Managerial Accounting: An Overview

Chapter 1

AC202 Managerial Accounting

ผศ.ดร. นนทวรรณ ยมจินดา

Financial and Managerial Accounting: Seven Key Differences

	Financial Accounting	Managerial Accounting
1. Users	External persons who make financial decisions	Managers who plan for and control an organization
2. Time focus	Historical perspective	Future emphasis
3. Verifiability versus relevance	Emphasis on objectivity and verifiability	Emphasis on relevance
4. Precision versus timeliness	Emphasis on precision	Emphasis on timeliness
5. Subject	Primary focus is on companywide reports	Focus on segment reports
6. Rules	Must follow GAAP / IFRS and prescribed formats	Not bound by GAAP / IFRS or any prescribed format
7. Requirement	Mandatory for external reports	Not Mandatory

Work of Management

Planning

Controlling

Decision Making

Planning

Establish Goals.

Specify How Goals Will Be Achieved.

Develop Budgets.

Planning

Marketing	Supply Chain Management	Human Resource Management
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

The control function gathers feedback to ensure that plans are being followed.

Feedback in the form of performance reports that compare actual results with the budget are an essential part of the control function.

Controlling

Marketing	Supply Chain Management	Human Resource Management
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

Decision making involves making a selection among competing alternatives.

What should we be selling?

Who should we be serving?

How should we execute?

Decision Making

Marketing	Supply Chain Management	Human Resource Management
Should we sell our services as one bundle or sell them separately?	Should we transfer production of a component part to an overseas supplier?	Should we hire an on-site medical staff to lower our healthcare 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?

Managerial Accounting: Beyond the Numbers

The primary purpose of this course is to teach measurement skills that managers use to support planning, controlling, and decision making activities.

Planning

Controlling

Decision Making

Managerial Accounting: Beyond the Numbers

Measurement skills help managers answer important questions.

What net income should my company report to its stockholders?

Measure and report historical data that complies with applicable rules.

How will my company serve its customers?

Measure and analyze mostly non-financial, process-oriented data.

Will my company need to borrow money?

Measure and analyze estimated future cash flows.

Managerial Accounting: Beyond the Numbers

Six Business Management Perspectives that go beyond the numbers to enable intelligent planning, control, and decision making:

- An Ethics Perspective
- A Strategic Management Perspective
- An Enterprise Risk Management Perspective
- A Corporate Social Responsibility Respective
- A Process Management Prospective
- A Leadership Perspective

An Ethics Perspective

The Institute of Management Accountant's (IMA) Statement of Ethical Professional Practice provides guidelines for ethical behavior.

Competence

Recognize and communicate professional limitations that preclude responsible judgment.

Maintain professional competence.

Follow applicable laws, regulations, and standards.

Provide accurate, clear, concise, and timely decision support information.

IMA Guidelines for Ethical Behavior

Confidentiality

Do not disclose confidential information unless legally obligated to do so.

Do not use confidential information for unethical or illegal advantage.

Ensure that subordinates do not disclose confidential information.

IMA Guidelines for Ethical Behavior

Integrity

Mitigate conflicts of interest and advise others of potential conflicts.

Refrain from conduct that would prejudice carrying out duties ethically.

Abstain from activities that might discredit the profession.

IMA Guidelines for Ethical Behavior

Credibility

Communicate information fairly and objectively.

Disclose delays or deficiencies in information timeliness, processing, or internal controls.

Disclose all relevant information that could influence a user's understanding of reports and recommendations.

IMA Guidelines for Resolution of an Ethical Conflict

Follow employer's established policies.

If this does not work, consider the following:

- Discuss the conflict with immediate supervisor or next highest uninvolved managerial level.
- If immediate supervisor is the CEO, consider the board of directors or the audit committee.
- Contact with levels above the immediate supervisor should only be initiated with the supervisor's knowledge, assuming the supervisor is not involved.

IMA Guidelines for Resolution of an Ethical Conflict

If following employer's established policies for conflict resolution do not work, consider these additional practices:

- Except where legally prescribed, maintain confidentiality.
- Clarify issues in a confidential discussion with an objective advisor.
- Consult an attorney as to legal obligations.

Why Have Ethical Standards?

Ethical standards in business are essential for a smooth functioning economy.

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Without ethical standards in business, the economy, and all of us who depend on it for jobs, goods, and services, would suffer.

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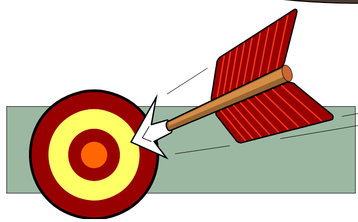
Abandoning ethical standards in business would lead to a lower quality of life with less desirable goods and services at higher prices.

A Strategic Management Perspective

A strategy is a "game plan" that enables a company to attract customers by distinguishing itself from competitors.



The focal point of a company's strategy should be its target customers.

Customer Value Propositions

Customer Intimacy Strategy → Understand and respond to individual customer needs.

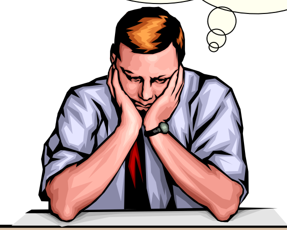
Operational Excellence Strategy → Deliver products and services faster, more conveniently, and at lower prices.

Product Leadership Strategy → Offer higher quality products.

An Enterprise Risk Management Perspective

A process used by a company to proactively identify and manage risk.

Should I try to avoid the risk, accept the risk, or reduce the risk?



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

An Enterprise Risk Management Perspective

Examples of Business Risks	Examples of Controls to Reduce Business Risks
• Intellectual assets stolen from computer files	• Create firewalls that prohibit computer hackers from corrupting or stealing intellectual property
• Products harming customers	• Develop a formal and rigorous new product testing program
• Losing market share due to the unforeseen actions of competitors	• Develop an approach for legally gathering information about competitors' plans and practices
• Poor weather conditions shutting down operations	• Develop contingency plans for overcoming weather-related disruptions
• Website malfunction	• Thoroughly test the website before going "live" on the Internet
• Financial statements unfairly reporting the value of inventory	• Count the physical inventory on hand to make sure that it agrees with the accounting records
• An employee accessing unauthorized information	• Create password-protected barriers that prohibit employees from obtaining information not needed to do their jobs

A Corporate Social Responsibility Perspective

Corporate social responsibility (CSR) is a concept whereby organizations consider the needs of all stakeholders when making decisions.

- Customers
- Employees
- Suppliers
- Communities
- Stockholders
- Environmental & Human Rights Advocates

CSR extends beyond legal compliance to include voluntary actions that satisfy stakeholder expectations.

Corporate Social Responsibility

Examples of Corporate Social Responsibility	
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 and their suppliers should provide **employees** with: • Safe and humane working conditions • Non-discriminatory treatment and the right to organize and file grievances • Fair compensation • Opportunities for training, promotion, and personal development
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 **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 **stockholders** with: • Competent management • Easy access to complete and accurate financial information • Full disclosure of enterprise risks • Honest answers to knowledgeable questions	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

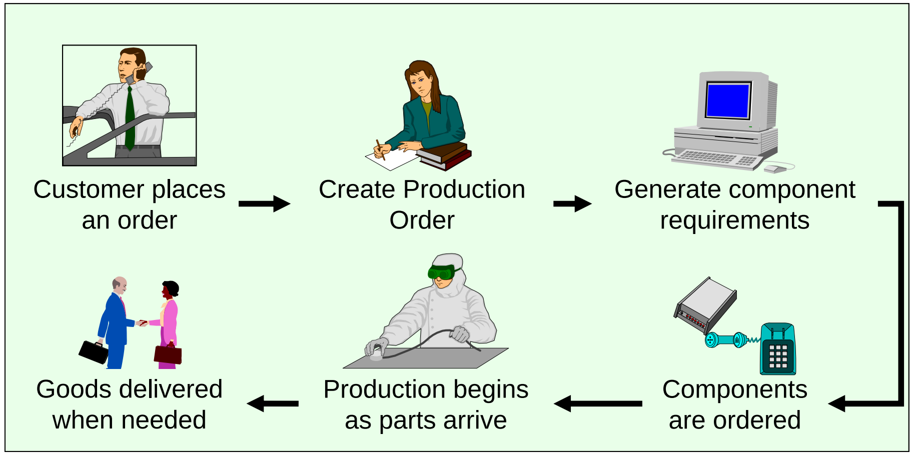
A Process Management Perspective

A business process is a series of steps that are followed in order to carry out some task in a business.

