CHAPTER 1 The Accountant's Role in the Organization

If you have not already read the Introduction page, do so now. It describes the purposes and contents of the *Student Guide* and recommends a six-step approach for using the *Student Guide* with the textbook.

Overview

Welcome to the study of cost accounting. This introductory chapter explains the intertwining roles of managers and management accountants in choosing an organization's strategy, and in planning and controlling its operations. Unlike the remainder of the textbook, this chapter has no "number crunching." Its main purpose is to emphasize the management accountant's role in providing information for managers.

Review Points

1. It is important to distinguish **management accounting** from **financial accounting**.

- *Management accounting* measures, analyzes, and reports financial and nonfinancial information that helps managers make decisions to fulfill the goals of an organization. Management accounting (a) emphasizes the future, (b) aims to influence the behavior of managers and employees in achieving the goals of an organization, and (c) is not particularly constrained by generally accepted accounting principles (GAAP).
- *Financial accounting* focuses on reporting to external parties, such as investors, government agencies, banks, and suppliers. It measures and records business transactions and provides financial statements—the balance sheet, income statement, statement of cash flows, and statement of retained earnings—based on GAAP.

2. **Cost** accounting measures and reports financial and nonfinancial information relating to the costs of acquiring or utilizing resources in an organization. Cost accounting provides information for both management accounting and financial accounting.

3. **Cost management** is the approaches and activities of managers in short-run and long-run planning and control decisions that increase value for customers and lower costs of products and services. For example, rearranging the production-floor layout might reduce manufacturing costs, or additional product design costs might be incurred in an effort to increase revenues and profits.

4. **Strategy** specifies how an organization matches its own capabilities with the opportunities in the marketplace to accomplish its objectives. In other words, strategy describes how an organization will compete and the opportunities its employees should seek and pursue. Companies follow one of two broad strategies:

- Sell quality products or services at low prices. An example is Southwest Airlines.
- Sell relatively unique products or services at higher prices than charged by competitors. An example is Ralph Lauren.

Choosing between these strategies is among the most important decisions that managers make. The term **strategic cost management** is often used to describe cost management that specifically focuses on strategic issues.

5. The **value chain** refers to the sequence of business functions in which usefulness (value to the customer) is added to the products or services of a company. These business functions are **research and development (R&D); design of products, services, or processes; production; marketing; distribution;** and **customer service.** Managers in each of these six business functions of the value chain are customers of management accounting information. Rather than proceeding sequentially through the value chain, companies can realize significant gains when various parts of

the value chain work together. For example, additional spending on R&D and product design might be more than offset by lower costs of production and customer service.

6. The term **supply chain** describes the flow of goods, services, and information from the initial sources of materials and services to the delivery of products to customers, regardless of whether those activities occur in the same organization or in other organizations. Cost management emphasizes integrating and coordinating activities across all companies in the supply chain, as well as across each business function in an individual company's value chain, to reduce costs.

7. Customers want companies to use the value chain and supply chain to deliver ever-improving levels of performance regarding four key success factors:

a. *Cost and efficiency*—Companies face continuous pressure to reduce the cost of the products or services they sell. Examples include eliminating the need for rework and outsourcing one or more business functions to foreign countries.
b. *Quality*—Customers expect high levels of quality. Total quality management (TQM) is a philosophy in which management improves operations throughout the value chain to deliver products and services that exceed customer expectations.
c. *Time*—Time has many components. Examples include the time to develop and bring new products to market and the speed at which an organization responds to customer requests.
d. *Innovation*—A constant flow of innovative products or services is the basis for ongoing company success. A main source of innovations is R&D.

Management accountants help managers track performance on the key success factors in comparison to the performance of competitors on the same factors. Tracking what is happening in other companies serves as a *benchmark* and alerts managers to the changes their own customers are observing and evaluating. The goal is for a company to *continuously improve* its critical operations.

8. Management accounting facilitates **planning** and **control**. Planning comprises (a) selecting organization goals, (b) predicting results under various alternative ways of achieving those goals, (c) deciding how to attain the desired goals, and (d) communicating the goals and how to attain them to the entire organization. Control comprises (a) taking actions that implement the planning decisions, (b) deciding how to evaluate performance, and (c) providing feedback that will help future decision making. Planning and control are linked by **feedback**. Managers use feedback to examine past performance (the control function) and systematically explore alternative ways of making better-informed decisions and plans in the future (the planning function).

9. Budgeting is essential for planning and control. A **budget** is the quantitative expression of a proposed plan of action by management for a specified period and is an aid to coordinating what needs to be done to implement that plan. The information used to develop budgets includes past financial and nonfinancial information routinely recorded in accounting systems.

10. Management accountants contribute to the company's decisions about strategy, planning, and control by performing three important roles: **problem solving, scorekeeping**, and **attention directing**. Problem solving uses comparative analysis for decision making. Scorekeeping accumulates data and reports results—to all levels of management—describing how the organization is doing. Attention directing helps managers focus on opportunities and problems. Often these roles are simultaneously performed due to the ongoing interaction among strategic decisions, planning decisions, and control decisions.

