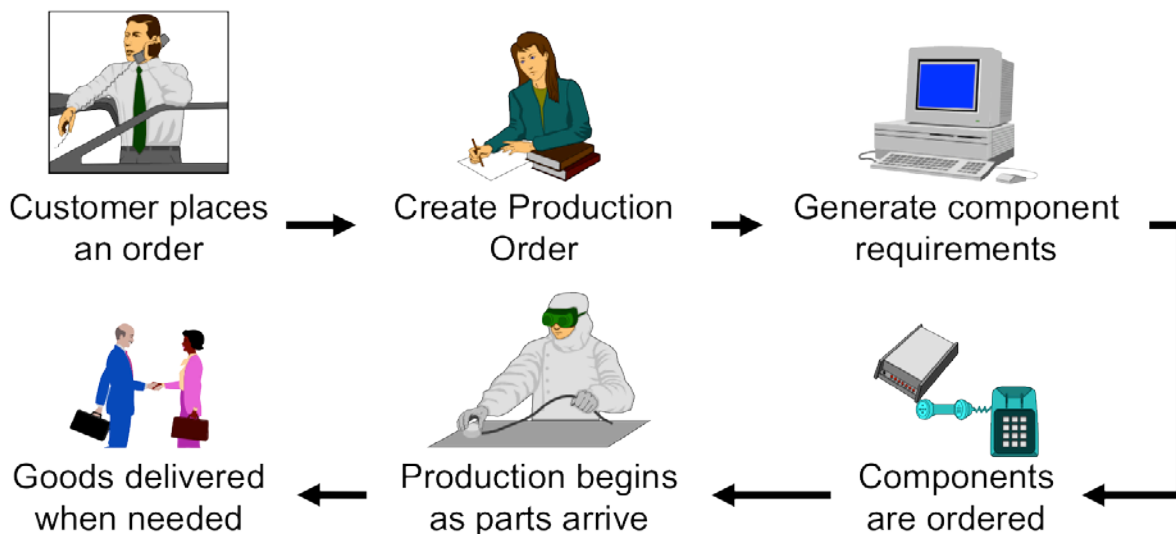
Process Management Skills

- A business process is a series of steps that are followed in order to carry out some task in a business.
- A value chain, as shown below, consists of the major business functions that add value to a company's products and services.



Lean Production

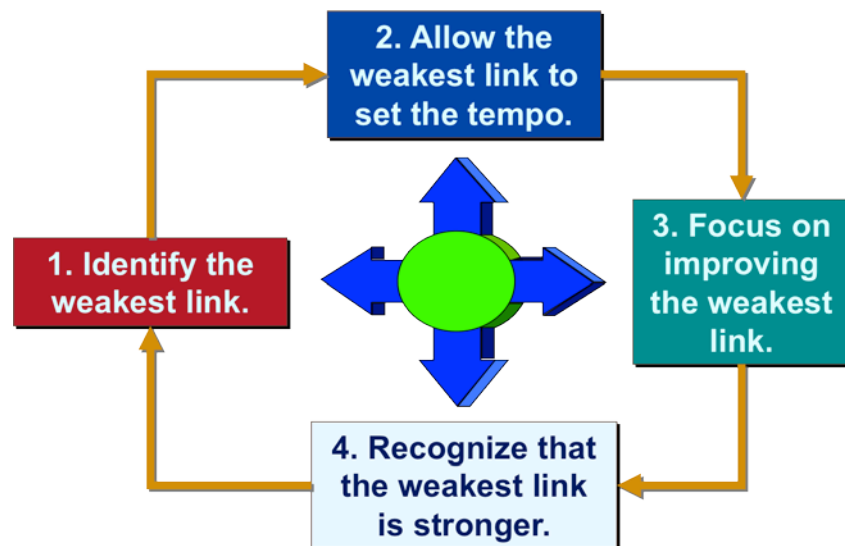
- Lean Production is a management approach that organizes resources such as people and machines around the flow of business processes and that only produces units in response to customer orders.
- The term just-in-time (JIT) production is often used because products are only manufactured in response to customer orders and they are completed just-in-time to be shipped to customers.



- Traditional manufacturing methods organize work departmentally and encourage those departments to maximize their output even if it exceeds customer demand and bloats inventories.
- Because lean thinking only allows production in response to customer orders, the number of units produced tends to equal the number of units sold, thereby resulting in minimal inventory.
- The lean approach results in fewer defects, less wasted effort, and quicker customer response times than traditional production methods.

Theory of Constraints (TOC)

- A constraint is anything that limits the ability of an individual or organization to attain its objectives.
- If the factory cannot satisfy demand, the constraint (i.e., bottleneck) is likely to be the workstation with the least capacity.
- The rate of output of the entire factory is determined by the capacity of the constraint.
- The other, non-constraint, work stations have excess capacity.



- Improvement efforts should usually be focused on the constraint.
- Improvements that increase the capacity of the constraint will increase the output of the entire factory.
- Improvements that increase the capacity of workstations that are not constraints will simply increase their excess capacity.
- If the capacity of the current bottleneck is increased enough, the constraint will shift. Improvement efforts should then be shifted to the new constraint (bottleneck).

Measurement Skills

The key to effective analysis is to understand that the question you are addressing defines what you measure and how you analyze the data.

- What net income should my company report to its stockholders?
- How will my company serve its customers?
- Will my company need to borrow money?

Chapter Number	The Key Question from a Manager's Perspective
Chapter 2	What cost classifications do I use for different management purposes?
Chapters 3 & 4	What is the value of our ending inventory and cost of goods sold for external reporting purposes?
Chapter 5	How will my profits change if I change my selling price, sales volume, or costs?
Chapter 6	How should the income statement be presented?
Chapter 7	How profitable is each of our products, services, and customers?
Chapter 8	How should I create a financial plan for next year?
Chapters 9 & 10	How well am I performing relative to my plan?
Chapter 11	What performance measures should we monitor to ensure that we achieve our strategic goals?
Chapter 12	How do I quantify the profit impact of pursuing one course of action versus another?
Chapter 13	How do I make long-term capital investment decisions?
Chapter 14	What cash inflows and outflows explain the change in our cash balance?
Chapter 15	How is our company performing through the eyes of our shareholders, short-term creditors, and long-term creditors?

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.

Leadership Skills

To be an effective leader, you'll need:

- (1) To be technically competent within your area of expertise and knowledgeable of your company's operations outside your functional area of expertise.
- (2) To be a person of high integrity.
- (3) To understand how to effectively implement organizational change.
- (4) Strong communication skills, including compelling presentation skills and effective listening skills.
- (5) To motivate and mentor other people.
- (6) To effectively manage team-based decision processes.

IV. THE IMPORTANCE OF 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.

V. 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.

APPENDIX 1A: 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.

Internal Controls for Financial Reporting

Type of Control	Classification	Description
Authorizations	Preventive	Requiring management to formally approve certain types of transactions.
Reconciliations	Detective	Relating data sets to one another to identify and resolve discrepancies.
Segregation of duties	Preventive	Separating responsibilities related to authorizing transactions, recording transactions, and maintaining custody of the related assets.
Physical safeguards	Preventive	Using cameras, locks, and physical barriers to protect assets.
Performance reviews	Detective	Comparing actual performance to various benchmarks to identify unexpected results.
Maintaining records	Detective	Maintaining written and/or electronic evidence to support transactions.
Information systems security	Preventive/Detective	Using controls such as passwords and access logs to ensure appropriate data restrictions.