

Student name: _____

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

Who are the primary users of financial accounting information? Who are the primary users of managerial accounting information?

For what activities do an organization's managers need accounting information?

How does the level of aggregation differ between financial accounting information and managerial accounting information?

How do information needs of employees change moving up the organization chart?

Financial accounting information is reported periodically, primarily at the end of each fiscal year. When is managerial accounting information reported to managers of an organization?

What costs are treated as product costs for a manufacturing company?

Discuss the regulation of financial accounting, and compare to the level of regulation of managerial accounting information.

Does the term "cost" mean the same thing as the term "expense?" Explain your answer.

What are period costs? How does the accounting for period costs differ from the accounting for product costs?

Is depreciation on manufacturing equipment expensed in the period incurred? Explain why or why not.

What are indirect costs, and how are the indirect costs incurred to make products accounted for?

What are upstream costs? What upstream costs would be incurred by a company that produces and sells computer software programs?

Is McDonald's a manufacturing company or a service company? How do they record the cost of materials, labor, and overhead?

What inventory holding costs would be incurred by a business that holds a large amount of inventory?

What benefits may result from use of a just-in-time system?

What part do management accountants play in corporate governance?

Discuss three practical implications of misclassifying product and/or period costs.

As a Certified Management Accountant, Steven is bound by the Institute of Management Accountant's Standards of Ethical Conduct. Describe the actions Steven should take when faced with an ethical dilemma at work.

Management accountants have a responsibility to demonstrate integrity. What does this ethical standard require of management accountants?

Management accountants have a responsibility to be objective. What does this ethical standard require of management accountants?

What is the fraud triangle? Which element of the fraud triangle is most closely connected with internal controls?

How does the Sarbanes-Oxley Act of 2002 affect the responsibilities of the managers of publicly held US corporations?

What is a value chain? And what relationship is there between the value chain and activity-based management?

Benchmarking involves the identification of the best practices used by world-class competitors. Discuss the following widely recognized best practices: activity-based management and just-in-time inventory.

Select the term from the list provided that best matches each of the following descriptions. The first is done for you.

Answer	Description	List of terms
4	A. Costs that are incurred after the manufacturing process is complete B. The identification of the best practices used by world-class competitors C. The linked sequence of activities that create value for the customer D. Costs that cannot be easily traced to specific products E. All costs related to obtaining or manufacturing a product intended for sale to customers F. Work that contributes to a product's ability to satisfy customer needs G. The process of dividing a total cost into parts and assigning the parts to relevant cost objects H. The field of accounting that is designed to meet the information needs of external users I. General, selling, and administrative costs that are expensed in the period in which the economic sacrifice is made J. Costs that can easily and conveniently be traced to products	1. Benchmarking 2. Cost allocation 3. Direct costs 4. Downstream costs 5. Financial accounting 6. Indirect costs 7. Period costs 8. Product costs 9. Value-added activity 10. Value chain

Select the term from the list provided that best matches each of the following descriptions. The first is done for you.

Answer	Description	List of terms
4	A. An inventory flow system that minimizes the amount of inventory on hand B. The organization established by the accounting profession to develop accounting standards C. The area of accounting designed to meet information needs of internal users D. The government agency authorized to establish and regulate public company reporting practices E. Assessing the value chain to create new value-added activities F. Tasks that do not contribute to a product's ability to satisfy customer needs G. Costs incurred before the manufacturing process begins H. Concentrates on maximizing the rate at which a system generates money through sales I. The ongoing process through which employees become more effective and learn to work more efficiently J. The term used for the amount of product costs expensed in the current period	1. Continuous improvement 2. Cost of goods sold 3. Financial Accounting Standards Board 4. Just in time 5. Managerial accounting 6. Nonvalue - added activities 7. Throughput 8. Upstream costs 9. Securities and Exchange Commission 10. Activity-based management

Complete the following table to compare and contrast financial and managerial accounting.

