

CHAPTER 1

THE CRUCIAL ROLE OF MANAGERIAL ACCOUNTING IN A DYNAMIC BUSINESS ENVIRONMENT

Learning Objectives

- 1-1. Define managerial accounting and describe its role in the management process.
- 1-2. Explain four fundamental management processes that help organizations attain their goals.
- 1-3. List and describe five objectives of managerial accounting activity.
- 1-4. Explain the major differences between managerial and financial accounting.
- 1-5. Describe the accounting and finance structure in an organization.
- 1-6. Describe the roles of an organization's chief financial officer (CFO) or controller, treasurer, and internal auditor.
- 1-7. Understand and explain the value chain concept.
- 1-8. Explain how investments in capacity affect managerial decision making.
- 1-9. Understand and explain big data and data analytics and how they interact with managerial accounting.
- 1-10. Discuss the professional organizations and certifications in the field of managerial accounting.
- 1-11. Describe the ethical responsibilities and ethical standards that apply to managerial accounting.

Chapter Overview

- I. Managerial Accounting: A Business Partnership with Management
 - A. What is managerial accounting?
- II. Managing Resources, Activities, and People
 - A. Management activities
 - 1. Decision making
 - 2. Planning
 - 3. Directing operational activities
 - 4. Controlling
- III. How Managerial Accounting Adds Value to the Organization
 - A. Objectives of managerial accounting activity
 - 1. Providing information for decision making and planning
 - 2. Assisting managers in directing and controlling operational activities
 - 3. Motivating managers and other employees toward the organization's goals
 - 4. Measuring the performance of activities, subunits, managers, and other employees within the organization
 - 5. Assessing the organization's competitive position, and working with other managers to ensure the organization's long-run competitiveness in its industry
 - B. Balanced Scorecard
 - 1. Financial Perspective
 - 2. Customer Perspective
 - 3. Internal Business Process Perspective
 - 4. Learning and Growth Perspective
- IV. Managerial Accounting in Different Types of Organizations
 - 1. Profit-seeking or nonprofit enterprises need information
 - 2. Managerial accounting information is vital in all types of organizations
 - 3. The five basic purposes of managerial accounting activity are relevant in each of these organizations
- V. Managerial versus Financial Accounting
 - 1. Focus of reports
 - 2. External vs. internal users of information
 - 3. Degree of regulation
 - 4. Information focus
- VI. Where Do We Find Managerial Accountants in an Organization?
 - A. Organization Chart
 - 1. Line and staff positions
 - 2. CFO or controller
 - 3. Treasurer
 - 4. Internal auditor
 - B. Cross-Functional Deployment
- VII. The Operational Context of Managerial Accounting

- A. Managerial Accounting and the Value Chain
- B. Capacity and Capacity Costs
- C. Big Data, Data Analytics, and Managerial Accounting
- VIII. Managerial Accounting as a Career
 - A. Professional Organizations
 - B. Professional Certification
- IX. Managerial Accounting and the Ethical Climate of Business
 - A. Sarbanes-Oxley
 - B. PCAOB
 - C. IMA

Key Lecture Concepts

I. Managerial Accounting: A Business Partnership with Management

- Types of organizations include manufacturers, retailers, service providers, agribusinesses, and nonprofit firms. These organizations have goals such as growth, profit, quality, leadership, etc.
- Organizations have information needs in the financial, production, personnel, environmental, and legal areas. Managerial accounting provides some of this information. **Managerial accounting** is the process of identifying, measuring, analyzing, interpreting, and communicating information in pursuit of an organization's goals.
- The role of managerial accountants has expanded in recent years. **Managerial accountants** are specialists in using the tools of managerial accounting to help the organization and its managers run the operation smoothly. Formerly in staff positions, managerial accountants now serve as internal business consultants, trusted advisors, and "business partners."

