Managerial Accounting

The Preview describes the purpose of the chapter and outlines the major topics and subtopics in it.

Chapter Preview

This chapter focuses on issues dealing with the field and substance of managerial accounting. In a previous financial accounting course, you learned about the form and content of financial statements for external users of financial information, such as shareholders and creditors. These financial statements are the main product of financial accounting. Managerial accounting focuses primarily on the preparation of reports for internal users of financial information, such as the managers and officers of a company. Managers are evaluated on the results of their decisions. In today’s rapidly changing global environment, managers must often make decisions that determine their company’s fate—and their own. Managerial accounting provides tools that help management make decisions and evaluate the effectiveness of those decisions.

The Feature Story helps you picture how the chapter topic relates to the real world of business and accounting. You will find references to the story throughout the chapter.

Feature Story

Accounting Keeps Businesses Afloat

Growing up on Vancouver Island, Brian Henry explored the beautiful coastline by kayak. Feeling the need to have better equipment that was suited to the rugged environment, Mr. Henry began building sea kayaks for himself and his friends. In the late 1970s, that turned into a business, Current Designs, which expanded to design and build kayaks out of increasingly sophisticated materials. Over the years, Current Designs teamed up with world-famous kayakers to design models sold all over the world.
Meanwhile, on the inland waterways of Minnesota, Mike Cichanowski grew up paddling a canoe to explore the Mississippi River. He, too, started designing and building his own boats—in this case, canoes—and eventually took out a bank loan and built his own small shop, giving birth to the company Wenonah Canoe.

In 1991, as kayaking became more popular, Wenonah Canoe became the U.S. distributor of Current Designs kayaks. By 1999, Mr. Cichanowski made another critical business decision when Wenonah Canoe purchased majority ownership of Current Designs. In 2004, Mr. Cichanowski moved Current Designs' operations in Victoria to Minnesota, saying that 70% of boats made in Victoria were shipped to the United States. “The logistics of invoicing, shipping and handling those boats multiple times has led the company to look at a strategy of consolidating manufacturing and shipping at a single U.S. location,” Wenonah said in a news release. In 2014, Wenonah expanded again, buying Hawaii-based paddleboard company C4 Waterman.

Every year, Wenonah Canoe’s 90 employees produce and sell about 10,000 canoes and kayaks per year through 500 retailers, and ship about 40 containers of goods around the world.

Entrepreneurs like Mr. Cichanowski and Mr. Henry will tell you that business success is “a three-legged stool.” The first leg is the knowledge and commitment to make a great product. Wenonah’s canoes and Current Designs’ kayaks are widely regarded as among the very best. The second leg is the ability to sell your product, which took both companies a little longer to figure out.

The third leg is not something that you would immediately associate with entrepreneurial success. It is what goes on behind the scenes—accounting. Good accounting information is absolutely critical to the countless decisions, big and small, that ensure the survival and growth of companies. Good accounting information allowed Mr. Henry to decide to sell to Wenonah and Mr. Cichanowski to decide to buy Current Designs and later move its production to Minnesota.

Bottom line: No matter how good your product is, and no matter how many units you sell, if you don’t have a firm grip on your numbers, you are up a creek without a paddle.


---

**Chapter Outline**

Learning Objectives give you a framework for learning the specific concepts covered in the chapter.

<table>
<thead>
<tr>
<th>LEARNING OBJECTIVES</th>
<th>REVIEW</th>
<th>PRACTICE DO IT!</th>
</tr>
</thead>
</table>
| **LO 1** Explain the distinguishing features of managerial accounting. | • Introduction  
• Comparing managerial and financial accounting | DO IT! 1 Managerial Accounting Concepts |
| **LO 2** Identify the three broad functions of management and the role of management accountants in an organizational structure. | • Management functions  
• Organizational structures | DO IT! 2 Managerial Accounting Overview |
| **LO 3** Explain the importance of business ethics. | • Creating proper incentives  
• Code of ethical standards  
• Corporate social responsibility | DO IT! 3 Managerial Accounting Concepts |
| **LO 4** Identify changes and trends in managerial accounting. | • Service industry trends  
• Managerial accounting practices  
• Accounting organizations and professional accounting careers in Canada | DO IT! 4 Trends in Managerial Accounting |
Managerial Accounting Basics

LEARNING OBJECTIVE 1
Explain the distinguishing features of managerial accounting.

Introduction

Managerial accounting, also called management accounting, is a field of accounting that provides economic and financial information for managers and other internal users. The skills that you will learn in this course will be vital to your future success in business. Do you believe us? Let’s look at some examples of the crucial activities of employees at Current Designs, and where those activities are addressed in this textbook.

In order to know whether it is making a profit, Current Designs needs accurate information about the cost of each kayak. But first, we explain the field and substance of managerial accounting (Chapter 1). Chapter 2 explains various managerial cost concepts that are useful in planning, directing, and controlling. We also present cost flows and the process of cost accumulation in a manufacturing environment, as well as costs and how they are reported in the financial statements. Chapters 3, 4, and 5 calculate the cost of providing a service or manufacturing a product. To stay profitable, Current Designs must adjust the number of kayaks it produces in light of changes in economic conditions and consumer tastes. It then needs to understand how changes in the number of kayaks it produces impact its production costs and profitability (Chapter 6). Further, Current Designs’ managers must often consider alternative courses of action. For example, should the company accept a special order from a customer, produce a particular kayak component internally or outsource it, or continue or discontinue a particular product line (Chapter 7)? Chapter 8 evaluates the impact on decision-making of alternative approaches for costing inventory. Finally, one of the most important, and most difficult, decisions is what price to charge for the kayaks (Chapter 9). In order to plan for the future, Current Designs prepares budgets (Chapter 10), and it then compares its budgeted numbers with its actual results to evaluate performance and identify areas that need to change (Chapters 11 and 12). Finally, it sometimes needs to make substantial investment decisions, such as the building of a new plant or the purchase of new equipment (Chapter 13).

Someday, you are going to face decisions just like these. You may end up in sales, marketing, management, production, or finance. You may work for a company that provides medical care, produces software, or serves up mouth-watering meals. No matter what your position, and no matter what your product, the skills you acquire in this class will increase your chances of business success. Put another way, in business you can either guess or you can make an informed decision. As the CEO of Microsoft once noted: “If you’re supposed to be making money in business and supposed to be satisfying customers and building market share, there are numbers that characterize those things. And if somebody can’t speak to me quantitatively about it, then I’m nervous.” This course gives you the skills you need to quantify information so you can make informed business decisions.

Managerial accounting applies to all types of businesses—service, merchandising, and manufacturing. It also applies to all forms of business organizations—proprietorships, partnerships, and corporations. Managerial accounting is needed in not-for-profit entities, including governments, as well as in profit-oriented enterprises.

In the past, managerial accountants were primarily engaged in cost accounting: collecting and reporting costs to management. Recently, that role has changed significantly. First, as the manufacturing environment has become more automated, methods used to determine the amount and type of cost in a product have changed. Second, today’s managerial accountants are now responsible for strategic cost management; that is, they help management evaluate how well the company is employing its resources. As a result, managerial accountants now serve as team members alongside personnel from production, marketing, and engineering when the company makes critical strategic decisions.
Comparing Managerial and Financial Accounting

There are both similarities and differences between managerial and financial accounting. First, both fields deal with the economic events of a business. Thus, their interests overlap. For example, *determining* the unit cost of manufacturing a product is part of managerial accounting. *Reporting* the total cost of goods manufactured and sold is part of financial accounting. In addition, both managerial and financial accounting require that a company’s economic events be quantified and communicated to interested parties.

*Illustration 1.1* summarizes the principal differences between financial accounting and managerial accounting. The varied needs for economic data among interested parties are the reason for many of the differences.