Characteristic	Financial Accounting	Managerial Accounting
Users		
Level of aggregation		
Regulation		
Characteristic of information		
Time horizon		
Reporting frequency		

Classify each of the following costs for Harrison Company as a selling or general and administrative period cost or as a direct or indirect product cost by entering the dollar amount(s) in the appropriate column(s):

1. Paid \$75,000 in wages for employees who assemble the company's products.
2. Paid sales commissions of \$58,000.
3. Paid \$38,000 in salaries for factory supervisors.
4. Paid \$88,000 in salaries for executives (president and vice presidents).
5. Recorded depreciation cost of \$25,000. \$13,000 was depreciation on factory equipment and \$12,000 was depreciation on the company headquarters building.
6. Paid \$4,000 for various supplies that it used in the factory (oil and materials used in machine maintenance).
7. Used \$10,000 in prepaid corporate liability insurance.

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The Giga Company produces tablet computers. The following information is provided:

a) Materials used	\$ 216,000
b) Advertising	\$ 40,000
c) Insurance, factory	\$ 20,000
d) Administrative salaries	\$ 50,000
e) Property taxes, factory	\$ 12,000
f) Utilities, administrative building	\$ 22,000
g) Factory labor	\$ 80,000
h) Sales commissions	\$ 56,000
i) Factory supervisor's salary	\$ 60,000
j) Research and development	\$ 18,000
k) Depreciation, factory	\$ 12,000
l) Depreciation, office	\$ 8,000
m) Indirect materials	\$ 14,000

Required:

Classify each of the company's costs as a period cost (general, selling, and administrative cost) or as a direct or indirect product cost. Enter the dollar amount of the cost in the appropriate column. After entering all amounts, calculate the total general, selling, and administrative cost, the total direct product cost, and the total indirect product cost.

Item	Period cost	Direct product cost	Indirect product cost
a)			
b)			
c)			
d)			
e)			
f)			
g)			
h)			
i)			
j)			
k)			
l)			
m)			
Total			

Jarvis Company provided the following information regarding its first year of operations:

Administrative salaries	\$ 60,000
Depreciation on factory equipment	16,000
Indirect materials	4,000
Marketing costs	40,000
Salaries for factory supervisors	28,000
Wages for production workers	80,000
Raw materials used	100,000
Research and development	32,000
Rent on factory building	18,000
Sales revenues	432,000
Sales salaries and other selling costs	56,000
Beginning inventory	0 units
Number of units produced	20,000
Number of units sold	18,000

Required:

Determine the following amounts:

1. (a) Total overhead costs.
2. (b) Total product costs.
3. (c) Product cost per unit.
4. (d) Total cost of ending finished goods inventory.
5. (e) Total cost of goods sold.

Arizona Company provided the following information regarding its most recent year of operations:

Administrative salaries	\$ 24,000
Direct labor	48,000
Direct raw material	80,000
Marketing and distribution costs	60,000
Overheads costs	36,000
Product design and testing	30,000
Research and development	40,000
Sales revenues	410,000
Sales salaries and commissions	54,000
Warranty costs	4,000
Number of units produced	20,000
Number of units sold	20,000

Required:

Determine the following amounts:

1. (a) Total product costs
2. (b) Total upstream costs
3. (c) Total downstream costs
4. (d) Product cost per unit
5. (e) Total cost per unit, including product costs and upstream and downstream costs
6. (f) The selling price per unit that would be required if the company wishes to earn a profit margin equal to 25% of total cost
7. (g) Comment on the company's profitability at its current selling price

Reno Company provided the following information regarding its operations for the month ending September 30:

Administrative costs	\$ 30,000
Depreciation on factory equipment	12,000
Indirect materials	2,000
Marketing and distribution costs	24,000
Salaries for factory supervisors	20,000
Wages for production workers	26,000
Raw materials used	38,000
Sales revenue	196,000
Selling costs	18,000
Utilities for production facilities	8,000
Number of units produced	20,000
Number of units sold	15,000

Required:

1. 1) Compute the firm's total manufacturing overhead cost.
2. 2) Prepare a schedule of inventory costs that shows total product costs, ending inventory, and cost of goods sold.
3. 3) Prepare an income statement for the month ending September 30.

