

CHAPTER 1

The Accountant's Vital Role in Decision Making

TRANSITION NOTES

This chapter introduces the five-step decision process utilized by managers to make a variety of decisions. This process becomes an underlying theme of the text as it is applied to a number of types of decisions throughout the text. The five steps include (1) identify the problem and uncertainties, (2) obtain information, (3) make predictions about the future, (4) make decisions by choosing among alternatives, (5) implement the decision. With the emphasis on the five-step decision process, material relating to the problem solving, scorekeeping, and attention-directing roles of the management accountant are streamlined. There is also an increased emphasis on the linkage between the set of business functions in the value chain and customer expectations as key success factors.

Learning Outcomes

After studying this chapter, a student should be able to:

1. Explain how management accounting data are essential to the process of rational operating and strategic decision-making;
2. Explain how business functions help management accountants organize accounting information;
3. Identify the five steps of decision-making and the role of relevant accounting information;
4. Describe key guidelines management accountants follow and roles they assume to support management decisions;
5. Distinguish among corporate governance, professional codes of conduct, ethics, and corporate social responsibility.

CHAPTER OVERVIEW

Chapter 1 is an important introductory chapter. Exhibit 1-1 delineates the differences between the roles of management accounting and financial accounting. Distinction is made between financial accounting and managerial accounting. **Financial accounting** information is reported to external users and used by investors, lenders, suppliers, and other external stakeholders to evaluate and compare companies. It follows prescribed standards and formats. In contrast, **management accounting** provides financial and nonfinancial information to internal users employing whatever format or costing approach that will allow managers to make the best possible business decisions in today's competitive environment. **Cost accounting** provides information for both financial accounting and management accounting.

The introduction of a **strategic management** focus becomes the reason for developing the subsequent chapters of the text book. As stated in this chapter, "the best-designed strategies and the best-developed capabilities are of no value, unless they are executed well." Management accounting facilitates management in achieving its strategic goals.

Exhibit 1-2 introduces the value chain of business functions and costs -- an important management concept. The major purposes of management accounting systems are discussed. Financial and management accounting are compared. The role of the management accountant in developing strategy and building resources and capabilities is examined. Emphasis is on the integral role accounting systems have in managerial decision-making and the manager as the consumer of the management accountant's analyses.

Elements of management control are introduced. Planning and control are defined and illustrated. The budget is the most important planning tool for both short-term and long-term decision-making. The concept of feedback and its central role in a management control system is discussed and illustrated in Exhibit 1-4. Tracking performance of key success factors relative to the performance of competitors is an important focus of feedback.

Successful management accounting systems capture and report information that helps managers make decisions to fulfill organizational goals in an effective and efficient manner. Management accounting also provides information critical to the planning and control decisions of managers.

A five-step decision-making process is introduced to guide successful decision-making: Identify the problem, obtain information, make predictions about outcomes, make a decision, and implement the decision.

Key guidelines for management accountants include: Cost benefit analysis, behavioural considerations, technical considerations, and different costs for different purposes. Understanding these guidelines is essential for the student to have a solid foundation for material that is presented later in the text.

As those responsible for the integrity of the accounting information used by external and internal parties, accountants must maintain the highest of ethical standards. They must take special care to avoid the appearance of ethical improprieties—not only avoid unethical behaviour, but avoid the appearance of such.

POINTS OF EMPHASIS

1. Make sure that the students understand the perspective of cost accounting and how it differs from that of financial accounting.
2. The cost-benefit ratio is pervasive throughout the text. The students should grasp this concept early or they will not fully understand cost accounting.
3. Another recurring theme throughout the text is the five-step decision model. Emphasize this concept and be certain the students are operationally familiar with it.
4. The guidelines to management accounting covered in Learning Outcome 5 give the student a proper perspective in order to “do” management accounting.
5. It is helpful and sets an ethical tone for the class if you go over the points included in the SMAC, CICA, and CGA of Ethical Conduct. Discuss the definitions of the terms covered in the Code, making certain that the students have a grasp of what is involved in ethical conduct.

TEACHING TIP: *Begin the session on the chapter with an overview of the chapter. Make the major points in a three to five minute opening statement. Use the points of emphasis to guide your comments. At the end of the session close with a reiteration of the same points.*

TEACHING TIP: *Hand out the quiz questions (quiz fits two sided 8.5 by 11 sheet) at the beginning of the lecture so that students can write their answer and/ or make corrections as necessary. The quiz paper gives the opportunity to make a note about the correct answer as explained during feedback session.*

CHAPTER OUTLINE

Learning Outcome 1:

Explain how management accounting data are essential to the process of rational operating and strategic decision-making.

I. Management Accounting Data: Cost Accounting and Cost Management

Management information systems (MIS) measures and reports financial and nonfinancial information that helps managers make decisions to fulfill the goals of the organization behavior

Financial accounting focuses on reporting to external parties – it provides financial statements that are based on GAAP

Cost accounting provides information for management accounting and financial accounting. It measures and reports financial and nonfinancial information related to the cost of acquiring or utilizing resources in an organization.

Cost management includes the activities of identifying, reporting, and analyzing all costs of operations. Management decisions range from the quantity and quality of materials used to whether to shut down an entire company.

A. Operating Decisions and Management Accounting

Operations refer to the activities that convert various resources into a product or service ready for sale. Procuring and converting resources most efficiently, with a limited amount of money and time, is the economics of conducting business.

B. Strategic Decisions and Management Accounting

Strategy specifies how an organization matches its own capabilities with the opportunities in the marketplace and formally communicates how it will compete. One of two strategies is available: either cost leadership or value leadership by means of product (service) differentiation.

Pursuing the most appropriate strategy sustains competitive advantage for each type of company.

Management accountants work closely with managers in formulating strategy by providing information and helping them answer questions such as:

- Who are our most important customers, and how do we deliver value to them?
- What substitute products exist in the marketplace, and how do we attract customers to purchase our product instead of others?
- What are we particularly competent at doing? Innovating? Applying technology? Production? Multiple factors such as price, quality, and timely delivery drive the customer's perception of value. How do we decide to create that value in an affordable way?
- Will adequate cash be available to fund the strategy? If not, how can we acquire these additional funds?

Do Chapter Quiz multiple choice questions 1 to 3.

In-class exercise 1-15

TEACHING TIP: The Strategic Cost management process should be illustrated by a simple example from everyday life (such as the examples given in the text readings, the concepts in action, and others from current business news).

Learning Outcome 2:

Explain how business functions help management accountants organize accounting information

II. Value-Chain is and Supply-Chain Analysis and Key Success Factors

A. Value-Chain Analysis

Value chain is the sequence of business functions in which customer usefulness is added to products or services. The flow of costs incurred in a corporation can be classified into the value-adding activities of research and development (R&D), design, production, marketing, distribution, and customer service.

[refer to Exhibit 1-2 on page 5]

1. **R & D** - what does the customer need and want
2. **Design of products, services, or processes** – what is the best design for the customer's needs and wants
3. **Production** – what is the most efficient and effective process includes the supply chain
4. **Marketing** – what is the most cost effective means of communicating the value
5. **Distribution** – what is the most efficient and effective way of getting the product or service into the hands of the customer
6. **Customer service** – what is necessary to meet the customers' expectations

Customer relationship management (CRM) a term used by companies to describe a strategy that integrates people and technology in all business functions to enhance relationships with customers, partners, and distributors.

B. Supply-Chain Analysis

Supply-Chain is the flow of goods, services, and information from their initial sources to the delivery of products and services to consumers, regardless of whether those activities occur in one or more organizations.

External -- materials and services are brought together in the production function initially, but are necessary through to the end of the customer service function. The need to manage the costs at every stage is critical to the success of the organization. [*Refer to Exhibit 1-3, on page 6*]

Internal – coordination of the flow of products and services is measured by a number of measures: financial as well as nonfinancial, throughput contribution and on-time delivery are two respective examples.

C. Key Success Factors (KSF)

Key success factors are performance measures within the value chain and supply chain. Customer focus is strategic to any organization. Is the company going to provide the customer with good quality at a reasonable price, or will the company produce a higher than industry standards and charge a high price?