**DO IT! 1 | Managerial Accounting Concepts**

Indicate whether the following statements are true or false.

1. Managerial accountants have a single role within an organization: collecting and reporting costs to management.
2. Financial accounting reports are general-purpose and intended for external users.
3. Managerial accounting reports are special-purpose and issued as frequently as needed.

**Solution**

1. False. Managerial accountants determine product costs. In addition, managerial accountants are now held responsible for evaluating how well the company is employing its resources. As a result, when the company makes critical strategic decisions, managerial accountants serve as team members alongside personnel from production, marketing, and engineering.
2. True.
3. True.

Related exercise material: E1.3, E1.7, E1.8, and DO IT! D1.1.
Management Functions and Organizational Structures

LEARNING OBJECTIVE 2
Identify the three broad functions of management and the role of management accountants in an organizational structure.

Management Functions

Managers’ activities and responsibilities can be classified into three broad functions:

1. Planning
2. Directing
3. Controlling

In performing these functions, managers make decisions that have a significant impact on the organization.

Planning requires management to look ahead and to establish objectives. These objectives are often diverse: maximizing short-term profits and market share, maintaining a commitment to environmental protection, and contributing to social programs. For example, Hewlett-Packard, in an attempt to gain a stronger foothold in the computer industry, greatly reduced its prices to compete with Dell. A key objective of management is to add value to the business under its control. Value is usually measured by the trading price of the company’s shares and by the potential selling price of the company.

Directing involves coordinating a company’s diverse activities and human resources to produce a smoothly running operation. This includes implementing planned objectives and providing necessary incentives to motivate employees. For example, manufacturers such as General Motors of Canada, Magna International, and Dare Foods must coordinate their purchasing, manufacturing, warehousing, and selling. Service corporations such as Air Canada, Telus, and CGI must coordinate their scheduling, sales, service, and acquisitions of equipment and supplies. Directing also involves selecting executives, appointing managers and supervisors, and hiring and training employees.

The third management function, controlling, is the process of keeping the company’s activities on track. In controlling operations, managers determine whether planned goals are being achieved. When there are deviations from target objectives, managers must decide what changes are needed to get back on track. Scandals at companies like Nortel Networks and Hollinger attest to the fact that companies must have adequate controls to ensure that the company develops and distributes accurate information.

How do managers achieve control? A smart manager in a small operation can make personal observations, ask good questions, and know how to evaluate the answers. But using this approach in a large organization would result in chaos. Imagine the president of Current Designs trying to determine whether planned objectives are being met without some record of what has happened and what is expected to occur. Thus, large businesses typically use a formal system of evaluation. These systems include such features as budgets, responsibility centres, and performance evaluation reports—all of which are features of managerial accounting.

Decision-making is not a separate management function. Rather, it is the outcome of the exercise of good judgement in planning, directing, and controlling.
Organizational Structures

In order to assist in carrying out management functions, most companies prepare organizational charts that show the interrelationships of activities and the delegation of authority and responsibility within the company. Illustration 1.2 provides a typical organization chart showing the delegation of responsibility.

Shareholders own the corporation, but they manage it indirectly through a board of directors, which they elect. Even not-for-profit organizations have boards of directors. The board formulates the operating policies for the company or organization. The board also selects officers, such as a president and one or more vice-presidents, to execute policy and perform daily management functions.

The chief executive officer (CEO) has overall responsibility for managing the business. Obviously, even in a small business, in order to accomplish organizational objectives, the

---

**Business Insight**

**“Lean” Luxury**

Louis Vuitton is a French manufacturer of high-end handbags, luggage, and shoes. Its reputation for quality and style allows it to charge up to several thousand dollars for an item. But often in the past, when demand was hot, supply was nonexistent—shelves were empty, and would-be buyers left empty-handed.

Luxury-goods manufacturers used to consider stock-outs to be a good thing, but Louis Vuitton changed its attitude. The company adopted “lean” processes used by car manufacturers and electronics companies to speed up production. Work is done by flexible teams, with jobs organized based on how long a task takes. Team members were reconfigured into U-shaped workspaces to save time and floor space, and robots are used in some factories to save workers from walking to get more materials. By reducing wasted time and eliminating bottlenecks, what used to take 20 to 30 workers eight days to do now takes 6 to 12 workers one day. Also, production employees who used to specialize on a single task on a single product are now multiskilled. This allows them to quickly switch products to meet demand.

To make sure that the factory is making the right products, within a week of a product launch, Louis Vuitton stores around the world feed sales information to the headquarters in France, and production is adjusted accordingly. Finally, the new production processes have also improved quality. Returns of some products are down by two-thirds, which makes quite a difference to the bottom line when the products are pricey.


What are some of the steps that this company has taken in order to ensure that production meets demand?
company relies on the delegation of responsibilities. As the organization chart in Illustration 1.2 shows, the CEO delegates responsibility to other officers. Each member of the organization has a clearly defined role to play.

Responsibilities within the company are frequently classified as either line or staff positions. Employees with line positions are directly involved in the company’s main revenue-generating operating activities. Examples of line positions would be the vice-president of operations, vice-president of marketing, plant managers, supervisors, and production personnel. Employees with staff positions are involved in activities that support the efforts of the line employees. In firms like General Motors or Petro-Canada (part of Suncor Energy), employees in the finance, legal, and human resources departments have staff positions. While the activities of staff employees are vital to the company, these employees are really there only to serve the line employees involved in the company’s main operations.

The chief financial officer (CFO) is responsible for all of the accounting and finance issues the company faces. The CFO is supported by the controller and the treasurer. The controller’s responsibilities include (1) maintaining the accounting records; (2) maintaining an adequate system of internal control; and (3) preparing financial statements, tax returns, and internal reports. The treasurer has custody of the corporation’s funds and is responsible for maintaining the company’s cash position.

Also serving the CFO are the internal audit staff. The audit staff’s responsibilities include reviewing the reliability and integrity of financial information provided by the controller and treasurer. Audit staff members also ensure that internal control systems are functioning properly to safeguard corporate assets. In addition, they investigate compliance with policies and regulations and, in many companies, they determine whether resources are being used in the most economical and efficient fashion.

The vice-president of operations oversees employees with line positions. For example, the company might have multiple plant managers, and each one would report to the vice-president of operations. Each plant would also have department managers, such as fabricating, painting, and shipping managers, each reporting to the plant manager.

**DO IT! 2 | Managerial Accounting Overview**

Indicate whether the following statement is true or false.

1. Managers’ activities and responsibilities can be classified into three broad functions: cost accounting, budgeting, and internal control.

**Solution**

1. False. Managers’ activities are classified into three broad functions: planning, directing, and controlling. Planning requires managers to look ahead to establish objectives. Directing involves coordinating a company’s diverse activities and human resources to produce a smooth-running operation. Controlling is keeping the company’s activities on track.

Related exercise material: E1.5, E1.6, and DO IT! D1.1.

---

**Business Ethics**

**LEARNING OBJECTIVE 3**

Explain the importance of business ethics.

All employees in an organization are expected to act ethically in their business activities. Given the importance of ethical behaviour to corporations and their owners (shareholders), an increasing number of organizations provide codes of business ethics for their employees.
Despite these efforts, recent business scandals have resulted in massive investment losses and large employee layoffs. A recent survey of fraud by international accounting firm KPMG reported a 13% increase in instances of corporate fraud compared with five years earlier. It noted that, while employee fraud (such things as expense account abuse, payroll fraud, and theft of assets) represented 60% of all instances of fraud, financial reporting fraud (the intentional misstatement of financial reports) was the most costly to companies. That should not be surprising given the long list of companies, such as Nortel, Enron, Global Crossing, and WorldCom, that have engaged in or been accused of engaging in massive financial frauds, which have led to huge financial losses and thousands of lost jobs.