The Szakos Company engaged in the following transactions during the current year:

1. a) Acquired \$50,000 of cash by issuing common stock to owners.
2. b) Paid \$10,000 to acquire manufacturing equipment.
3. c) Paid \$5,000 cash for materials used in production.
4. d) Paid \$2,000 for wages of production workers.
5. e) Paid \$8,000 in general, selling, and administrative costs.
6. f) Recognized \$1,000 of depreciation on the manufacturing equipment.
7. g) Sold inventory for \$18,000 cash.
8. h) The cost of the inventory sold was \$6,500.

Required:

Show the balance sheet and income statement effects of the transactions by completing the financial statement model provided.

B	Income
a	Statement
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C+I	=C+R+R-E=N
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The Carson Company was started at the beginning of the current year when it acquired \$20,000 by issuing common stock to its owners. During the year, the company incurred the following cash costs:

Direct material costs	\$ 10,000
Direct labor costs	8,000
Overhead costs	4,000
Selling and administrative costs	2,000

The company produced 5,000 units of product and sold 4,500 units. The average selling price was \$7.00 per unit. The accountant who prepared the firm's financial statements misclassified the selling and administrative costs as product costs.

Required:

Demonstrate the impact of the error on the company's financial statements by completing the following schedule.

	Scenario 1: With the error	Scenario 2: Without the error
Income Statement:		
Revenue		
Less: Cost of goods sold		
Gross margin		
Less: Selling, general, and administrative expenses		
Net income		
Balance sheet:		
Assets		
Cash		
Inventory		
Total assets		
Stockholders' equity		
Common stock		
Retained earnings		
Total stockholders' equity		

The Jacobson Manufacturing Company was started at the beginning of the current year when it acquired \$200,000 from its owners. During the year, the company incurred the following costs, all for cash:

Direct material costs	\$ 80,000
Direct labor costs	100,000
Overhead costs	40,000
Selling and administrative costs	60,000

The company produced 10,000 units of product and sold 8,000 units. The average selling price was \$34.00 per unit; all sales were for cash. The accountant who prepared the firm's financial statements misclassified the selling and administrative costs as product costs.

Required:

Demonstrate the impact of the error on the company's income statement and balance sheet by completing the following schedule:

	Scenario 1: With the error	Scenario 2: Without the error
Income Statement:		
Revenue		
Less: Cost of goods sold		
Gross margin		
Less: Selling, general, and administrative expenses		
Net income		
Balance sheet:		
Assets		
Cash		
Inventory		
Total assets		
Stockholders' equity		
Common stock		
Retained earnings		
Total stockholders' equity		

Answer Key

Test name: ch1 Fundamental Managerial e10

Essay

Answers will vary.

Financial accounting information is used primarily by investors, creditors, and others who are outside a business. Managerial accounting information focuses on information users who are inside the business, including its managers and other employees.

Essay

Answers will vary.

Managers of an organization use accounting and other information to plan, direct, and control business operations.

Essay

Answers will vary.

Most financial accounting information is prepared for the organization as a whole, so the level of aggregation is high. Most managerial accounting information is prepared for subunits of the company (departments, sales territories, etc.), so the level of aggregation is lower than for financial accounting.

Essay

Answers will vary.

Lower-level employees use primarily nonfinancial information, such as schedules and company policies. Moving up the organization, there is an increasing need for and use of financial information about the company or segments of the company. The top-level managers also use more information from outside the company, such as information about general economic conditions.

Essay

Answers will vary.

Managerial accounting information is reported as needed, much more often than financial accounting. Managerial accounting information is delivered on a continuous basis.

Essay

Answers will vary.

Product costs for a manufacturing company include the costs associated with making the products, specifically, materials, labor and overhead.

Essay

Answers will vary.