11. Three guidelines help management accountants provide the most value to their companies in planning and control activities:

a. *Employ the* **cost-benefit approach.** This approach guides decision making: resources should be spent if they are expected to better attain company goals in relation to the expected costs of those resources. For example, consider budgeting systems as economic goods. The *expected costs* of a proposed budgeting system (such as personnel, software, and training) should be compared with its *expected benefits*, which are the collective decisions of managers that will better attain the company's goals. In particular, measurement of the expected benefits is seldom easy.

b. *Give full recognition to behavioral as well as technical considerations*. A management accounting system should have two simultaneous missions for providing information: (i) to help managers make wise economic decisions by providing them with desired information (the technical mission), and (ii) to help motivate managers and other employees to aim for the goals of the organization (the behavioral mission). Management is primarily a human activity that should focus on how to help individuals do their jobs better.

c. *Use different costs for different purposes.* To illustrate this guideline, consider how to account for advertising. For the purpose of preparing financial statements under GAAP, advertising is an expense in the accounting period when it is incurred. For the purpose of determining a product's selling price, its advertising costs, along with its other costs from all business functions of the value chain, should be taken into account.

12. Most organizations distinguish **line management** from **staff management**. Line management is directly responsible for attaining the goals of an organization. Staff management exists to provide advice and assistance to line management. When organizations rely on teams for attaining their goals, the traditional distinction between line and staff management is less clear-cut than it was a decade ago.

13. The **chief financial officer (CFO)**, a staff management function, is the executive responsible for overseeing the financial operations of an organization, which typically include controllership, treasury, risk management, taxes, and internal audit. The **controller**, also a staff management function, is the financial executive primarily responsible for management accounting and financial accounting. In performing the problem-solving and attention-directing roles, the controller "controls" by exerting a force or influence that helps managers make better-informed decisions as they implement their strategies.

14. Professional accounting organizations promote high ethical standards. Professional accounting organizations such as the **Institute of Management Accountants (IMA)**, the largest association of management accountants in the United States, play an important role in promoting high ethical standards. For example, the IMA has identified four standards of ethical conduct for management accountants: competence, confidentiality, integrity, and objectivity. EXHIBIT 1-7, text p. 16, provides the IMA's guidance on issues relating to the four standards, and EXHIBIT 1-8, text p. 17, gives the IMA's guidance on how to resolve ethical conflict.

Featured Exercise

Exon Tackle Company manufactures a wide range of fishing equipment and supplies for the retail market. In the current fiscal year, Exon incurred the costs described below. For each of these costs, indicate the applicable business function of the value chain by putting the identifying number in the space provided.

Business Functions of the Value Chain

1. Research and development
2. Design of products, services, or processes
3. Production
4. Marketing
5. Distribution
6. Customer service

_____ a. Cost of repairing reels that malfunctioned during the warranty period.
_____ b. Cost of hooks used in making fishing lures.
_____ c. Salary of a mechanical engineer working on the basic concept for the next generation of ultra-light fishing rods.
_____ d. Cost of overnight delivery of rods and reels to winter boat shows.
_____ e. Cost of running advertisements in fishing magazines.
_____ f. Cost of printing operating instructions to be packaged with a new model of trolling motor.

Solution (on next page)

Solution

a. 6 c. 1 e. 4
b. 3 d. 5 f. 3

Review Questions and Exercises

This section is designed to help determine how well you have mastered the textbook material. Try to answer all of these questions and exercises without using your textbook or the Highlights in the *Student Guide*. *In answering the Review Questions and Exercises, be sure to follow Step 4 of the study approach recommended in the Introduction, p. vii*. All answers are at the end of the chapter.

Completion Statements

Fill in the blank(s) to complete each statement.

1. ________________________ (a) emphasizes the future, (b) aims to influence the behavior of managers and other employees in achieving the goals of an organization, and (c) is not particularly constrained by generally accepted accounting principles (GAAP).
2. ___________________________ is the approaches and activities of managers in short-run and long-run planning and control decisions that increase value for customers and lower costs of products and services.
3. Selecting organization goals, predicting results under various alternative ways of achieving these goals, and then deciding how to attain the desired goals are aspects of _________________.
4. A ___________ is a quantitative expression of a proposed plan of action by management for a specified period and is an aid to coordinating what needs to be done to implement that plan.
5. Name the six business functions in the value chain in their sequential order: _____________ ______________________________________ ______________________________________ ______________________________________
6. The _____________________ approach helps managers choose among alternative accounting systems.
7. The Institute of Management Accountants' four standards of ethical conduct for management accountants are _____________ __________________________________ and ______________________.

True-False

Indicate whether each statement is true (T) or false (F).