Creating Proper Incentives

Companies like BCE (owner of Bell Canada), CGI, Motorola, IBM, and Nike use complex systems to control and evaluate the actions of managers. They dedicate substantial resources to monitor and effectively evaluate the actions of employees. Unfortunately, these systems and controls sometimes unwittingly create incentives for managers to take unethical actions. For example, companies prepare budgets to provide direction. Because the budget is also used as an evaluation tool, some managers try to play a “game” by using budgetary slack; that is, they build some slack into the budget by understating their division’s predicted performance so that it will be easier to meet their performance targets. On the other hand, if the budget is set at unattainable levels, managers sometimes take unethical actions to meet the targets in order to receive higher compensation or, in some cases, to keep their jobs.

Accusations of unethical behaviour similar to those at Nortel have also taken place in the United States. For example, in recent years, airline manufacturer Boeing has been plagued by a series of scandals, including charges of overbilling, corporate espionage, and illegal conflicts of interest. Some long-time employees of Boeing blame the decline in ethics on a change in the corporate culture that took place after Boeing merged with McDonnell Douglas. They suggest that evaluation systems that were implemented after the merger to monitor results and evaluate employee performance made employees believe they needed to succeed no matter what.

Although manufacturing companies need to establish production goals for their processes, if controls are not effective and realistic, problems develop. To illustrate, Schering-Plough, a pharmaceutical manufacturer, found that employees were so concerned with meeting production standards that they failed to monitor the quality of the product, and as a result, the dosages were often wrong.

Business Insight  Ethics Breach at Nortel

Canadian-based Nortel Networks Corp. was once the largest supplier of telecommunications equipment in the world. In 2004, Nortel fired CEO Frank Dunn and two other senior executives in connection with an internal probe of the company’s financial practices. Later that year, Nortel fired seven more financial managers as it continued to sort out the accounting scandal that led to the dismissal of its president. The situation drew the attention of federal prosecutors from the U.S. Attorney’s office in Dallas, and from the RCMP. Dunn and two other former senior executives were charged with fraud but found not guilty in 2013, as the judge said the accounting decisions that led to the charges were either not fraudulent or were immaterial for such a large company as Nortel. Securities regulators in both countries were also looking into the accounting irregularities that caused Nortel to restate its results for several years. Among other things, the company said it actually lost money in the first half of 2003, whereas it had previously reported a net profit of $40 million. In 2006, Nortel reached an agreement in principle for a proposed global settlement of class action litigation launched by shareholders who suffered huge losses as Nortel’s stock price plummeted. The company agreed to pay U.S. $575 million cash and issue common shares representing 14.5% of current equity. In 2009, Nortel declared bankruptcy and liquidated, auctioning off its patents for $4.5 billion, but the company didn’t reach a legal settlement with creditors until early 2017. In late 2014, the Ontario Securities Commission and U.S. Securities and Exchange Commission dropped the civil charges against Nortel.


What can companies do to create disincentives for managers to act unethically?
Code of Ethical Standards

In response to corporate scandals in 2000 and 2001, the U.S. Congress enacted legislation to help prevent lapses in internal control. This legislation, referred to as the Sarbanes-Oxley Act of 2002 (SOX), had important implications for the financial community. One result of SOX was the clarification of top management’s responsibility for the company’s financial statements. CEOs and CFOs must now certify that the financial statements give a fair presentation of the company’s operating results and its financial condition. In addition, top managers must certify that the company maintains an adequate system of internal controls to safeguard the company’s assets and ensure accurate financial reports.

Another result of Sarbanes-Oxley is that companies now pay more attention to the composition of the board of directors. In particular, members of the audit committee of the board of directors must all be entirely independent (that is, non-employees) and at least one must be a financial expert.

Finally, to increase the likelihood of compliance with the rules that are part of the new legislation, the law substantially increases the penalties for misconduct.

Canada similarly took action after scandals involving Canadian companies such as Bre-X, which fraudulently reported gold samples; Cinar, a media company accused of misusing tax credits; and Livent, a theatre production company whose top executives were found guilty of fraud in misstating financial statements. As discussed in the December 2003 issue of CA Magazine, “after the Bre-X Minerals Ltd., Cinar, and Livent Inc. scandals, steps were also taken to remedy market and financial manipulations . . . the Canadian Securities Administrators, federal and provincial securities regulators, the Office of the Superintendent of Financial Institutions (OSFI) and the accounting profession set up the Canadian Public Accountability Board (CPAB), which is charged with overseeing the independence and transparency of the Canadian accounting system. According to the OSFI, ‘The mission of the CPAB is to contribute to public confidence in the integrity of financial reporting of Canadian public companies by promoting high quality, independent auditing . . .’”

In January 2004, the Ontario Securities Commission (OSC), in conjunction with the Canadian Securities Administrators, introduced regulations governing the composition and duties of audit committees, as well as their members’ behaviour. The new regulations were also adopted by all provincial and territorial securities regulators, except for British Columbia’s. “The rules are as robust as parallel rules required by the U.S. Sarbanes-Oxley legislation, but address unique Canadian concerns,” said OSC chair David Brown.1

Canadian corporate governance regulation was established in 2005. National Policy 58-201 Corporate Governance Guidelines provides guidance on corporate governance practices for various reasons including the need to achieve a balance between protecting investors and encouraging fair and efficient capital markets.

To provide guidance for managerial accountants, the U.S. Institute of Management Accountants (IMA) has developed a code of ethical standards entitled IMA Standards of Ethical Conduct for Practitioners of Management Accounting and Financial Management. The code states that management accountants should not commit acts in violation of these standards, nor should they condone such acts by others within their organization. In Canada, each province has its own code of ethics, and rules and guidelines of professional conduct.

In Canada, Chartered Professional Accountants of Canada plays an important role in promoting high standards of ethics in the accounting profession, including managerial accounting. These standards of ethics can be used as guidelines in dealing with the public and the association’s members.

The IMA’s Statement of Ethical Professional Practice provides the following codes of conduct regarding competence, confidentiality, integrity, and credibility:

**Competence**

Management accountants have a responsibility to

- maintain professional competence.
- perform professional duties in accordance with relevant laws, regulations, and technical standards.

---

• prepare complete and clear reports and recommendations.
• communicate professional limitations that would preclude responsible judgement or successful performance of an activity.

**Confidentiality**
Management accountants have a responsibility to
• refrain from disclosing confidential information.
• inform subordinates as to how to handle confidential information.
• refrain from using confidential information for unethical or illegal advantage.

**Integrity**
Management accountants have a responsibility to
• avoid conflicts of interest.
• refrain from activity that would prejudice their ability to carry out their duties ethically.
• refrain from engaging in or supporting any activity that would discredit the accounting profession.

**Credibility**
Management accountants have a responsibility to
• communicate information fairly and objectively.
• disclose fully all relevant information that could reasonably be expected to influence a user’s understanding of the reports, comments, and recommendations presented.

**Corporate Social Responsibility**
Another aspect of business ethics is the growing trend toward corporate social responsibility. Many companies have begun to evaluate not just corporate profitability but also a corporate social responsibility. In addition to profitability, corporate social responsibility considers a company’s efforts to employ sustainable business practices with regard to its employees and the environment. This is sometimes referred to as the **triple bottom line** because it evaluates a company’s performance with regard to people, planet, and profit. These companies are still striving to maximize profits—in a competitive world, they won’t survive long if they don’t. In fact, you might recognize a few of the names on the Forbes.com list of the 100 most sustainable companies in the world, such as General Electric, Adidas, Toyota, Coca-Cola, or Starbucks. These companies have learned that, with a long-term, sustainable approach, they can maximize profits while also acting in the best interest of their employees, their communities, and the environment. At various points within this textbook, we will discuss situations where real companies use the very skills that you are learning to evaluate decisions from a sustainable perspective.