The financial accounting information prepared by a company is governed by accounting standards (generally accepted accounting principles), most of which have been established by the Financial Accounting Standards Board (FASB). The Securities and Exchange Commission has authority to set these standards, but it has generally deferred to FASB. In comparison, the practice of managerial accounting is unregulated. The information is not made available to the public, so managerial accounting is limited only by the value-added principle: the cost of preparing the information should not exceed the benefits to be received from using the information.

Essay

Answers will vary.

The term "cost" can be used to refer to an expense or an asset. For example, wages paid to production workers are recorded in an inventory account, so they are treated as an asset and part of the cost of goods that the company has produced. The cost of the goods (including the amount spent for wages) becomes an expense when the related goods are sold.

Essay

Answers will vary.

Period costs include general, selling, and administrative costs. Period costs are expensed in the period they are incurred. In contrast, product costs are initially recorded as assets, and become expenses in the period that the related goods are sold.

Essay

Answers will vary.

Depreciation on manufacturing equipment is a product cost. Therefore, it is expensed when the products are sold. Depreciation on manufacturing equipment is initially recorded in an asset account.

Essay

Answers will vary.

Indirect costs are costs that cannot be traced to products and services in a cost-effective manner. These costs are initially recorded in a Manufacturing Overhead account, then they are allocated to the products that the company has produced.

Essay

Answers will vary.

Upstream costs are incurred before a company begins manufacturing a product. For a company producing computer software, upstream costs would include research and development for the product itself and market research.

Essay

Answers will vary.

McDonald's and other restaurants are considered to be service companies because their product is consumed immediately. Even though McDonald's has costs related to materials, labor, and overhead, these costs are recorded as expenses.

Essay

Answers will vary

Inventory holding costs include storage costs, theft, damage, obsolescence, and financing costs. In addition, a company with a large amount of inventory may experience diminished motivation and sloppy work by its employees and increased production time.

Essay

Answers will vary.

A just-in-time system reduces the amount of inventory that a business holds. Therefore, the inventory holding costs (theft, obsolescence, damage, financing costs, warehousing costs, and others) will be reduced. Inventory holding costs are non-value-added costs that a business should seek to reduce. Additionally, a just-in-time system may improve the flow of products to customers and may actually improve customer satisfaction.

Essay

Answers will vary.

Management accountants are the guardians of the information used to report on the financial condition of their companies. They prepare and analyze the information used by the board of directors and management to formulate the company's strategy. As such, they constitute the "intelligence" function of corporate governance.

Essay

Answers will vary.

The temporary effects on the financial statements can have important implications with respect to the

1. (1) availability of financing,
2. (2) motivations of management, and
3. (3) payment of income taxes.

When period costs are misclassified as product costs, net income of the period will be higher than it should be, assuming that production exceeds sales. This might influence a lender's decision to extend credit to the firm. If managers are paid a bonus based on some measure of income, managers may be tempted to misclassify period costs as product costs in those periods when production exceeds sales. Finally, if a firm misclassifies product costs as period costs in a period of increasing inventory levels, net income will be lower than it should be, resulting in lower income taxes than should be the case.

Essay

Answers will vary.

Steven should first identify the ethical issues involved. He should consider the consequences of not pursuing the issue (i.e., the consequences of possible violations of the code of ethics). If he decides to pursue the issue, he should discuss the matter with his immediate superior unless he believes that the superior is involved. In that case, he should discuss the matter at the next higher level. He should continue in this way until the matter is resolved. If the matter goes all the way to the company's board of directors and is still not resolved, Steven may have to consider resigning. It would not be appropriate for Steven to contact outside parties unless required by law.

Essay

Answers will vary.

The integrity standard requires management accountants to avoid conflicts of interest; refrain from any activity that would limit their ability to carry out their duties ethically; refuse any gift or favor that would appear to influence their actions; avoid subverting the attainment of the organization's legitimate objectives; communicate professional limitations that would prevent successful performance of an activity; communicate both favorable and unfavorable information and professional judgments; and avoid any activity that would discredit the profession.

Essay

Answers will vary.