__ 1. Management accounting is not particularly constrained by generally accepted accounting principles.
__ 2. Cost accounting provides information for management accounting but not for financial accounting.
__ 3. Control is defined as the process of setting maximum limits on expenditures.
__ 4. Managers use feedback to examine past performance and systematically explore alternative ways of making better informed decisions in the future.
__ 5. The scorekeeping role of management accountants uses comparative analysis for decision making.
__ 6. Managers should proceed sequentially through the value chain of business functions.
__ 7. The term supply chain describes the flow of goods, services and information from the initial sources of materials and services to the delivery of products to customers, regardless of whether those activities occur in the same organization or in other organizations.

___ 8. The CFO, a line management function, is the executive responsible for overseeing the financial operations of an organization.

Multiple Choice

Select the best answer to each question.

___ 1. Control includes:
   a. selecting organization goals.
   b. implementing the planning decisions.
   c. deciding how to attain the desired results.
   d. preparing budgets.

___ 2. The primary responsibility of the controller is:
   a. risk management.
   b. overseeing the financial operations of an organization.
   c. management accounting and financial accounting.
   d. obtaining short-term and long-term financing.

___ 3. Maintaining records on traffic tickets issued by the city of Atlanta is performing what management accounting role?
   a. Scorekeeping
   b. Attention directing
   c. Problem solving
   d. Internal auditing

___ 4. The Institute of Management Accountants' *Standards of Ethical Conduct for Management Accountants* includes standards on:
   a. competence and responsibility.
   b. integrity and professionalism.
   c. objectivity and responsibility.
   d. competence and confidentiality.

Exercises

1. Define *strategy*. Then specify the two broad strategies that companies choose between.

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2. For each of the following activities, identify what role is being performed by the management accountant.

PS: Problem solving
SK: Scorekeeping
AD: Attention directing

__ a. Interpreting a monthly report that compares actual and budgeted fuel consumption for each major building at a large university.
__ b. Recording the cost of a sewer project on the books of a construction company.
__ c. Analyzing the costs and benefits to a school district that is considering the purchase of new school buses.
__ d. Preparing the monthly statement for a customer.

3. For each of the following actions by companies, identify the applicable management theme.

CF: Customer focus
KSF: Key success factors (cost and efficiency, quality, time, innovation)
CI: Continuous improvement and benchmarking
VC: Value-chain and supply-chain analysis

__ a. Company X monitors the number and nature of customer complaints on a customer-by-customer basis.
__ b. Company Y reports how long it takes a new product to be introduced to the market after the initial concept for the product is approved by management.
__ c. Company Z reduces the budgeted labor cost of a product by 1% each month when evaluating the performance of a plant manager.

Answers to Chapter 1 Review Questions and Exercises

Completion Statements

1. Management accounting
2. Cost management
3. planning
4. budget
5. research and development (R&D); design of products, services, or processes; production; marketing; distribution; customer service
6. cost-benefit
7. competence, confidentiality, integrity, objectivity

True-False

1. T
2. F Cost accounting provides information for *both* management accounting and financial accounting. Cost accounting measures, analyzes, and reports financial and nonfinancial information relating to the cost of acquiring and using resources in an organization.
3. F Control comprises: (a) taking actions that implement the planning decisions, (b) deciding how to evaluate performance, and (c) providing feedback that will help future decision making.
4. T
5. F The statement describes the *problem-solving role* of management accountants, not the *scorekeeping role*. The scorekeeping role accumulates data and reports results—to all levels of management—describing how the organization is doing.

6. F Rather than proceeding sequentially through the value chain, organizations can realize significant gains when various parts of the value chain work together. For example, additional spending on R&D and product design might be more than offset by lower costs of productions and customer service.
7. T
8. F The CFO, a *staff management* function (not a *line management* function) is the executive responsible for overseeing the financial operations of an organization, which typically include controllership, treasury, risk management, taxes, and internal audit. Staff management exists to provide advice and assistance to line management. Line management is directly responsible for attaining the goals of the organization.

Multiple Choice

1. b Control includes (i) taking actions that implement the planning decisions, (ii) deciding how to evaluate performance, and (iii) providing feedback that will help future decision making. Answers (a), (c) and (d) are aspects of planning.
2. c The controller, a staff management function, is the financial executive primarily responsible for both management accounting and financial accounting.
3. a The scorekeeping role is accumulating data and reporting reliable results—to all levels of management—describing how the organization is doing.
4. d The IMA's *Standards of Ethical Conduct for Management Accountants* has four standards: competence, confidentiality, integrity, and objectivity.

Review Exercise 1

Strategy specifies how an organization matches its own capabilities with the opportunities in the marketplace to accomplish its objectives. In other words, strategy describes how an organization will compete and the opportunities its employees should seek and pursue. Companies follow one of two broad strategies:

- Sell quality products or services at low prices. Examples are Wal-Mart and Southwest Airlines.
- Sell relatively unique products or services at higher prices than those charged by competitors. Examples are Gucci and Ralph Lauren.

Deciding between these strategies is a critical part of what managers do. Management accountants work closely with managers in formulating strategy.

Exercise 2

a. AD b. SK c. PS d. SK

Exercise 3

a. CF b. KSF c. CI