Sustainable business practices present numerous issues for management and managerial accountants. First, companies must decide what items need to be measured, generally those that are of utmost importance to its stakeholders. For example, a particular company might be most concerned with minimizing water pollution or maximizing employee safety. Then, for each item identified, the company must determine measurable attributes that provide relevant information about the company’s performance with regard to that item, such as the amount of waste released into public waterways or number of accidents per 1,000 hours worked. Finally, the company needs to consider the materiality of the item, the cost of measuring these attributes, and the reliability of the measurements. If the company uses this information to make decisions, then accuracy is critical. Of particular concern is whether the measurements can be verified by a third party. Unlike financial reporting, the reporting of sustainable business practices currently has no agreed-upon standard-setter. A number of organizations have, however, published sustainability reporting guidelines. Illustration 1.3 provides a list of major categories in guidelines from the Global Reporting Initiative and from the International Organization for Standardization (ISO), and a sample of topics or “aspects” that companies might consider within each category.
## ILLUSTRATION 1.3

Categories and sample aspects in Global Reporting Initiative and ISO 26000:2010 guidelines

<table>
<thead>
<tr>
<th>Global Reporting Initiative aspects</th>
<th>Economic</th>
<th>Environmental</th>
<th>Labour Practices and Decent Work</th>
<th>Human Rights</th>
<th>Social</th>
<th>Product Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Procurement practices</td>
<td>Effluents and waste</td>
<td>Training and education</td>
<td>Indigenous</td>
<td>Anti-competitive behaviour</td>
<td>Product and service labelling</td>
</tr>
<tr>
<td></td>
<td>Social investment</td>
<td>Sustainable resource use</td>
<td>Conditions of work and social protection</td>
<td>Discrimination and vulnerable groups</td>
<td>Fair operating practices</td>
<td>Protecting consumers’ health and safety</td>
</tr>
<tr>
<td></td>
<td>Wealth and income creation</td>
<td>Climate change mitigation and adaptation</td>
<td>Human development and training in the workplace</td>
<td>Civil and political rights</td>
<td>Responsible political involvement</td>
<td>Fair marketing, factual and unbiased information, and fair contractual practices</td>
</tr>
</tbody>
</table>


---

## DO IT! 3 | Managerial Accounting Concepts

Indicate whether the following statements are true or false.

1. As a result of the Sarbanes-Oxley Act of 2002, managerial accounting reports must now comply with accounting principles accepted by the accounting profession.
2. Top managers must certify that a company maintains an adequate system of internal controls.
3. A company’s efforts to employ sustainable business practices with regard to its employees, society, and the environment is referred to as corporate social responsibility.

**Solution**

1. False. SOX clarifies top management’s responsibility for the company’s financial statements. In addition, top managers must certify that the company maintains an adequate system of internal control to safeguard the company’s assets and ensure accurate financial reports.
2. True.
3. True.

Related exercise material: E1.4 and DO IT! D1.1.

---

## Managerial Accounting Today

### LEARNING OBJECTIVE 4

Identify changes and trends in managerial accounting.

To compete successfully in today’s deregulated global environment, many Canadian and American manufacturing and service industries have begun implementing strategic management programs. These are designed to improve quality, reduce costs, and regain the competitive position the companies once held in the world marketplace. This approach focuses on the long-term goals and objectives of the organization, as well as a full analysis of the environment in which the business is operating. The analysis covers all the internal operations and resources...
of the organization, as well as the external aspects of its environment. It includes competitors, suppliers, customers, and legal and regulatory changes, as well as the economy as a whole.

This new approach requires changes to traditional management accounting, which has been widely criticized for being too narrow, highly quantitative, and aimed at the needs of financial reporting, and for contributing little to the overall policy and direction of the organization. In this regard, as one author says, management accounting needs to be released from the factory floor so that it can meet market challenges directly. The result is a new variety of management accounting that expands the information provided to decision makers. The following section explains the expanding role of management accounting in the twenty-first century due to the expansion of the service industry.

Service Industry Trends

In recent decades, the Canadian and U.S. economies, in general, have shifted toward an emphasis on providing services, rather than goods. Today over 50% of Canadian and U.S. workers are employed by service companies, and that percentage is expected to increase in coming years. Most of the techniques that you will learn in this course are equally applicable to service and manufacturing entities.

Managers of service companies look to managerial accounting to answer many questions. Illustration 1.4 presents examples of such questions. In some instances, the managerial accountant may need to develop new systems for measuring the cost of serving individual customers. In others, he or she may need new operating controls to improve the quality and efficiency of specific services. Many of the examples we present in subsequent chapters will relate to service companies. To highlight the relevance of the techniques used in this course for service companies, we have placed a service company wordmark next to those items in the end-of-chapter materials that relate to non-manufacturing companies.

ILLUSTRATION 1.4 Service industries and companies and the managerial accounting questions they face

<table>
<thead>
<tr>
<th>Industry/Company</th>
<th>Questions Faced by Service-Company Managers</th>
</tr>
</thead>
</table>
| Transportation (WestJet Airlines) | Should we buy new or used planes?  
Should we service this new route? |
| Package delivery services (Purolator, FedEx) | What fee structure should we use?  
What mode of transportation should we use? |
| Telecommunications (BCE Inc.) | What fee structure should we use?  
Should we service this new community?  
How many households will it take to break even?  
Should we invest in a new satellite or lay new cable? |
| Professional services (lawyers, accountants, dentists) | How much should we charge for particular services?  
How much office overhead should we allocate to particular jobs?  
How efficient and productive are individual staff members? |
| Financial institutions (Bank of Montreal, TD Waterhouse) | Which services should we charge for, and which should we provide for free?  
Should we build a new branch office or install a new ATM there?  
Should our fees vary depending on the size of the customers’ accounts? |
| Health care (TLC The Laser Center Inc.) | Should we invest in new equipment?  
How much should we charge for various services?  
How should we measure the quality of the services provided? |

--

Managerial Accounting Practices

As discussed earlier, the practice of managerial accounting has changed significantly in recent years to better meet the needs of managers. The following sections explain some well-established managerial accounting practices.

Focus on the Value Chain

The value chain is all activities associated with providing a product or service. For a manufacturer, these include research and development, product design, the acquisition of raw materials, production, sales and marketing, delivery, customer relations, and subsequent service. Illustration 1.5 shows the value chain for a manufacturer. In recent years, companies have made huge advances in analyzing all stages of the value chain in an effort to improve productivity and eliminate waste, all while continually trying to improve quality. Japanese automobile manufacturer Toyota pioneered many of these innovations.

ILLUSTRATION 1.5 A manufacturer’s value chain

In the 1980s, many companies purchased giant machines to replace humans in the manufacturing process. These machines were designed to produce large batches of products. In recent years, these manufacturing processes have been recognized as being very wasteful. They require vast amounts of inventory storage capacity and a lot of movement of materials. Consequently, many companies have re-engineered their manufacturing processes. For example, the manufacturing company Pratt and Whitney has replaced many of its large machines with smaller, more flexible ones, and has begun reorganizing its plants for a more efficient flow of goods. With these changes, Pratt and Whitney was able to reduce the time that its turbine engine blades spend in the grinding section from 10 days to two hours. It also cut the total amount of time spent making a blade from 22 days to 7 days. The improvements that have resulted from analyses of the value chain have made companies far more responsive to customer needs, and have improved profitability.

Technological Change

Technology has played a large role in the value chain. Computerization and automation have permitted companies to be more effective in streamlining production, thus enhancing the value chain. For example, many companies now employ enterprise resource planning (ERP) software systems, such as those provided by SAP. ERP systems provide a comprehensive, centralized, and integrated source of information that is used to manage all major business processes, including purchasing, manufacturing, and recording human resources.