This standard requires accountants to communicate information fairly and objectively and to disclose fully all relevant information that could influence a user's understanding of reports and recommendations.

Essay

Answers will vary.

The fraud triangle describes the three elements typically present when fraud occurs. They are: the availability of an opportunity, the existence of some form of pressure leading to an incentive, and the capacity to rationalize. Opportunity is the one element of the fraud triangle most easily controlled by the company through a system of internal controls.

Essay

Answers will vary.

Under the terms of the Act, the chief executive officer and chief financial officer are responsible for development and enforcement of a strong set of internal controls. The company must report on the effectiveness of its internal controls. The CEO and CFO have ultimate responsibility for the accuracy of the company's financial statements. They must certify that, to their knowledge, the financial statements do not include False information or omit information that would be material. The managers of the company are required to establish a code of ethics and to report on the code of ethics in the 10K annual report filed with the Securities and Exchange Commission. Managers are also required to provide mechanisms for anonymous reporting of fraud within the company (to protect a potential whistleblower).

Essay

Answers will vary.

The value chain is the sequence of activities a company uses to provide products or services to its customers. Under activity-based management, a company examines its value chain, seeking to create and maintain value-added activities and to eliminate non-value-added activities.

Essay

Answers will vary.

Many companies have come to the conclusion that activities drive costs. To control or lower costs, companies must focus on activities. Activity-based management seeks to manage the value chain in order to create new or refine existing value-added activities. A value chain is the sequence of activities through which an organization provides products and services to its customers. A value-added activity is an activity that customers are willing to pay for. Companies should try to reduce or eliminate non-value-added activities. Just-in-time inventory seeks to reduce inventory holding costs and other hidden inventory-related costs such as diminished motivation, sloppy work, and increased production time. In a JIT manufacturer, no units are produced until customer orders are received.

Essay

Answer	Description	List of terms
4	A. Costs that are incurred after the manufacturing process is complete	1. Benchmarking
1	B. The identification of the best practices used by world-class competitors	2. Cost allocation
10	C. The linked sequence of activities that create value for the customer	3. Direct costs
6	D. Costs that cannot be easily traced to specific products	4. Downstream costs
8	E. All costs related to obtaining or manufacturing a product intended for sale to customers	5. Financial accounting
9	F. Work that contributes to a product's ability to satisfy customer needs	6. Indirect costs
2	G. The process of dividing a total cost into parts and assigning the parts to relevant cost objects	7. Period costs
5	H. The field of accounting that is designed to meet the information needs of external users	8. Product costs
7	I. General, selling, and administrative costs that are expensed in the period in which the economic sacrifice is made	9. Value-added activity
3	J. Costs that can easily and conveniently be traced to products	10. Value chain

Essay

Answer	Description	List of terms
4	A. An inventory flow system that minimizes the amount of inventory on hand	1. Continuous improvement
3	B. The organization established by the accounting profession to develop accounting standards	2. Cost of goods sold
5	C. The area of accounting designed to meet information needs of internal users	3. Financial Accounting Standards Board
9	D. The government agency authorized to establish and regulate public company reporting practices	4. Just in time
10	E. Assessing the value chain to create new value-added activities	5. Managerial accounting
6	F. Tasks that do not contribute to a product's ability to satisfy customer needs	6. Nonvalue - added activities
8	G. Costs incurred before the manufacturing process begins	7. Throughput
7	H. Concentrates on maximizing the rate at which a system generates money through sales	8. Upstream costs
1	I. The ongoing process through which employees become more effective and learn to work more efficiently	9. Securities and Exchange Commission
2	J. The term used for the amount of product costs expensed in the current period	10. Activity-based management

Essay

	Financial Accounting	Managerial Accounting
Characteristic Users	External (including investors and creditors)	Internal (managers of the organization)
Level of aggregation	Highly aggregated (looks at the organization as a whole)	Disaggregated (focuses on the entity's parts)
Regulation	Regulated by SEC and FASB	Unregulated
Characteristic of information	Financial information, characterized by objectivity and reliability	Financial and nonfinancial information; characterized by relevance and timeliness
Time horizon	Historically based	Oriented to the present and future
Reporting frequency	Periodically, with emphasis on annual and quarterly reports	Continuous reporting