R&D	Product Design	Manufacturing	Marketing	Distribution	Customer Service

Business functions making up the value chain

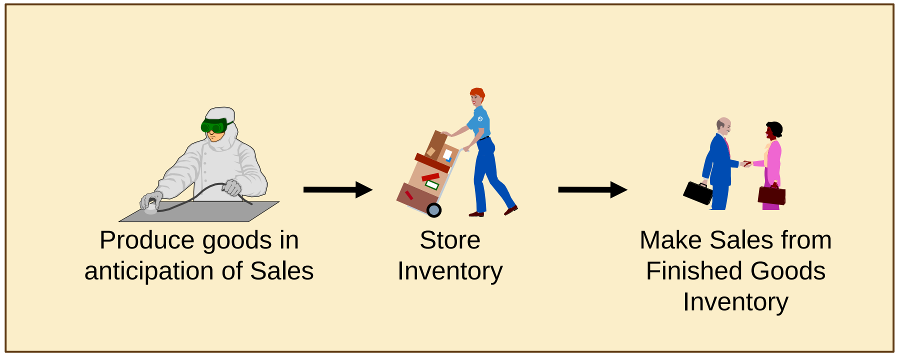
Lean Production



Lean Production is often called Just-In-Time (JIT) production.

Lean Production

Traditional Manufacturing



Lean Production

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

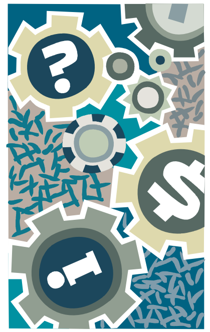
The lean approach also results in fewer defects, less wasted effort, and quicker customer response times than traditional production methods.

A Leadership Perspective

Organizational leaders unite the behavior of employees around two common themes—pursuing strategic goals and making optimal decisions.

Factors that influence behavior:

- Intrinsic Motivation
- Extrinsic Incentives
- Cognitive Bias



Appendix 1A: Corporate Governance

The system by which a company is directed and controlled.

Board of Directors

Incentives and monitoring for

Top Management

To pursue objectives of

Stockholders

The Sarbanes-Oxley Act of 2002

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:

❶ 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.

❷ The Act establishes the Public Company Accounting Oversight Board to provide additional oversight of the audit profession.

❸ The Act places the power to hire, compensate, and terminate public accounting firms in the hands of the audit committee.

❹ 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.

The Sarbanes-Oxley Act of 2002

(continued)

❺ The Act requires a public company's independent 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.

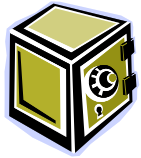
❻ The Act establishes severe penalties for certain behaviors, such as:

- Up to 20 years in prison for altering or destroying any documents that may eventually be used in an official proceeding.
- Up to 10 years in prison for retaliating against a "whistle blower."

Internal Control

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

Preventive Controls
Prevents or deters undesirable events



Detective Controls
Detects undesirable events

Internal Control

Type of Internal Controls for Financial Reporting

Type of Control	*Classification*	*Description*
Authorizations	Preventive	Requiring management to formally approve certain types of transactions.
Reconciliations and	Detective	Relating data sets to one another to identify resolve discrepancies.
Segregation of authorizing Duties	Preventive	Separating responsibilities related to transactions, recording transactions, and maintaining custody of the related assets.

Internal Control

Type of Internal Controls for Financial Reporting

Type of Control	*Classification*	*Description*
Physical to Safeguards	Preventive	Using cameras, locks, and physical barriers protect assets.
Performance Reviews	Detective	Comparing actual performance to various benchmarks to identify unexpected results.
Maintaining evidence to Records	Detective	Maintaining written and/or electronic support transactions.
Information access Systems Security	Preventive/ Detective	Using controls such as passwords and logs to ensure appropriate data restrictions.

Internal Control

Internal controls cannot guarantee that objectives are achieved because:

- Even well-designed internal control systems can break down.
- Two employees may collude to circumvent the control system.
- Senior leaders may manipulate financial results by intentionally overriding prescribed policies and procedures.

Certified Management Accountant

A management accountant who has the necessary qualifications and who passes a rigorous professional exam earns the right to be known as a Certified Management Accountant (CMA).

CMA Exam

Part 1 Financial Planning, Performance and Control
- Planning, budgeting, and forecasting
- Performance management
- Cost management
- Internal controls
- Professional ethics

Part 2 Financial Decision Making
- Financial statement analysis
- Corporate finance
- Decision analysis and risk management
- Investment decisions
- Professional ethics

Information about becoming a CMA and the CMA program can be accessed on the IMA's website at www.imanet.org.

End of Chapter 1