In large companies, an ERP system might replace as many as 200 individual software packages. For example, an ERP system can eliminate the need for individual software packages for personnel, inventory management, receivables, and payroll. Because the value chain goes beyond the company walls, ERP systems also collect information from and provide it to the company’s major suppliers, customers, and business partners. The largest ERP provider, the German corporation SAP, has more than 36,000 customers worldwide.

Another example of technological change is computer-integrated manufacturing (CIM). Using CIM, many companies can now manufacture products that are untouched by human hands. An example is the use of robotic equipment in the steel and automobile industries. Workers monitor the manufacturing process by watching instrument panels. Automation significantly reduces direct labour costs in many cases.
Also, the widespread use of computers has greatly reduced the cost of accumulating, storing, and reporting managerial accounting information. Computers now make it possible to do more detailed costing of products, processes, and services than was possible under manual processing. Technology is also affecting the value chain through business-to-business (B2B) e-commerce on the Internet. The Internet has dramatically changed the way corporations do business with one another. Inter-organizational information systems connected to the Internet enable customers and suppliers to share information nearly instantaneously. In addition, the Internet has changed the marketplace, often cutting out intermediaries (the “middlemen”). The automobile, airline, hotel, and electronics industries have made commitments to purchase some or all of their supplies and raw materials in the huge B2B electronic marketplaces. For example, Hilton Hotels recently committed itself to purchasing as much as $1.5 billion of bedsheets, pest control services, and other items from an online supplier, PurchasePro.com.

Just-in-Time Inventory Methods

Many companies have significantly lowered their inventory levels and costs by using just-in-time (JIT) inventory methods, which is an innovation that resulted from the focus on the value chain. Under a just-in-time method, goods are manufactured or purchased just in time for use. Alcoa is famous for having developed a system for making products in response to individual customer requests, with each product custom-made to meet each customer’s particular specifications. Another example is Dell Corporation, which takes less than 48 hours to assemble a computer to customer specifications and put it on a truck. By integrating its information systems with those of its suppliers, Dell reduced its inventories to nearly zero. This is a huge advantage in an industry where products become obsolete nearly overnight. No wonder that JIT is sometimes also called “lean production.”

Quality

JIT inventory systems also require an increased emphasis on product quality. If products are produced only as they are needed, it is very costly for the company to have to stop production because of defects or machine breakdowns. Many companies have installed total quality management (TQM) systems to reduce defects in finished products. The goal is to achieve zero defects. These systems require timely data on defective products, rework costs, and the cost of honouring warranty contracts. Often this information is used to help redesign the product so it is less likely to have a defect. Or it may be used to re-engineer the production process to reduce set-up time and decrease the potential for error. TQM systems also provide information on non-financial measures, such as customer satisfaction, the number of service calls, and the time needed to generate reports. Attention to these measures, which employees can control, leads to increased profitability and improves all aspects of the value chain.

Activity-Based Costing

Overhead costs have become an increasingly large component of product and service costs. By definition, overhead costs cannot be directly traced to individual products. But to determine each product’s cost, overhead must be allocated to the various products. In order to obtain more accurate product costs, many companies now allocate overhead using activity-based costing (ABC). Under ABC, overhead is allocated based on each product’s use of economic resources as it undergoes various activities. For example, the company can keep track of the cost of setting up machines for each batch of a production process. Then a particular product can be allocated part of the total set-up cost based on the number of set-ups that product required.

Activity-based costing is beneficial because it results in more accurate product costing and in the more careful scrutiny of all activities in the supply chain. For example, if a product’s cost is high because it requires a high number of set-ups, management will be motivated to determine how to produce the product using as few machine set-ups as possible. ABC is now widely used by both manufacturing and service companies. Chapter 5 discusses ABC further.

Theory of Constraints

All companies have certain aspects of their business that create “bottlenecks”—constraints that limit the company’s potential profitability. An important aspect of managing the value
Lean Manufacturing

Lean manufacturing is a process increasingly used by many firms to manage their operations more efficiently and with more control. It sets out to eliminate waste and to concentrate more accurately on customer needs. The process is in contrast to traditional mass-production operations, which maximize profits through efficiency of machine utilization and economies of scale and require large amounts of direct labour to complete most products. Today most products require little direct labour to complete, due in large part to advancements in automation. Customers now dictate requirements to suppliers and often look for smaller quantities of individualized products. Lean manufacturing was developed in response to this changing manufacturing environment.

Researchers have highlighted five basic principles that are crucial to the lean thinking process: specify a value, identify the value stream, create flow, respond to customer pull or demands, and aim for perfection.

Step one, value, is the process of “target costing,” which is the acceptable cost customers are willing to pay for a specific product. The key is to achieve the optimal price for customers while realizing the greatest profit potential for the company. Step two, the value stream, is the entire flow of a product’s life cycle through each stage of production. It is the central element in understanding how a company can evaluate what is value-added and what is a waste. Step three, the flow, refers to the need for the production process to have a continuous flow. Any disruptions in the value stream can have detrimental effects on a company’s operations and on its customer satisfaction. Step four, the pull principle, states that a product should not be made until a customer orders it. To achieve this pull approach, the company’s production capacity is flexible and each stage of the value chain is well designed and defined. The final principle, perfection, deals with the target quality that management seeks to obtain via its customers’ needs.

Changing traditional mass-production thinking to lean thinking requires changes in the ways companies control, measure, and account for their processes. Chapters 8 and 9 discuss some applications of lean manufacturing.
Balanced Scorecard

As companies implement various business practice innovations, managers have sometimes focused too enthusiastically on the latest innovation and paid less attention to other areas of the business. For example, in focusing on improving quality, companies sometimes lose sight of cost/benefit considerations. Similarly, in focusing on reducing inventory levels through just-in-time inventory, companies sometimes lose sales due to inventory shortages. A balanced scorecard is a performance-measurement approach that uses both financial and non-financial measures to evaluate all aspects of a company’s operations in an integrated way. As shown in Illustration 1.6, the performance measures are linked by cause and effect to ensure that they all connect to the company’s overall objectives.

For example, the company may want to increase its return on assets, a common financial performance measure (calculated as net income divided by average total assets). It will then identify a series of linked goals that, if each one is accomplished, will ultimately result in an increase in return on assets. For example, in order to increase return on assets, sales must increase. In order to increase sales, customer satisfaction must be increased. In order to increase customer satisfaction, product defects must be reduced. In order to reduce product defects, employee training must be increased. Note the linkage, which starts with employee training and ends with return on assets. Each objective will have associated performance measures.

The use of the balanced scorecard is widespread among some well-known and respected companies. For example, Hilton Hotels Corporation uses the balanced scorecard to evaluate the performance of employees at all of its hotel chains. Walmart employs the balanced scorecard and actually extends its use to the evaluation of its suppliers. For example, Walmart recently awarded Welch Company the “Dry Grocery Division Supplier of the Year Award” for its balanced scorecard results. The Palladium Group, a U.S. management consulting firm, even has awards for effective use of the balanced scorecard. Among the recent recipients of the Balanced Scorecard Hall of Fame Award is the Government of New Brunswick, which in 2011 undertook a government renewal initiative. According to the Palladium Group, “the results have been impressive: over the past two years the cost per capita of delivering services has dropped by nearly 5%, the job quality index has improved by 5%, private sector job growth has swung from a negative to a positive, the expense budget is running a surplus, and employee engagement has grown by 18%.” The balanced scorecard is discussed further in Chapter 12.

Accounting Organizations and Professional Accounting Careers in Canada

In Canada, the accounting profession has recently been reorganized by the founding of CPA Canada (Chartered Professional Accountants of Canada) in 2013, into which the three legacy accounting bodies (Chartered Accountants (CA), Certified Management Accountants (CMA), and Certified General Accountants (CGA)) were merged.