Essay

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Product costs are all costs incurred to obtain a product or provide a service. Period costs are all costs not associated with a product. They are associated with the general, selling, and administrative functions of the business. Wages of workers that assemble the products are a direct, product cost. Sales commissions are a period cost (selling cost). Salaries for factory supervisors are an indirect, product cost. Salaries for executives (president and vice presidents) are a period cost (general and administrative). Depreciation on factory equipment is an indirect, product cost. Depreciation on the company headquarters building is a period cost (general and administrative). Supplies used in the factory (oil and materials used in the machine maintenance) is an indirect, product cost. Corporate liability insurance is a period cost (general and administrative).

Essay

Item	Period cost	Direct product cost	Indirect product cost
a)		\$ 216,000	
b)	\$ 40,000		
c)			\$ 20,000
d)	50,000		
e)			12,000
f)	22,000		
g)		80,000	
h)	56,000		
i)			60,000
j)	18,000		
k)			12,000
l)	8,000		
m)			14,000
Total	\$ 194,000	\$ 296,000	\$ 118,000

Product costs are all costs incurred to obtain a product or provide a service. An indirect product cost cannot be easily or economically traced to a specific product. Period costs are all costs not associated with a product. They are associated with the general, selling, and administrative functions of the business. Materials used and factory labor are direct, product cost. Insurance factory, property taxes factory, factory supervisory salary, depreciation factory, and indirect materials are indirect, product costs. Advertising, administrative salaries, utilities administrative building, sales commissions, research and development, and depreciation office are period costs.

Essay

1. (a) Overhead costs:

Depreciation on factory equipment	\$ 16,000
Indirect materials	4,000
Salaries for factory supervisors	28,000
Rent on factory building	18,000
Total overhead	\$ 66,000
2. (b) Product costs:

Raw materials used	\$ 100,000
Wages for production workers	80,000
Overhead costs	66,000
Total product costs	\$ 246,000
3. (c) Product cost per unit: Total product costs ÷ units produced = \$246,000 ÷ 20,000 = \$12.30 per unit
4. (d) Total cost of ending finished goods inventory: 2,000 units in ending inventory (20,000 units produced – 18,000 units sold) times \$12.30 cost per unit = \$24,600
5. (e) Cost of goods sold: 18,000 units sold times \$12.30 cost per unit = \$221,400

Essay

1. (a) Overhead costs:

Depreciation on factory equipment	\$ 16,000
Indirect materials	4,000
Salaries for factory supervisors	28,000
Rent on factory building	18,000
Total overhead	\$ 66,000
2. (b) Product costs:

Raw materials used	\$ 100,000
Wages for production workers	80,000
Overhead costs	66,000
Total product costs	\$ 246,000
3. (c) Product cost per unit: Total product costs ÷ units produced = \$246,000 ÷ 20,000 = \$12.30 per unit
4. (d) Total cost of ending finished goods inventory: 2,000 units in ending inventory (20,000 units produced – 18,000 units sold) times \$12.30 cost per unit = \$24,600
5. (e) Cost of goods sold: 18,000 units sold times \$12.30 cost per unit = \$221,400

Essay

1. 1) Total manufacturing overhead cost:

Depreciation on factory equipment	\$ 12,000
Indirect materials	2,000
Salaries for factory supervisors	20,000
Utilities for production facilities	8,000
Total overhead cost	<u>\$ 42,000</u>

2. 2) Schedule of inventory costs:

Raw materials used	\$ 38,000
Wages for production workers	26,000
Manufacturing overhead cost	42,000
Total product costs	<u>\$ 106,000</u>
Less: Cost of goods sold 15,000 units × \$ 106,000 ÷ 20,000	79,500
Ending inventory balance	<u>\$ 26,500</u>

3. 3) Income statement: