Chapter 1

Introduction to Managerial Accounting

LEARNING OBJECTIVES:

When your students have finished studying this chapter, they should be able to:

1. Identify managers' four primary responsibilities.
2. Distinguish financial accounting from managerial accounting.
3. Describe organizational structure and the roles and skills required of management accountants within the organization.
4. Describe the role of CPA Canada and apply its guidelines for ethical behavior.
5. Discuss and analyze the implications of regulatory and business trends.
6. Describe a lean production system.
7. Describe and use the costs of quality framework.

OVERVIEW

This chapter provides an overview of the focus of management accounting and its role in organizations.

Section One: The chapter introduces managerial accounting along with the fundamental principle of the text, which is the importance of using managerial accounting data in decision-making. Students are introduced to the importance of cost of goods sold and decision-making by discussing the primary responsibilities of a managerial accountant: planning, directing, controlling, and decision-making.

Section Two: To help students understand the managerial accounting focus, financial and managerial accounting are contrasted and compared. Managerial accounting has internal users relying on relevant information prepared specifically for management's needs and financial accounting has external users using reliable and objective information in the form of financial statements.

Section Three: The importance of using managerial accounting for decision-making is illustrated through the presentation of organizational structures and the roles and skills required of management accountants. In addition to their traditional costing and reporting roles, management accountants also play an important role in developing budgets that influence the organization's culture and strategy.

Section Four: The importance of ethics is underscored. Ethical dilemmas are discussed and the Code of Professional Ethics for Management Accountants is outlined. This section also looks at Management accountants' professional associations. Professional accountants are now represented by the Chartered Professional Accountants of Canada (CPA Canada) in addition to the provincial associations (eg CPA Ontario). The three legacy accounting bodies in Canada are also discussed.

Section Five: The next section of the chapter presents the implications of regulatory and business trends. These include the Sarbanes-Oxley Act of 2002, IFRS, XBRL, the shift towards a service economy, competition in the global marketplace, sustainability and social responsibility, time-based competition, advanced information systems, and e-commerce.

Section Six: Traditional production systems are compared to lean production systems. The advantages and drawbacks of lean production are discussed and the concept of just-in-time inventories is introduced. Total quality management is presented as a key to succeeding in the global economy and ISO 9001:2008 is also discussed. Differences between traditional and lean production systems are presented including the differences in equipment arrangement between the two systems.

Section Seven: The chapter concludes with a discussion of the costs of quality framework and the four costs of quality: prevention, appraisal, internal failure, and external failure costs. This framework is used to aid managers in their decision making

CHAPTER 1: OUTLINE

1. Identify managers' four primary responsibilities {LO 1}

Management accounting can be described as the process of identifying, measuring, accumulating, analyzing, preparing, interpreting, and communicating information that helps managers fulfill organizational objectives.

Management accounting can be further divided into processes of planning and control. **Planning** entails setting objectives and specifying how those objectives will be attained. **Controlling** entails implementing plans and using feedback to attain objectives.

The management accountant's role can be broken down into the following activities:

1. **Planning:** This involves setting goals and objectives for the company and determining how to achieve them. This aspect quantifies the likely results of possible courses of action and often recommends the best course of action to follow. Problem-solving is especially important for long-range planning and special decisions. Managerial accounting translates plans into budgets to determine if plans make financial sense.

2. **Directing**: This means overseeing the day-to-day operations of a company. Involves the reporting and interpreting of information that helps managers focus on operational problems, imperfections, inefficiencies and opportunities. Management uses product cost reports, product sales information, and other managerial reports to run daily business operations.

3. **Controlling**: This means evaluating the results of business operations against the plan and making adjustments to meet its goals. Scorekeeping enables both internal and external parties to evaluate the organization's performance and position.

4. **Decision Making:** is central to all of the above activities. Managerial accounting gathers, summarizes, and reports cost and revenue data relevant to the decisions being made in the planning, directing and controlling phases.

TEACHING TIPS {LO1}

TIP #1 **Exhibit 1-1** highlights Managers Four Primary Responsibilities. Instructor may want to draw this table on the board (or show on PPT) and then discuss and write the main points of each type of responsibility.

TIP #2: After covering managers' four primary responsibilities, consider offering the following example:
A manager may wish to expand a company's custodial service from only cleaning private homes to also cleaning corporate offices and plants. This goal is then developed into a budget (planning). That budget is analyzed thoroughly to determine both the price points and how to market the service (directing). After comparing the budget to the actual results, the managerial accountant determines that the expansion into the new market is somewhat slower than expected and decides to change its marketing strategy (controlling). Decision-making is the fourth

responsibility and occurs at all levels of the process. For example, if the marketing strategy works and the corporation proceeds toward meeting its goals, the managerial accountant focuses attention on which new services will be offered, how much to charge for the services, and if loyalty discounts should be given to existing customers who purchase these services (decision-making).

TIP#3 In teams or in partners, have students complete **E1-26B Managers' Responsibilities,** which should take about five minutes. Call on a student to give the answers.

2. Distinguish Financial Accounting from Managerial Accounting {LO 2}

At this point, the accounting student has most likely only been exposed to financial accounting. Students sometimes have a difficult time making the adjustment from financial to managerial accounting.

This is a great time to review the role of financial accountants in our society and then explain the role of management accountants. In doing so, be sure to also point out some of the similarities between financial and management accounting, as this will help students understand that their study of management accounting focuses on external decision-makers, whereas managerial accounting focuses on internal decision-makers.

TEACHING TIPS: {LO 2}

TIP #1: Use Exhibit 1-2 to emphasize the differences between financial and managerial accounting. Consider presenting the following summarized version of the chart:

	Managerial Accounting	**Financial Accounting**
Users	Internal (e.g. managers)	External (e.g. banks)
Purpose	To assist in management decision making	To help external users make investing and lending decisions
Primary Accounting Product	Any internal accounting report worthwhile by management	Financial Statements
Content/Format	Management determines what is needed in report and how it is formatted	Standards (IFRS, ASPE) must be followed
Focus	Future-oriented	Historical basis
Emphasis	Relevant Data	Reliable and Objective Data
Business unit	Segmented Information	Company as a whole
Frequency of Reports	Dependent on management's needs	Annually and quarterly
Audit requirement	Not required	Independent certified public accountants audit required
Information required by outside group	No	Yes. Each province has its own security commissions that require companies to issue audited financial statements

Employee Behavioural Implications Considered	Carefully Considered	First concern is adequacy and disclosure; behavioural implications are secondary.

TIP#2: Use the following example: A manager is setting the price of items in the store. In order to make this decision, the manager needs to know the cost of the items, the other organizational costs, the sales prices for other similar items, etc. Of course, these matters are of great importance to an internal management accountant. An external accountant would not make the same decisions; instead, he/she would make decisions based on information contained in the financial statements.

TIP #3: Have students complete **E1-28B Identify users of accounting information** (10 minutes). Point out that most decisions impact non-accountants and stress the importance for non-accounting majors to understand managerial accounting.

3. Describe Organizational Structure and the Roles and Skills Required of Management Accountants within the Organization {LO 3}

Describes the levels of the organization, starting with the highest level, the Board of Directors.

Role	Responsibility
Board of Directors	Elected by shareholders to oversee the company
Chief Executive Officer	Manages company on a daily basis.
Chief Financial Officer	All the company's financial concerns
Chief Operating Officer	The company's operations, such as R&D, production and distribution
Treasurer	Raising capital (through issuing stocks and bonds) and investing funds.
Controller	General financial accounting, managerial accounting and tax reporting
Internal Audit Function	To ensure that the company's internal controls and risk management policies are functioning properly
Audit Committee	Oversees the internal audit department. Internal audit department and Independent auditors report directly to the audit committee.
Management Accountants	Act as internal business advisors. They provide the financial information and in-depth analysis that managers need to make good business decisions.

Management accountants needs the following skills:

- Solid knowledge of both financial and managerial accounting
- Problem-solving and decision making skills
- Knowledge of how a business functions
- Ability to lead and to work on a team
- Professionalism and ethical standards
- Oral and written communication skills

TEACHING TIPS: {LO3}

Tip #1: **Exhibit 1-3** depicts the Typical Organization Structure
Tip #2: **Use Exhibit 1-4** to discuss The Skills Required of Management Accountants

4. Describe the Role of CPA Canada and apply its guidelines for ethical behaviour {LO 4}

Professional accountants in Canada are represented by the Chartered Professional Accountants of Canada (CPA Canada) in addition to provincial accounting associations (e.g. CPA Ontario).

Prior to the unification process, which began in 2013, there were three professional accounting designations in Canada. The purpose of unification was to bring strength of training, knowledge and practice in one accounting body which is now the CPA. There are three legacy professional accounting organizations in Canada. The **Canadian Institute of Chartered Accountants (CICA)** which regulated **Chartered Accountants (CA).** The **Society of Management Accountants of Canada**, governed Certified Management Accountants (CMAs). The **Certified General Accountants Association of Canada** awarded members the **CGA (Certified General Accountant)** designation.

In addition to preparing you for a position in an accounting department, studying accounting, and working as a management accountant, can prepare you for the very highest levels of management, such as CEO.

A. Standards of ethical conduct

A summary of CPA Guidelines for Ethical Behaviour in **Exhibit 1-5** includes:

- Adhering to Rules of Professional Conduct
- Enabling Competencies
- Assessing the Situation
- Integrative Analysis
- Conclude/Advise/Communicate

Standards of ethical conduct have been adopted by professional accounting organizations because of the reliance by so many parties on the product of accountants. See **page 12** for the **CPA Canada Principles of Ethical Conduct** which includes:

- Professional Behaviour
- Integrity and Due Care
- Professional Competence
- Confidentiality
- Objectivity

B. Ethical dilemmas

Competing obligations to shareholders, customers, suppliers, fellow managers, society, and self and family create ethical dilemmas for management accountants. Many companies have formal codes of ethical conduct that must be signed by employees. However, ethical standards are personal and depend on the values of the individual. Four ethical dilemmas are provided in the textbook (pages 11-12)

TEACHING TIPS: {LO4}

TIP #1: Many students love to discuss ethical issues. Sometimes students may have ethical issues presented to them in a casual way.

Example: A supervisor requests that you don't record your overtime on your timesheet. This will allow the supervisor to stay within the budget, but it doesn't properly reflect what is happening within the organization. You feel pressure from the supervisor. Ask students what ethical issues are involved in this example.

Ask students how many of them were left unsupervised when they first started a new job. How accurate was their work? Would the students feel responsible for making an error if they had been properly trained?

TIP #2: Ask students to assume they work for a company. In this scenario, they will have heard that their company is being sold. The information is confidential, and they can't speak about it. What would they do if their best friend wanted to buy stock?

TIP #3: use **E1-31B Ethical dilemma** (5 minutes) as a group or partner exercise.

5. Discuss and Analyze the Implications of Regulatory and Business Trends {LO 5}

1. **Sarbanes-Oxley Act of 2002:**

   Teaching Tip: Remember that many of today's students probably don't remember businesses before accounting scandals. Students have likely become cynical about accounting practices based on news media. Ask students to identify what would give them confidence in the accounting decisions of an organization.

2. **International Financial Reporting Standards (IFRS):**

   Teaching Tip: students may be familiar with GAAP depending on when they took their financial course. Explain the impact of globalization and how it created a need for consistent reporting standards. In Canada, the adoption of IFRS for public companies took place in 2011. The securities commissions of many countries have recently moved to adopt IFRS for all publicly traded companies.

3. **Extensible Business Reporting Language (XBRL):**

   Teaching Tip: consider presenting advantages of XBRL in chart format. XBRL allows companies to release financial and business information in a format that can be more easily analysed by different users.

4. **Shifting Economy:**

   Teaching Tip: ask students if they think Apple manufactures its own headphones or if they are manufactured by an outside company. Ask them what information might be part of Apple's decision: How much it would cost Apple

to make the headphones? How much would it cost to have someone else make them? If someone else made them, could that manufacturing space be used for additional funds?
Globalization has several implications for managerial accounting:
-stiffer competition which requires more accurate and timely information
-should companies expand sales and/or production into foreign countries?
-new management techniques by observing their international competitors.

5. Social Responsibility and the Triple Bottom Line

Sustainability – ability to meet the needs of the present without compromising the ability of future generations to meet their own needs.

Triple Bottom Line – company's performance should not only be viewed in terms of its ability to generate economic profit for its owners, but also by its impact on people and the planet.

Sustainability has three factors: profit, people, planet.

Green initiatives (environmental responsibility) – companies are finding ways of doing business that have fewer negative consequences for the earth's resources.

6. Integrated Reporting

An integrative report is a concise communication about how an organization's strategy, governance, performance and prospects lead to value creation. The report not only looks at financial capital; it also looks at manufactured, intellectual, human, social and environmental capital.

7. Tools for Time-Based Competition

Teaching Tip: Ask students about things that have changed in business that saves time for consumers (eg self checkout at grocery stores). Ask them if self check out actually does save time.

8. E-Commerce:

Teaching Tip: In order to survive in a competitive, globally wired economy, companies use the internet in budgeting, planning, selling and customer service. Discuss with the students how e-commerce is an important means of **supply-chain management.** Ask how many students bought their textbooks online. Why/why not?

6. Describe a Lean Production System {LO 6}

Traditional Production Systems ("push systems"): once the production schedule has been determined, products are pushed through the manufacturing process and then stored in finished goods inventory until sold.

Lean Production: primary goal is to eliminate the waste of time and money that accompanies large inventories. Lean companies adopt a **just-in-time (JIT) inventory system** where materials are purchased just in time to be used in production and finished goods are made just in time for customer delivery.

JIT is a demand-pull system where raw materials are ordered when the customer places the order. Then, small batches of product are made quickly to meet the customer needs. The quick production and low inventory maintained in a JIT system requires a quality product be produced in order to have the product reach the customer in a timely manner.

Companies that adopt lean production have several common characteristics that help minimize the amount of inventory on hand yet enable the company to meet customer needs. Characteristics include:

1. Production occurs in self-contained cells
2. Broad employee roles
3. Small batches produced just in time
4. Shortened set-up times
5. Shortened manufacturing cycle times
6. Emphasis on quality
7. Supply-chain management

While there are many advantages to a lean production system, companies leave themselves vulnerable as there are no inventory buffers. If their supplier runs out of raw materials, the company will not be able to meet their production needs.

TEACHING TIPS:

TIP#1: JIT management is easily illustrated by using milk as an example. If a company bought more milk than the space allowed on a store shelf, where would it be kept? Can it be kept cold? Is it worth paying for the refrigeration? How long can it be held to keep it fresh? JIT is more economical if the store does not buy large quantities of milk, but instead buys small amounts of milk more often.

TIP #2: Use **Exhibit 1-8** to demonstrate the differences between a traditional and Just-In-Time system.

TIP #3: Use **Exhibit 1-9** to demonstrate the equipment arrangement in Traditional and Lean Production Systems.

TIP #4: Have students complete **E1-35B** Lean Production Cost-Benefit Analysis (5 minutes) in teams or partners.

TIP #5: Have students complete **E1-36B** Differentiate between Traditional and Lean Production (5 minutes) in teams or partners.

7. Describe and use the Costs of Quality Framework {LO 7}

Lean companies strive for high-quality production as the system only produces what is needed. As such, companies implement total quality management (TQM). The goal of TQM is to provide customers with superior products and services.

As part of TQM, companies prepare Cost of Quality Reports. These reports categorize and list the costs incurred by the company related to quality. Quality related costs fall into four categories:

1. Prevention costs – costs incurred to avoid producing poor quality goods or services.
2. Appraisal costs – costs incurred to detect poor quality goods or services.
3. Internal failure costs – costs incurred on defective units before delivery to customers.
4. External failure costs – costs incurred because the defective goods or services are not detected until after delivery to customers.

TEACHING TIPS {LO7}

TIP #1: Make it clear to students that the goal of total quality management (TQM) is to provide customers with superior products and services. This is accomplished by each business function in the value chain examining its own activities, improving quality, and eliminating defects and waste.

TIP #2: Students can better understand the benefits of TQM if they understand that the quality costs and benefits are hard to measure. Explain to student that the biggest benefit of TQM is the reduction of unhappy customers who would never return. Unhappy customers do not appear directly in the accounting records, so TQM programs emphasize nonfinancial measures such as the number of customer complaints.

TIP #3: Use **EXHIBIT 1-10** to provide examples of the four types of quality costs (prevention costs, appraisal costs, internal failure costs, external failure costs).

TIP #4: Have students complete **E1-37B Prepare a Cost of Quality Report** (15 minutes).

CHAPTER 1: STUDENT SUMMARY HANDOUT

1. Managers' four primary responsibilities
    a. Planning
    b. Directing
    c. Controlling
    d. Decision-Making

2. Differences between Financial Accounting and Managerial Accounting

3. Organizational structure and how management accountants fit in
    a. Changing roles
    b. Skills required

4. The CPA and ethical guidelines
    a. Professional Behaviour
    b. Integrity and Due Care
    c. Competence
    d. Confidentiality
    e. Objectivity

5. Regulatory and business trends
    a. Competition in today's global marketplace

6. Describe a lean production system.

7. Describe and use the costs of quality framework.

CHAPTER 1: ASSIGNMENT GRID

Assignment	Topic(s)	Learning Objective(s)	Estimated Time in Minutes	Level of Difficulty	Available in Excel Templates
Short					
S1-1	Roles of managers	1	5	Easy	
S1-2	Contrast managerial and financial accounting	2	5	Easy	
S1-3	Accounting roles in the organization	3	5	Easy	
S1-4	Role of internal audit function	3	5	Easy	
S1-5	Importance of ethical standards	4	5	Easy	
S1-6	Violations of ethical standards	4	5	Easy	
S1-7	Identify current competitive tools	5	5	Easy	
S1-8	Understand key terms	6 & 7	5	Easy	
S1-9	Identify lean production characteristics	6	5	Easy	
S1-10	Classify costs of quality	7	5	Easy	
S1-11	Quality initiative decisions	7	10	Medium	
S1-12	Categorize different costs of quality	7	5	Easy	
Exercises (Set A)					
E1-13A	Manager's responsibilities	1	5	Easy	X
E1-14A	Define key terms	1 & 2	5	Easy	
E1-15A	Identify users of accounting Information	3	10	Easy	
E1-16A	Classify roles within the Organization	3	5	Easy	
E1-17A	Professional organization and certification	4	5	Easy	
E1-18A	Ethical dilemma	4	5	Medium	
E1-19A	Classify ethical Responsibilities	4	10	Medium	
E1-20A	Define key terms	5	10	Medium	
E1-21A	Summarize the Sarbanes-Oxley Act	5	10	Medium	
E1-22A	Lean production cost-benefit Analysis	6	10	Medium	
E1-23A	Differentiate between traditional and lean production	6	10	Medium	
E1-24A	Prepare a Cost of Quality Report	7	30	Difficult	

E1-25A	Classify costs and make a quality-initiative decision	7	15	Medium	
Exercises (Set B)					
E1-26B	Manager's responsibilities	1	5	Easy	
E1-27B	Define key terms	1 & 2	5	Easy	
E1-28B	Identify users of accounting Information	3	10	Easy	X
E1-29B	Classify roles within the Organization	3	5	Easy	
E1-30B	Professional organization and certification	4	5	Easy	
E1-31B	Ethical dilemma	4	5	Medium	
E1-32B	Classify ethical responsibilities	4	10	Medium	
E1-33B	Define key terms	5	10	Medium	
E1-34B	Summarize the Sarbanes-Oxley Act	5	10	Medium	
E1-35B	Lean production cost-benefit Analysis	6	10	Medium	
E1-36B	Differentiate between traditional and lean production	6	10	Medium	
E1-37B	Prepare a Cost of Quality Report	7	30	Difficult	
E1-38B	Classify cost and make a quality-initiative decision	7	15	Medium	
Problems (Set A)					
P1-39A	Management processes and accounting	1 & 2	15	Medium	
P1-40A	Ethical dilemmas	4	10	Medium	
P1-41A	ERP, cost-benefit analysis	5	20	Medium	
P1-42A	E-commerce cost-benefit Analysis	5	10	Medium	X
P1-43A	Continuation of P1-42A: revised estimates	5	15	Difficult	
Problems (Set B)					
P1-44B	Management processes and accounting information	1 & 2	15	Medium	
P1-45B	Ethical dilemmas	4	10	Medium	
P1-46B	ERP cost-benefit analysis	5	20	Medium	X
P1-47B	E-commerce cost-benefit Analysis	5	10	Medium	
P1-48B	Continuation of P1-47B: revised estimates	5	15	Difficult	
Other					

Serial Case	Discuss how managerial accounting can be used at Casino Halifax	1,2,3,4, & 5	15	Medium	
Application A1-49	Ethical standards	4	5	Easy	
Ethical Issue I1-50	Ethical dilemma	4	10	Medium	
Team Project T1-51	Interviewing a local company about ecommerce	5	60	Difficult	
Discussion and Analysis		All	60	Medium	
Application and Analysis 1-1	Accountants and Their Jobs	1,2, & 3	15	Easy	
Application and Analysis 1-2	Ethics at Enron	All	30-60	Medium	

Name

Date

Section

CHAPTER 1
TEN-MINUTE QUIZ

Circle the letter of the best response.

1. Which of the following are a manager's four primary responsibilities?
   A. Budgeting, Directing, Controlling, Decision-Making
   B. Budgeting, Planning, Controlling, Decision-Making
   C. Planning, Directing, Controlling, Decision-Making
   D. Budgeting, Planning, Directing, Controlling

2. Which of the following is an example of controlling?
   A. Management decides to open a new storage facility in Canada.
   B. After comparing budget to actual, management adjusts its plan to keep the company on goal.
   C. After reviewing the daily sales, management revises its staffing schedule.
   D. Management sets goals to meet in the next fiscal year.

3. Which of the following is TRUE about managerial accounting vs. financial accounting?
   A. Both managerial and financial reports are prepared quarterly and annually.
   B. Managerial accounting is primarily utilized by internal users, while financial accounting is primarily utilized by external users.
   C. The primary information characteristics for managerial accounting are reliability and objectivity, while the primary information characteristic for financial accounting is relevance.
   D. The CPA requires managerial accounting reports and the SEC requires financial accounting reports.

4. Which of the following statements is FALSE?
   A. Managers are concerned with the internal use of accounting information.
   B. Managerial accounting information relies heavily on its reliability and objectivity.
   C. Managerial accounting reports are not required by any authoritative body.
   D. Managerial accounting information must be relevant.

5. Which of the following statements is FALSE?
   A. The treasurer and controller report directly to the CFO.
   B. The COO is responsible for the company's operations.
   C. The board of directors hires the CEO to manage the company on a daily basis.
   D. The internal audit department reports solely to the CFO.

6. The individual responsible for managing all of the operations of the organization, such as product packaging, is the:

   A. COO.
   B. CFO.
   C. CEO.
   D. CPA.

7. Which of the following skills is NOT required of management accountants?

   A. Analytical skills
   B. Ability to work on a team
   C. Oral and written communication skills
   D. Speak a foreign language

8. Management accountants must comply with all of the following ethical standards EXCEPT:
   A. Reporting ethical breaches to the CMA.
   B. Maintaining professional competence.
   C. Performing duties with credibility.
   D. Preserving confidentiality of information.

9. Which of the following is NOT a current business trend?
   A. Total Quality Management
   B. Inventories delivered in large quantities at a discount
   C. Time sensitivity for purchase, delivery, & service
   D. ISO quality standards

10. Which of the following is NOT an important result of the Sarbanes-Oxley Act of 2002?
   A. Stiffer penalties and imprisonment were instituted for white collar crimes.
   B. The audit committee must be independent and include a financial expert.
   C. Employees are responsible for the financial reporting completed in their department.
   D. CA firms have limitations on non-audit service for audit clients.

ANSWER KEY TO CHAPTER 1 QUIZ

1. C
2. B
3. B
4. B
5. D
6. A
7. D
8. A
9. B
10. C