Because of the risks and opportunities facing the accounting profession in Canada and worldwide, CPA Canada was founded to create a larger unified profession that would mean a more prominent and cohesive Canadian presence internationally. For instance, the AICPA (American Institute of Certified Public Accountants) is aggressively seeking to expand its global footprint by opening exam centres for the U.S. CPA exam outside of the United States. In conjunction with the CIMA (Chartered Institute of Management Accountants—in the U.K.), the AICPA jointly developed a new global management accounting designation (CGMA).

Further, it was thought that CPA Canada could provide enhanced professional development and training opportunities as well as improved services and benefits to its members.

---

by eliminating duplication and competition among the former accounting bodies. Lifelong learning is an important part of the profession and, as a CPA, member professional development continues through taking courses, some leading to specializations such as tax, forensic accounting, strategic management, and public sector accounting.

DO IT! 4 | Trends in Managerial Accounting

Match the descriptions that follow with the corresponding terms.

Descriptions:
1. __________ All activities associated with providing a product or service.
2. __________ A method of allocating overhead based on each product’s use of activities in making the product.
3. __________ Systems implemented to reduce defects in finished products with the goal of achieving zero defects.
4. __________ A performance-measurement approach that uses both financial and non-financial measures, tied to company objectives, to evaluate a company’s operations in an integrated fashion.
5. __________ Inventory system in which goods are manufactured or purchased just as they are needed for use.

Terms:

a. Activity-based costing
b. Balanced scorecard
c. Just-in-time (JIT) inventory
d. Total quality management (TQM)
e. Value chain

Solution
1. c  2. a  3. d  4. b  5. c

Related exercise material: E1.9 and DO IT! D1.2.

All About You

How Sharp Are Your Decision-Making Skills?

As you will see in this text, good financial information is crucial for management decision-making. You’ve already made important decisions in choosing a university, a program, and courses. What factors went into your decision—how much was factual and how much was intuitive? Do you feel you made the right decisions? A 2016 survey of almost 15,000 first-year students at 34 Canadian universities found that more than 9 in 10 said they were satisfied with their decision to attend their university, and about 7 in 10 felt that a university degree was worth the cost. This is good news for them, because the average undergraduate tuition in Canada for the 2016–17 academic year was $6,373, so a lot of money is at stake.

What Do You Think?

Suppose you haven’t chosen a major yet. You research information on expected salaries for graduates in various fields. Should you choose your major based on potential earnings?

YES—University is costly and hard work so I want to see a good return on my money and time invested.

NO—I want to study and work in a field that I love; the money will follow.

Review and Practice

Learning Objectives Review

1. Explain the distinguishing features of managerial accounting.

Managerial accounting is needed in all types of businesses—service, merchandising, and manufacturing. It also applies to all forms of business organization—proprietorships, partnerships, and corporations. Managerial accounting is needed in not-for-profit entities, as well as in profit-oriented enterprises. Managerial accounting provides tools that help management make decisions and evaluate the effectiveness of those decisions.

The distinguishing features of managerial accounting are:
- the primary users of reports—internal users, who are officers, department heads, managers, and supervisors in the company;
- the type and frequency of reports—internal reports that are issued as frequently as needed;
- the purpose of reports—to provide special-purpose information for a particular user for a specific decision;
- the content of reports—pertains to subunits of the business and may be very detailed and may extend beyond the double-entry accounting system; the reporting standard is relevant to the decision being made; and
- the verification of reports—no independent audits.

2. Identify the three broad functions of management and the role of management accountants in an organizational structure.

The three functions are planning, directing, and controlling. Planning requires management to look ahead and to establish objectives. Directing involves coordinating a company’s diverse activities and human resources to produce a smoothly running operation. Controlling is the process of keeping the activities on track.

Management accountants serve as staff members in an organization and play an important role in providing the required information for decision-making.

3. Explain the importance of business ethics.

All employees in an organization are expected to act ethically in their business activities. In Canada, the professional accounting organization promotes high standards of ethics in the accounting profession. These standards of ethics can be used as guidelines in dealing with the public and the organizations’ members. In the United States, the Institute of Management Accountants’ Statement of Ethical Professional Practice provides the codes of conduct regarding competence, confidentiality, integrity, and credibility. Moreover, companies are now evaluating their performance with regard to their corporate social responsibility.

4. Identify changes and trends in managerial accounting.

Managerial accounting has experienced many changes in recent years. Among these are a shift toward meeting the needs of service companies and improving practices to better meet the needs of managers. Improved practices include a focus on managing the value chain through techniques such as just-in-time inventory and technological applications such as enterprise resource planning (ERP). In addition, techniques have been developed to improve decision-making, such as the theory of constraints and activity-based costing (ABC). Finally, many companies now use the balanced scorecard in order to have a more comprehensive view of the company’s operations.

In Canada, the accounting profession has recently been reorganized by the founding of CPA Canada (Chartered Professional Accountants of Canada) in 2013, into which the three legacy accounting bodies—Chartered Accountants (CA), Certified Management Accountants (CMA), and Certified General Accountants (CGA)—were merged.

Glossary Review

Activity-based costing (ABC) A method of allocating overhead based on each product’s use of activities. (p. 14)

Balanced scorecard A performance-measurement approach that uses both financial and non-financial measures that are tied to company objectives to evaluate a company’s operations in an integrated way. (p. 16)

Board of directors The group of officials elected by the shareholders of a corporation or non-profit organization to formulate operating policies, select officers, and otherwise manage the company. (p. 6)

Chief executive officer (CEO) The corporate officer who has overall responsibility for managing the business; he or she delegates parts of that responsibility to other corporate officers. (p. 6)

Chief financial officer (CFO) The corporate officer who is responsible for all of a company’s accounting and finance issues. (p. 7)

Controller The financial officer who is responsible for a company’s accounting records, system of internal control, and preparation of financial statements, tax returns, and internal reports. (p. 7)

Corporate social responsibility The efforts of a company to employ sustainable business practices with regard to its employees and the environment. (p. 10)

Enterprise resource planning (ERP) software system Software that provides a comprehensive, centralized, integrated source of information that is used to manage all major business processes. (p. 13)
**Just-in-time (JIT) inventory** An inventory system in which goods are manufactured or purchased just in time for use. (p. 14)

**Line positions** Jobs that are directly involved in a company’s main revenue-generating operating activities. (p. 7)

**Managerial accounting** A field of accounting that provides economic and financial information for managers and other internal users. (p. 3)

**Staff positions** Jobs that support the efforts of line employees. (p. 14)

**Supply chain** All activities from the receipt of an order to the delivery of a product or service. (p. 14)

**Theory of constraints** The practice of identifying constraints that impede a company’s ability to provide a good or service, and dealing with the constraints to maximize profitability. (p. 15)

---

**WileyPLUS**

Exercises, and many more components are available for practice in WileyPLUS.

---

**Self-Study Questions**

**Answers are at the end of this section.**

1. (LO 1) Managerial accounting
   a. is governed by generally accepted accounting principles.
   b. emphasizes special-purpose information.
   c. pertains to the entity as a whole and is highly aggregated.
   d. is limited to cost data.

2. (LO 3) Which of the following is not one of the categories in the Institute of Management Accountants’ Statement of Ethical Professional Practice?
   a. Confidentiality
   b. Competence
   c. Integrity
   d. Independence

3. (LO 2) The management of an organization performs several broad functions. They are
   a. planning, directing, and selling.
   b. planning, directing, and controlling.
   c. planning, manufacturing, and controlling.
   d. directing, manufacturing, and controlling.