II. Managing Resources, Activities, and People

- Management functions performed within an organization can often be summarized as decision making, planning, the directing of operational activities, and controlling.
 - **Decision making**—the process of choosing among available alternatives
 - **Planning**—developing a detailed financial and operational description of anticipated operations
 - **Directing operational activities**—running the organization on a day-to-day basis
 - **Controlling**—ensuring that the organization operates in the intended manner to achieve its goals

III. How Managerial Accounting Adds Value to the Organization

Managerial accounting:

- Provides managers with information (e.g., product costs, budgets, cash flows). The information includes financial and nonfinancial data to help managers with strategic planning and decision making.
- Assists in directing and controlling (analyzing and comparing actual performance to budgeted plans; **attention-directing** to highlight successful or problem areas).
- Motivates managers to achieve the organization's goals by communicating the plans, providing a measurement of how well the plans were achieved, and prompting an explanation of deviations from plans.
- Measures performance not only for the entire organization, as in financial accounting, but also for many subunits (divisions, departments, managers).
- Assesses the organization's competitive position in the rapidly changing business environment. Looks at how well the firm is doing internally, in the eyes of its customers, from the standpoint of innovation and continuous improvement, and financially.
 - The preceding factors are integrated in a model of performance evaluation known as the **balanced scorecard**.

IV. Managerial Accounting in Different Types of Organizations.

- Profit-seeking or nonprofit enterprises need information.
- Managerial accounting information is vital in all types of organizations. Some organizations that have managerial accountants include:
 - Ford (manufacturing)
 - J.Crew (retail)
 - GoDaddy.com (Internet) ByteDance/TikTok (Internet)
 - American Airlines (transportation)

- Marriott Hotels (tourism)
- Goldman Sachs (financial services)
- The University of Texas (education)
- The American Red Cross (nonprofit)
- M. D. Anderson Cancer Center (health care)
- U.S. Department of Defense (government)
- The five basic purposes of managerial accounting activity are relevant in each of these organizations.

V. Managerial versus Financial Accounting

- **Financial accounting** is intended for external users (investors, creditors, etc.); is heavily regulated by the FASB, SEC; is mandatory for publicly-traded companies; is historic in nature.
- **Managerial accounting** is intended for internal users (managers); is not heavily regulated; is not mandatory but rather is adopted based on costs/benefits; is future-oriented.

VI. Where Do We Find Managerial Accountants in an Organization?

- **Line** personnel are directly involved in carrying out the mission of the organization (e.g., assembly workers in a factory, doctors in a hospital, teachers in a school).
- **Staff** personnel (accountants, lawyers, personnel directors, and other administrative positions) provide support for the organization's mission.
 - An accountant in a CPA firm would be in a line position, because the organization's mission is providing accounting services. In contrast, an accountant at a university would be in a staff position.
- The **chief financial officer (CFO)** or **controller** is the chief accountant responsible for the supervision of the accounting department, preparation of reports, and the interpretation of information to line managers.
- The **treasurer** is responsible for raising capital, safeguarding assets, and managing investments, insurance coverage, and the credit policy of an

organization.

- The **internal auditor** reviews accounting procedures, reports, and performance on behalf of top management.
- More and more, managerial accountants work throughout an entire enterprise and are deployed in cross-functional management teams, working with top executives and personnel from a variety of functional areas (e.g., marketing, production, engineering, and operations).

VII. The Operational Context of Managerial Accounting

- More attention is being paid to the **value chain**—the set of linked, value-creating activities, from conducting product research, to manufacturing, to providing customer service.
 - A number of activities occur prior to the production of a good or service (i.e., upstream activities) and several occur after (so-called downstream activities).
- To achieve an organization's goals, managers must understand the entire value chain as well as the related cost-causing factors (**cost drivers**).
- Managing the cost relationships within a value chain to the firm's advantage is called **strategic cost management**.
- A key objective of managerial accounting information is the management of an organization's capacity and the costs of providing that capacity.
 - Capacity is the upper limit on the amount of goods or services that an organization can produce in a specified period of time. There are various concepts of an organization's capacity:
 - Theoretical capacity refers to the upper limit on production of goods or services if everything works perfectly.
 - Practical capacity allows for normal occurrences such as machine downtime and employee fatigue or illness.
- Important questions for the managerial accounting system to address are:
 - What is an organization's *practical capacity*?
 - What are the costs of the *resources supplied* to provide that capacity?
 - How have those *resources* been *used* in creating value? (And, therefore, what is the unused capacity and how is it managed?)
- The vast trove of data that is generated in an organization, together with the data it can acquire to supplement and provide context for its internal

data, is often referred to as **big data**. While presenting organizations with the opportunity to improve their operations, big data also brings big challenges.

VIII. Managerial Accounting as a Career

- The Institute of Management Accountants (IMA) administers the **Certified Management Accountant (CMA)** program. Students interested in internal accounting rather than employment in a public accounting firm may wish to pursue this designation.

IX. Managerial Accounting and the Ethical Climate of Business

- There is a fairly long history of corporate scandals that have involved mismanagement, alleged ethical lapses, and criminal behavior. Causes of these scandals were attributable to:
 - Greedy corporate executives, managers who made over-reaching business deals, and a lack of oversight by boards of directors and audit committees.
 - Substandard work by external auditors, a lack of sufficient probing by Wall Street analysts and the financial press, and pressure to meet market expectations.
- Managers must learn to identify requests or opportunities that cross ethical boundaries and decide how they will respond to such issues *before* they occur.
- Various reforms have been implemented to remedy deficiencies in corporate governance and accounting. For example, after the notorious Enron scandal, in 2002 the Sarbanes-Oxley Act was passed. Its impact has been significant. It both:
 - Created the Public Company Accounting Oversight Board (PCAOB) to establish auditing standards and provide for an audit quality review process, and
 - Limited the types of non-audit work that public accounting firms can perform for their audit clients.
- **Professional ethics** The IMA Statement of Ethical Professional Practice require high standards of conduct from management accountants in the areas of competence, confidentiality, integrity, and credibility.

Teaching Tip: If you plan to highlight ethics throughout the course, you may want to spend extra time in class discussing the *Focus on Ethics* box at the end of this chapter. The box summarizes the standards of conduct just noted by the use of various detailed examples.

Teaching Overview

The main objective of the first two class meetings is to help students understand the overall context in which managerial accounting satisfies the information needs of an enterprise. I urge students to think not only about the discipline in its current form but also how it should evolve to meet the changing needs of organizations. Therefore, the first two classes include not only the usual discussion of the syllabus but also the role of the management accountant in an organization, the differences between financial accounting and managerial accounting, managerial accounting as a tool for managers, and emerging trends in the field. It is especially important to stress the cost-benefit theme, as cost-benefit analysis will surface throughout the course and text.

I also include a discussion of professional certifications in the first class meetings and encourage students to begin thinking about pursuing one or more of them. As we contrast and compare financial and managerial accounting, a rich opportunity presents itself to also compare and contrast certifications such as the CPA and CMA. I often share about my own experience in these areas. Students seem to relate more when they discover that I have worked in the profession. Discussion is often guided by students at that point as they ask questions and relate professional certifications to cost-benefit analysis.

Students have very insightful thoughts on the emerging trends in business today. Therefore, I try to generate some discussion of their ideas early on. (I also want to communicate the need for student participation—not always an easy task if the group is large.) After some discussion, I like to conclude the second class by having the students suggest some accounting information needs that they feel managers have in the current business environment. Their suggestions usually include: how much does my product or service cost? How much inventory should I have on hand? At what point does my business break even? How do I put together a budget? How do I project cash flows? As class ends, I tell students that these are the very issues we will be working on during the semester and that one of our first tasks will be to answer the basic question, "How can we calculate the cost to produce a product or service?" In summary, by the end of the

second class, students should have a basic understanding of managerial accounting's purpose and appreciate the need to study the discipline.

Links to the Text

Homework Grid – CHAPTER 1

<i>Item No.</i>	<i>Learning Objectives</i>	<i>Completion Time (min.)</i>	<i>Special Features*</i>
Exercises:			
1-25	1, 2, 3	25	
1-26	3, 4	20	
1-27	1, 3, 5	30	C
1-28	7, 9		C, G
Problems:			
1-29	5, 6, 8, 9	25	W
1-30	3	45	W
1-31	6, 7, 10, 11	25	E, W
1-32	4, 6, 9, 10	40	E, W
Cases:			
1-33	1, 3, 6, 10, 11	40	E, W

* W = written response E = Ethical issue G = Group work
 I = International C = Internet use