In either case the customer has expectations and those expectations need to be met. If the customer's expectations are met, the company will expect to realize their performance goals. These become the key success factors to superior performance. The key success factors can be categorized as follows:

1. **Cost and efficiency** – continuous improvement is the goal for any organization and it can happen in small increments. Employees and their managers are charged to make positive changes “across all value-chain functions and over the entire life cycle of the product” or service. Eliminate waste and rework, serve the customer more efficiently and effectively.
2. **Quality** – materials and services in the supply chain are important to the overall quality of the products and services. Total Quality Management (TQM) is critical and has caused organizations to adhere to the international standards set by the International Standards Organization (ISO). Customers receive the quality they deserve and expect.
3. **Time** – the amount of time to accomplish at task is measurable and therefore manageable. Every function has a time component. Customer response time is one that we are most familiar with when communicating by telephone.
4. **Innovation** – ongoing company success is dependent on new and relevant products and services to meet customers' demand.

TEACHING TIP: Emphasize the concept of value – what is the customer willing to pay for. Quality is essential as customers expect high level of quality. Emphasize TQM (p.6). On-time delivery is important for customers. Companies compete to meet or exceed customers' expectations of responsiveness.

Do Chapter Quiz multiple choice questions 4 to 6.

In-class exercise – 1-17

Assign exercise 1-18

Learning Outcome 3:

Identify the five steps of decision making and the role of relevant accounting information

III. Decision making, Planning, and Control: The Five-Step Decision-Making Process

The Five-Step Decision-Making Process

1. Identify the problem and uncertainties
2. Obtain Information
3. Make predictions about the future
4. Decide on and implement one of the available alternatives
5. Implement the decision, evaluate performance, and learn

Planning is choosing goals, predicting results, and deciding how to attain desired goals.

Control is both the action implementing the plan and performance evaluation of the personnel and operations.

TEACHING TIP: Emphasize that learning arises from comparing actual performance. Plans must be flexible because the future and outcomes are always uncertain. The plan is not a guarantee of any outcome. Therefore managers need flexibility to make the decision and take new action.

Do Chapter Quiz multiple choice question 7.

In-class exercise 1-19

Assign exercise 1-21

Learning Outcome 4:

Describe key guidelines management accountants follow and roles they assume to support management decisions.

IV. Key Management Accounting Guidelines and Organization Structure

Three guidelines help management accountants provide the most value to their companies in strategic and operational decision making:

1. Use a cost-benefit approach.
2. Recognize both behavioural and technical considerations.
3. Use different costs for different purposes.

A. Cost-Benefit Approach

Cost-Benefit Approach is used to make resource allocations such that the expected benefits exceed the expected costs. This approach requires explicit comparisons of the financial costs and benefits of different alternatives. Upside potential and downside risk must both be taken into consideration when managers are forecasting costs and benefits.

B. Behavioural and Technical Consideration

Behavioural considerations motivate managers and other employees to try to achieve the goals of the organization. Budgets improve decisions within an organization because of better collaboration, planning, and motivation.

Technical considerations help managers make wise economic decisions. Technical data in an appropriate format and at the preferred frequency improve the quality of information upon which managers make decisions.

C. Different Costs for Different Purposes

A cost concept used for external reporting may not be the appropriate concept for internal reporting to managers. Management accountants must ensure that the cost concept used meets the needs of the decision maker.

D. Organization Structure and The Management Accountant

Line management is directly responsible for completing routine tasks that attain operating goals.

Staff management, including management accountants, human resources managers, and information technology staff, provide advice and assistance to line management.

The **chief financial officer (CFO)**, also called the finance director, is the senior officer empowered to oversee the financial operations of an organization. In Canada the CFO is

legally and personally responsible for the quality of financial information publicly reported. Responsibilities encompass the following five areas:

- **Controllershship**, which includes providing legal assurance of a high-quality internal control system.
- **Audit**, which ensures internal and external audits are conducted as per the direction of the audit committee
- **Treasury**, which includes short- and long-term financing and investments, banking, cash management, foreign exchange, and derivatives management.
- **Taxation**, which includes reporting and managing income taxes, sales taxes, and domestic and international tax planning.
- **Risk management**, which includes analysis, evaluation, and minimization of external risks over which management has no control and internal risks over which management has control.
- **Investor relations**, which includes responding to and interacting with shareholders.

The **controller** is responsible for the quality of the information supplied from the accounting department.

Do Chapter Quiz multiple choice questions 8 to 10.

In-class exercise 1-19

Assign exercise 1-21

Learning Outcome 5:

Distinguish among corporate governance, professional codes of conduct, ethics, and corporate social responsibility

V. Corporate Governance, Ethics, and Corporate Social Responsibility

Corporate governance comprises activities undertaken both to ensure legal compliance and that accountants fulfill their fiduciary responsibilities.

Ethics comprise agreed upon standards of honesty and fairness that apply to everyone in all their dealings with one another. Corporate social responsibility (CSR) is the integration of social and environmental with financial stewardship in the conduct of business.

A. Corporate Governance

Exhibit 1-6 shows a legally compliant, generic corporate governance structure for a corporation listed on a stock exchange.

The **Board of Directors (BOD)** is the independent group of external experts responsible for holding the external auditors, the **Chief Executive Officer (CEO)**, CFO, and **Chief Operating Officer (COO)** accountable for the quality of financial information and organizational outcomes.

Legislation now permits people injured as a result of poor corporate governance to conduct lawsuits against alleged perpetrators, which includes not only the corporation but also these individuals personally.

B. Ethical Guidelines

Professional accounting organizations such as the SMAC promote high ethical standards, and exist in many countries around the world. Appendix B discusses professional organizations in Canada, the United States, Australia, Japan, and the United Kingdom. Some issue ethical guidelines to help their members reason through appropriate responses to ethical issues.

SMAC is the largest association of management accountants in Canada, and provides programs leading to the **Certified Management Accountant (CMA)** certificate as well as assuring CMA competence. All graduates must be competent in their knowledge of the Professional Misconduct and Code of Professional Ethics.

Exhibit 1-7, on page 15, provides excerpts from the Certified Management Accountants of Ontario's Code, which not only refers to ethical practice, but also to ethical character and general behaviour.

C. Corporate Social Responsibility (CSR)

Corporate social responsibility (CSR) is the voluntary integration of social and environmental concerns into business decisions.

In for-profit companies, CSR policies are controversial to shareholders in whose financial interests managers are supposed to act first. But recent research indicates that exercising CSR improves profitability, strengthens customer relationships, and increases employee commitment.

Triple bottom line, which includes GAAP-compliant reports of financial results, corporate governance, and CSR, is a formal type of reporting response to Global Reporting Initiative (GRI) and augments standard financial reports with specific environmental and social sustainability reports.

TEACHING TIP: Bring the students up to date on the various outcomes of the trials related to some of the high profile companies. The Sarbanes-Oxley Act has affected the way companies do business in the United States, but this has ramifications in Canada for any company with shares listed on the US exchanges. This Act impacts the communication of financial information within organizations as well as externally and therefore has important implications on role of management accountant.

Do Chapter Quiz multiple choice question 11.

In-class exercise 1-27

Assign Exercise 1-26

MyAccountingLab

www.myaccountinglab.com

Pearson's MyAccountingLab is available for students, and includes an online version of the text, along with a vast array of assessment material. Any questions marked in red in the textbook are found on MyAccountingLab for students to practise as often as they want, and also receive step-by-step guided instructions to get the answer.

CHAPTER 1 QUIZ

1. _____ provides information for both management and financial accounting.
 - a. Cost accounting
 - b. Value chain analysis
 - c. Financial accounting
 - d. Management accounting

2. _____ provides financial and non-financial information in a customized format that is most useful for making decisions.
 - a. Strategic accounting
 - b. Financial accounting
 - c. Management accounting

3. A strategy :
 - a. quantifies a long range plan
 - b. outlines how a certain problem will be solved
 - c. specifies how an organization accomplishes its objectives
 - d. coordinates managers in their control over employees

4. Value chain analysis is conducted preferably by:
 - a. the chief financial officer
 - b. the chief operating officer
 - c. the auditor
 - d. a team of managers from different business functions

5. The value chain
 - a. involves external companies as well as internal activities.
 - b. is the sequence of business functions in which customer usefulness is added to products or services.
 - c. applies only to manufacturing companies.
 - d. is not relevant in today's cost accounting environment.

6. Which of the following is *not* a key success factor in a company's effort to deliver increased levels of performance to the customer?
 - a. Time
 - b. Innovation
 - c. Quality
 - d. Price reduction

7. The five-step decision-making process
 - a. includes planning and control activities.
 - b. is performed exclusively by management accountants.
 - c. is not often used, as the costs exceed the benefits.
 - d. must be performed following GAAP guidelines.

8. Management accountants are not guided by the following:
 - a. cost-benefit approach
 - b. maximization of personal compensation
 - c. behavioural considerations
 - d. relevant cost concept

9. _____ management exists to provide advice and assistance to managers to attain the objectives of the organization.
 - a. Delegated
 - b. Line
 - c. Staff
 - d. Functional

10. Which of the following lists the areas of responsibilities of the chief financial officer (CFO)?

- a. Controllershship; Treasury; Tax; and external audit
 - b. Controllershship; Treasury; Tax; and Investor relations
 - c. Controllershship; Treasury; Tax; and Government relations
 - d. Controllershship; Treasury; Tax; internal audit
11. Which of the following is not one of the ethical responsibilities of a management accountant?
- a. Compliance
 - b. Confidentiality
 - c. Integrity
 - d. Objectivity

CHAPTER 1 QUIZ SOLUTIONS:

- 1. [a]
- 2. [c]
- 3. [c]
- 4. [d]
- 5. [b]
- 6. [d]
- 7. [a]
- 8. [b]
- 9. [c]
- 10. [b]
- 11. [a]

WRITING/DISCUSSION EXERCISES

1. Describe how cost accounting supports financial, management, and strategic decisions;

- Compare/contrast management accounting with financial accounting.

The points should come from the definitions of each and Exhibit 1-1 on page 3.

- Describe the role management accounts take in developing strategies and building resources and capabilities

Management accountants provide support to the formulation and the implementation of strategy. Management accountants support the planning and control functions of the organization to ensure the overall attainment of organizational goals through the collective decision-making of managers.

2. Explain how the value-chain concept relates to the dimensions of performance customers expect;

- Describe how each of the six business function enhances customer relationships.

Research and development is essential to creating products and services that are relevant to customers' needs. Products can be launched, but customers do not perceive value in them.

Design incorporates the needs of the customer into the products and services. Products succeed or fail on how well the customer receives the way the product is designed. Ease of use would be one example.

Production impacts customers' perception of value in the materials used, the quality of workmanship, and time required to complete production.

Marketing introduces the products and services to potential customers and existing customers. Customer relationship management (CRM) integrates people and technology in all the business functions.

Distribution unites the products and the services with the customers. Various means are used from retail outlets to courier services.

Customer service is the after-sale support to the customer. This is an important part of the customer relationship. The internet has proven to be one of the most significant tools in building customer relations, both pre-sale and after-sale support.

- What support do management accounts provide to customer relations?

Management accountants provide support to managers in tracking performance. The content of the information provided through regular reporting of performance in relation to the key success factors for instance. Key performance factors are related to how well the company is performing compared to predetermined goals and just as importantly, competitors. Customers make distinctions among the companies so why not give managers the same perspective in reporting by providing benchmarks as a standard to compare internal performance.

Two examples are given in the text; WestJet and EBay®.

Cost of serving customers is just as important as on-time-delivery and management accountant's role in providing the customer perspective is critical to the overall attainment of the organization's goal.

3. Identify differences between the planning and control decisions of managers and the different roles of relevant accounting information

- What is the connection between planning and control?

Managers are charged with the responsibility to plan and control. These responsibilities are performed in a continuum. Planning would seem to precede control but without some prior experience in controlling planning future events will be less effective.

Planning consists of choosing goals, predicting results and deciding various action plans to achieve goals. Control covers implementing the action plan and subsequent evaluation of how well the action plan was executed. To provide an objective benchmark to measure against a budget is created. The budget is the quantitative expression of those action plans.

Feedback links planning and control and is used to help managers respond to the feedback they receive. Changing goals, changing how the company operates, changing the reward system, and changing the responsibilities of personnel are some of the responses resulting from feedback received.

- Using the exercises and problems in the text, list verbs (action words) that clarify the activities of problem solving, scorekeeping, and attention directing.

Words such as analyze and predict are primarily used for problem solving.

Words such as accumulate, tally, and report are primarily used for scorekeeping.

Words such as report and compare are primarily used for attention directing.

4. Describe three guidelines management accountants follow in supporting managers, and describe the profession's role in an organization

- What three important guidelines help management accountants provide the most value to the planning and control process?

*Management accountants provide the most value by supporting managers in focusing on three perspectives. Managers are responsible for efficiency in operations. Efficiency is measured by how much it costs per unit of output and how much input was used to produce a given output. Cost of input can be improved by a perspective known as **cost-benefit approach**. The cost benefit approach should be used in all decisions so that the collective set of decisions will better attain the organization's goals. Simply stated cost-benefit seeks the greatest benefit for the cost of an alternative action chosen.*

Efficiency is enhanced when the amount of input used to achieve an outcome is minimized. That is why collaborative planning is so important because it addresses the perspective of behavioural and technical considerations. The human element is a critical component to successful execution. The question should be asked "are the employees ready and do they have the resources necessary to carryout the action plan?" Without consensus about how and when an action plan is executed time and resources will be wasted. Ineffective management is when goals are not achieved in accordance with the predetermined performance standard.

The third perspective that guides management accountants is the cost concept used for internal reporting of events before and after they occur. The example used is the cost of advertising and expense in the context of financial reporting but a life-cycle cost in the context of management accounting. The financial reporting view is the matching principle while the management accounting view is total life-cycle cost of a product (includes all costs throughout the business functions).

- What is the position of the controller in an organization?

Controllers are financial executives responsible for both management accounting and financial accounting. So they provide guidance to the planning and controlling responsibilities of managers throughout the organization. This distinguishes the difference between the relationship of line authority and staff authority. Managers are under the line authority of higher level executives who exercise the responsibility to plan and direct lower levels of management. Management teams exist throughout the organization and the management accountant plays a significant and necessary role in these teams.

Controllers exercise staff authority in regards to other executives and managers by providing input to manager's decisions. This input is to be taken seriously and as

such exerts a force or influence to achieve better-informed collective decisions for the good of the organization as a whole.

The president would heed the advice of the controller on matters pertaining to financial impact of a decision on the organization as a whole.

5. Explain how professional accounting codes of ethics relate to corporate governance.

- From the perspective of (a) a stockholder, (b) a company manager, (c) an employee other than a manager, and (d) a customer, explain why a code of ethics is important for the accountants within a company. Consider the functions performed, the measures employed, and the concept of professional status.

The section in the text on professional ethics can be helpful in addressing this exercise. Accountants consider themselves to be professionals. A code of ethics is usually regarded as a necessary aspect of a professional class. In the explanation of management accounting functions, the function of scorekeeping receives particular attention as one in which accountants are responsible for the reliability of the reported information and act as watchdogs for top management.

Discussion on the "Focus on Values and Behaviours" article in the text, page 16 will help the student to see clearly the role of the management accountant and the conduct in relation to professional ethics.

- What constitutes "unprofessional conduct"?

From the Regulated Accounting Profession Act, Alberta, also page 20 of the textbook: Unprofessional conduct includes:

- conduct that is detrimental to the best interest of the public or harms the integrity of the accounting profession;*
- conduct that contravenes the Act, regulations, or bylaws;*
- conduct that contravenes the rules of professional conduct or practice standards;*
- conduct that displays a lack of competence.*