4. (LO 4) Which one of the following is not a main component of the value chain sequence?
   a. ERP
   b. Sales and marketing
   c. Production
   d. Customer relations

5. (LO 4) What is “balanced” in the balanced scorecard approach?
   a. The number of products produced
   b. The emphasis on financial and non-financial performance measurements
   c. The amount of costs allocated to products
   d. The number of defects found in each product

6. (LO 1) Managerial accounting information is generally prepared for
   a. shareholders.
   b. managers.
   c. regulatory agencies.
   d. investors.

7. (LO 1) Managerial accounting information
   a. pertains to the entity as a whole and is highly aggregated.
   b. must be prepared according to generally accepted accounting principles.
   c. pertains to subunits of the entity and may be very detailed.
   d. is prepared only once a year.

8. (LO 1) The major reporting standard for management accountants is
   a. the Statement of Ethical Professional Practice.
   b. the Sarbanes-Oxley Act of 2002.
   c. relevance to decisions.
   d. generally accepted accounting principles.

9. (LO 4) Which of the following managerial accounting techniques attempts to allocate manufacturing overhead in a more meaningful fashion?
   a. Just-in-time inventory
   b. Total quality management
   c. Balanced scorecard
   d. Activity-based costing
10. (LO 3) Corporate social responsibility refers to:
   a. management’s practice of reviewing all business processes in an effort to increase productivity and eliminate waste.
   b. an approach used to allocate overhead based on each product’s use of activities.
   c. the attempt by management to identify and eliminate constraints within the value chain.
   d. efforts by companies to employ sustainable business practices with regard to employees and the environment.

Solutions

1. b. Managerial accounting emphasizes special-purpose information. The other choices are incorrect because (a) financial accounting is governed by generally accepted accounting principles, (c) financial accounting pertains to the entity as a whole and is highly aggregated, and (d) cost accounting and cost data are a subset of management accounting.

2. d. Independence is not a category in the Institute of Management Accountants’ Statement of Ethical Professional Practice but confidentiality, competence, and integrity are.

3. b. Planning, directing, and controlling are the broad functions performed by the management of an organization. The other choices are incorrect because (a) selling is performed by the sales group in the organization, not by management; (c) manufacturing is performed by the manufacturing group in the organization, not by management; and (d) manufacturing is performed by the manufacturing group in the organization, not by management.

4. a. The value chain is all activities associated with providing a product or service. It includes production, sales and marketing, delivery, and customer relations. It does not include ERP.

5. b. A balanced scorecard is a performance-measurement approach that uses both financial and non-financial measures to evaluate all aspects of a company’s operations in an integrated way, not (a) the number of products produced, (c) the amount of costs allocated to products, or (d) the number of defects found in each product.

6. b. Managerial accounting information is generally prepared for internal users, such as managers, not for external users, such as (a) shareholders, (c) regulatory agencies, and (d) investors.

7. c. Managerial accounting information pertains to subunits of the entity, may be very detailed, and may be prepared at any time, when required by decision makers. Financial accounting (a) pertains to the entity as a whole and is highly aggregated, (b) must be prepared according to generally accepted accounting principles, and (d) is prepared only once a year or at other regular intervals, when required by governments, shareholders, lenders, and other stakeholders.

8. c. Relevance to decisions is the major reporting standard for management accountants. Therefore (a) the Statement of Ethical Professional Practice, (b) the Sarbanes-Oxley Act of 2002, and (d) generally accepted accounting principles are incorrect.

9. d. Activity-based costing attempts to allocate manufacturing overhead in a more meaningful fashion. Therefore, choices (a) just-in-time inventory, (b) total quality management, and (c) balanced scorecard are incorrect.

10. d. Corporate social responsibility refers to efforts by companies to use sustainable business practices with regard to employees and the environment. The other choices are incorrect because (a) defines lean manufacturing, (b) refers to activity-based costing, and (c) describes the theory of constraints.

DO IT! Review

Identify managerial accounting concepts.

D1.1 (LO 1, 2, 3) Indicate whether the following statements are true or false.

1. Managerial accountants explain and report manufacturing and non-manufacturing costs and determine cost behaviours, but are not involved in the budget process.
2. Financial accounting reports pertain to subunits of the business and are very detailed.
3. Managerial accounting reports must follow generally accepted accounting principles and are audited by chartered professional accountants.
4. Managers’ activities and responsibilities can be classified into three broad functions: planning, directing, and controlling.
5. As a result of the Sarbanes-Oxley Act of 2002, top managers must certify that the company maintains an adequate system of internal control.
6. Management accountants follow a code of ethics developed by the U.S. Institute of Management Accountants.

Identify trends in managerial accounting.

D1.2 (LO 4) Match the descriptions that follow with the corresponding terms.

Descriptions:

1. _________ Inventory system in which goods are manufactured or purchased just as they are needed for use
2. _________ A method of allocating overhead based on each product’s use of activities in making the product
Exercises

E1.3 (LO 1) The following table compares various features between managerial and financial accounting:

<table>
<thead>
<tr>
<th></th>
<th>Financial Accounting</th>
<th>Managerial Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary users</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Type of reports</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Frequency of reports</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purpose of reports</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Content of reports</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Verification</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Instructions

Complete the table above.

E1.4 (LO 3) The U.S. Institute of Management Accountants has developed ethical standards for managerial accountants.

Instructions

Identify the four specific standards.

E1.5 (LO 2) Listed below are the three functions of the management of an organization.

1. Planning
2. Directing
3. Controlling

Instructions

Identify which of the following statements best describes each of the above functions:

a. ______ requires management to look ahead and to establish objectives. A key objective of management is to add value to the business.

b. ______ involves coordinating a company’s diverse activities and human resources to produce a smoothly running operation. This function relates to the implementation of planned objectives.

c. ______ is the process of keeping the activities on track. Management must determine whether goals are being met and what changes are necessary when there are deviations.

E1.6 (LO 2) The following is a list of terms related to a company’s organizational structure:

1. ______ Board of directors
2. ______ Chief financial officer
3. ______ Treasurer
4. _______ Controller
5. _______ Line position
6. _______ Chief executive officer
7. _______ Staff position

Instructions
Match each of the above terms with the appropriate statement below.

a. Employee who has overall responsibility for managing the business
b. Employees who are directly involved in the company’s primary revenue-generating activities
c. Employee with overall responsibility for all accounting and finance issues
d. Group of people elected by the shareholders that selects and oversees company officers and formulates operating policies
e. Employees who provide support services to those employees who are directly involved in the company’s primary revenue-generating activities
f. Employee who maintains accounting records and the system of internal controls, and prepares financial statements, tax returns, and internal reports
g. Employee who has custody of the company’s funds and maintains the company’s cash position

E1.7 (LO 1) Financial accounting information and managerial accounting information have a number of distinguishing characteristics, which are listed below.

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>2.</td>
<td>3.</td>
<td>4.</td>
</tr>
<tr>
<td>General-purpose reports</td>
<td>Reports are used internally</td>
<td>Prepared in accordance with generally accepted accounting principles</td>
<td>Special-purpose reports</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial statements</td>
<td>Reporting standard is relevant to the decision to be made</td>
<td>Reports generally pertain to the business as a whole</td>
<td>Reports generally pertain to subunits</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reports issued quarterly or annually</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Instructions
For each of the characteristics listed above, indicate which characteristics are more closely related to financial accounting by placing the letter “F” in the space to the left of the item and indicate those characteristics that are more closely associated with managerial accounting by placing the letter “M” to the left of the item.

E1.8 (LO 1) Chris Koplinski has prepared the following list of statements about managerial accounting and financial accounting.

1. Financial accounting focuses on providing information to internal users.
2. Managerial accounting analyzes how changes in the number of units produced impact production costs and profitability.
3. Preparation of budgets is part of financial accounting.
4. Managerial accounting applies only to merchandising and manufacturing companies.
5. Both managerial accounting and financial accounting deal with many of the same economic events.
6. Managerial accounting reports are prepared only quarterly and annually.
7. Financial accounting reports are general-purpose reports.
8. Managerial accounting reports pertain to subunits of the business.
9. Managerial accounting reports must comply with generally accepted accounting principles.
10. Although managerial accountants are expected to behave ethically, there is no code of ethical standards for managerial accountants.

Instructions
Identify each statement as true or false. If false, indicate how to correct the statement.
E1.9 (LO 4) The following is a list of terms related to managerial accounting practices.

Instructions

Match each of the terms with the statement below that best describes the term.

- a. __________ A performance-measurement technique that attempts to consider and evaluate all aspects of performance using financial and non-financial measures in an integrated fashion
- b. __________ The group of activities associated with providing a product or service
- c. __________ An approach used to reduce the cost associated with handling and holding inventory by reducing the amount of inventory on hand
- d. __________ A method used to allocate overhead to products based on each product’s use of the activities that cause the incurring of the overhead cost

Cases

C1.10 Love All is a fairly large company manufacturing hockey equipment, located in Toronto. The company manufactures hockey sticks, pucks, clothing, and skates, all bearing the company’s distinctive logo, a large green question mark on a white flocked hockey puck. The company’s sales have been increasing over the past 10 years.

The hockey sticks division has recently implemented several advanced manufacturing techniques. Robot arms hold the hockey sticks in place while the glue dries, and machine vision systems check for defects. The engineering and design team uses computerized drafting and testing of new products. The following managers work in the hockey sticks division:

- Hayley Geagea, sales manager (supervises all sales representatives)
- Luc Lemieux, technical specialist (supervises computer programmers)
- Manny Cordoza, production supervisor (supervises all manufacturing employees)
- Patrick Dumoulin, engineer (supervises all new-product design teams)
- Gary Richardson, cost accounting manager (supervises cost accountants)

Instructions

a. What are the primary information needs of each manager?
b. Which, if any, financial accounting report (s) is each likely to use?
c. Name one special-purpose management accounting report that could be designed for each manager. Include the name of the report, the information it would contain, and how frequently it should be issued.

C1.11 Ethics Million Dollar Mills is a manufacturing firm. The company carefully prepares all financial statements in accordance with Accounting Standards for Private Enterprises (ASPE) and gives a copy of all financial statements to each department. In addition, the company keeps records for quality control, safety, and its environmental pollution. It then prepares “scorecards” for each department indicating their performance. Recently, the financial impact of the second set of information was added, and the information has been used in the evaluation of employees for merit pay and promotions.

At the most recent employee meeting, Thanh Nguyen, marketing manager, expressed his discomfort with the system. He said there was no guarantee that the second set of information was fair since there were no generally accepted principles for this kind of information. He also said that it was kind of like keeping two sets of books—one following all legal requirements, and the other one actually used by the company.

Instructions

a. Is it ethical to evaluate managers in the way described? Explain briefly.
b. Name at least two safeguards the company could use its system to ensure the ethical treatment of employees.

“All About You” Activity

C1.12 The primary purpose of managerial accounting is to provide information useful for management decisions. Many of the managerial accounting techniques that you learn in this course will be useful for decisions you make in your everyday life. After you graduate, one of the next important decisions you’ll have to make is where to work.
Instructions

Suppose that you go for job interviews and are given an offer of employment by two competing firms for the same entry-level position. They are offering the same salary and benefits. Their offices are in different cities. They are both public companies, so their annual reports containing financial and other information are available to you for free on their websites. For each of the following factors, provide an example of the numerical information you would need to help decide which firm to work for.

a. Which company is currently more profitable
b. Which city is more economical to live in
c. Which company has better long-term prospects
d. Which company might have more opportunities for advancement

Decision-Making at Current Designs

Each chapter contains an exercise based on Current Designs, the company that was featured at the beginning of this chapter. We are excited to present hypothetical managerial accounting situations that are based on the operations of a real company. However, to protect the proprietary nature of this information, the amounts in these exercises are realistic but not the actual data that would be found in Current Designs’ accounting records. Students can also work through this exercise following an Excel tutorial available in WileyPLUS and the book’s companion website. Each chapter’s tutorial focuses on a different Excel function or feature.

DM1.1 Mike Cichanowski founded Wenonah Canoe and later purchased Current Designs, a Canadian company that designs and manufactures kayaks. The kayak manufacturing facility is located just a few minutes from the canoe company’s headquarters in Winona, Minnesota.

Current Designs makes kayaks using two different processes. The rotational moulding process uses high temperature to melt polyethylene powder in a closed rotating metal mould to produce a complete kayak hull and deck in a single piece. These kayaks are less labour-intensive and less expensive for the company to produce and sell.

Its other kayaks use the vacuum-bagged composite lamination process (which we will refer to as the composite process). Layers of fibreglass or Kevlar® are carefully placed by hand in a mould and are bonded with resin. Then, a high-pressure vacuum is used to eliminate any excess resin that would otherwise add weight and reduce the strength of the finished kayak. These kayaks require a great deal of skilled labour because each boat is individually finished. The exquisite finish of the vacuum-bagged composite kayaks gave rise to Current Designs’ tagline, “A work of art, made for life.”

Current Designs has the following managers:
Mike Cichanowski, CEO
Diane Buswell, Controller
Deb Welch, Purchasing Manager
Bill Johnson, Sales Manager
Dave Thill, Kayak Plant Manager
Rick Thrune, Production Manager for Composite Kayaks

Instructions

a. What are the primary information needs of each manager?
b. Name one special-purpose management accounting report that could be designed for each manager. Include the name of the report, the information it would contain, and how frequently it should be issued.

Waterways Continuing Problem

WCP.1 Waterways Corporation is a private company providing irrigation and drainage products and services for residential, commercial, and public sector projects, including farms, parks, and sports fields. It has a plant located in a small city north of Toronto that manufactures the products it markets to retail outlets across Canada. It also maintains a division that provides installation and warranty servicing in the Greater Toronto Area.

The mission of Waterways is to manufacture quality parts that can be used for effective water management, be it drainage or irrigation. The company hopes to satisfy its customers with its products, provide rapid and responsible service, and serve the community and the employees who represent it in each community.

The company has been growing rapidly, so management is considering new ideas to help the company continue its growth and maintain the high quality of its products. Waterways was founded by Phil Clark Sr., who has since retired. He continues to own a majority of the company shares. Now his son, Phil Clark Jr., is the company president and chief executive officer (CEO). Working with Phil Sr. from the company’s inception is his brother, Ben, whose sprinkler designs and ideas about the installation of proper systems have been a major reason for the company’s success. Ben is the vice-president of operations and oversees all aspects of design and production in the company.

The plant itself is managed by Ryan Smith, who reports to Ben. First-line supervisors reporting to Ryan are responsible for the plant employees. The plant makes all of the parts for the irrigation and drainage systems. The purchasing department is managed by Jo Chan, who also reports to Ryan.

The installation and training division is overseen by service vice-president Lee Williams, who supervises the managers of the six local installation operations. Each of these local managers hires his or her own local service people. These service employees are trained at headquarters under Lee’s direction because of the uniqueness of the company’s products.

Kim Martin acts as vice-president of human resources. Kim manages a small team that is responsible for human resource development, salary administration, and group benefits. Each department does its own hiring. Madison Tremblay is the sales and marketing vice-president, with a sales force of 10 experienced professionals.

The company’s accounting and finance division is headed by Jordan Leigh, CPA, as vice-president of finance and chief financial officer (CFO). There is a small staff of professionally designated accountants, including a controller and a treasurer, and clerical staff members who maintain the financial records.

Instructions

Based on the information provided, construct an organizational chart for Waterways Corporation.