### Chapter 1

**How Management Accounting Information Supports Decision Making**

**Learning Objectives―Coverage by question type**

**LO1** – Understand the major differences between financial and management accounting.

**True / False Multiple Choice Exercises, Problems & Short Answer**

1-8 1-23 1, 2

**LO2** – Appreciate the historical evolution of management accounting to its present set of practices.

**True / False Multiple Choice Exercises, Problems & Short Answer**

9, 10 24 3

**LO3** – Explain why management accounting uses nonfinancial as well as financial measures.

**True / False Multiple Choice Exercises, Problems & Short Answer**

11 25-29 4-6

**LO4** – Explain the role for the balanced scorecard in measuring a company’s intangible assets and capabilities.

**True / False Multiple Choice Exercises, Problems & Short Answer**

12-16 30-38 7, 8

**LO5** – Be sensitive to the behavioral consequences that result from the introduction of new measurement and management systems.

**True / False Multiple Choice Exercises, Problems & Short Answer**

17-19 39-44 9

**Chapter 1: How Management Accounting Information Supports Decision Making**

**True / False**

**LO1**

**Terms: Management accounting**

**Difficulty: 1**

**1.** Management accounting is subject to the rules formulated by standard setters such as the Financial Accounting Standards Board (FASB).

Answer: FALSE

Explanation: Financial accounting is subject to the rules of the FASB.

**LO1**

**Terms: Management accounting**

**Difficulty: 1**

**2.** Management accounting information is primarily oriented to external stakeholders, such as investors, creditors, regulators, and tax authorities.

Answer: FALSE

Explanation: Management accounting information is primarily oriented to management.

**LO1**

**Terms: International Accounting Standards Board**

**Difficulty: 1**

**3.** The International Accounting Standards Board sets the guidelines used for management accounting.

Answer: FALSE

Explanation: Financial accounting must be consistent with the rules of the IASB.

**LO1**

**Terms: Management Accounting**

**Difficulty: 1**

**4.** A good management accounting system can become a source of competitive advantage for a company.

Answer: TRUE

**LO1**

**Terms: Management Accounting**

**Difficulty: 1**

**5.** Management accounting information is sometimes predictive and forward looking.

Answer: TRUE

**LO1**

**Terms: Management Accounting**

**Difficulty: 2**

**6.** Management accounting has no prescribed rules about its content, how the content is to be developed, and how the content is to be presented.

Answer: TRUE

**LO1**

**Terms: Management Accounting**

**Difficulty: 1**

**7.** Management accounting measures can provide advance warnings of problems.

Answer: TRUE

**LO1**

**Terms: Nonfinancial information**

**Difficulty: 1**

**8.** Information about customer satisfaction is an example of financial information.

Answer: FALSE

Explanation: Information about customer satisfaction is an example of nonfinancial information.

**LO2**

**Terms: Evolution of management accounting**

**Difficulty: 2**

**9.** During the history of management accounting, innovations were developed to address the decision-making needs of managers.

Answer: TRUE

**LO2**

**Terms: Evolution of management accounting**

**Difficulty: 2**

**10.** Management accounting innovations are usually developed by academics.

Answer: FALSE

Explanation: Management accounting innovations are usually developed by management accountants in the field.

**LO3**

**Terms: Financial information**

**Difficulty: 1**

**11.** Operating profit is an example of nonfinancial information.

Answer: FALSE

Explanation: Operating profit is an example of financial information.

**LO4**

**Terms: Database and information systems**

**Difficulty: 1**

**12.** Database and information systems are physical assets that create distinctive value for companies.

Answer: FALSE

Explanation: Database and information systems are intangible assets.

**LO4**

**Terms: Balanced scorecard**

**Difficulty: 1**

**13.** The balanced scorecard measures organizational performance across five different but linked perspectives.

Answer: FALSE

Explanation: The balanced scorecard measures organizational performance across four different but linked perspectives that are derived from the organization's mission, vision, and strategy.

**LO4**

**Terms: Learning and growth perspective**

**Difficulty: 1**

**14.** The learning and growth perspective addresses what employee capabilities, information systems, and organizational capabilities we need to continually improve.

Answer: TRUE

**LO4**

**Terms: Process perspective**

**Difficulty: 2**

**15.** The customer perspective of the balanced scorecard focuses on excellence in processes which satisfy customers.

Answer: FALSE

Explanation: The process perspective of the balanced scorecard focuses on excellence in processes which satisfy customers.

**LO4**

**Terms: Customer perspective**

**Difficulty: 2**

**16.** Important measures in the customer perspective usually include the percentage of repeat customers and growth in sales to existing customers.

Answer: TRUE

**LO5**

**Terms: Nonfinancial information**

**Difficulty: 2**

**17.** The design and introduction of new measurements and systems must be accompanied by an analysis of the behavioral and organizational reactions to the measurements.

Answer: TRUE

**LO5**

**Terms: Measurements**

**Difficulty: 2**

**18.** People react when they are being measured, and they react to the measurements.

Answer: TRUE

**LO5**

**Terms: Financial information, nonfinancial information**

**Difficulty: 2**

**19.** Information is never neutral; just the act of measuring and reporting information affects the individuals involved.

Answer: TRUE

**Multiple Choice**

**LO1**

**Terms: Management accounting**

**Difficulty: 2**

1. Management accounting information can be used for all of the following *except*:

A) Calculate the cost of a product or service.

B) evaluate the performance of a company.

C) project materials needs.

D) evaluate the market price of the stock.

Answer: D

**LO1**

**Terms: Management accounting**

**Difficulty: 1**

1. Which of the following types of information are used in management accounting?

A) financial information

B) nonfinancial information

C) information focused on the long term

D) All of the above are correct.

Answer: D

**LO1**

**Terms: Management accounting**

**Difficulty: 2**

1. Management accounting:

A) is both retrospective, providing feedback about past operations, and also prospective, incorporating forecasts and estimates about future events.

B) is primarily oriented to external stakeholders.

C) must be consistent with rules formulated by the Financial Accounting Standards Board (FASB).

D) provides information that is generally available only on a quarterly or annual basis.

Answer: A

**LO1**

**Terms: Management accounting**

**Difficulty: 2**

1. Which of the following descriptors refer to management accounting information?

A) It is only retrospective, reporting and summarizing in financial terms the results of past decisions and transactions.

B) It is driven by rules.

C) It is prepared for shareholders.

D) It is oriented to meeting the decision making needs of employees and managers inside the organization.

Answer: D

**LO1**

**Terms: Management accounting**

**Difficulty: 1**

1. Which of the following would be considered management accounting information?

A) Budgeted production for the current year.

B) Budgeted Balance Sheet.

C) Analysis of trend in stock prices.

D) Both budgeted production for the current year and the budgeted balance sheet.

Answer: D

**LO1**

**Terms: Management accounting**

**Difficulty: 2**

1. Management accounting information includes all of the following *except*:

A) tabulated results of customer satisfaction surveys.

B) the cost of producing a product.

C) the percentage of units produced that is defective.

D) market price of the stock.

Answer: D

**LO1**

**Terms: Management accounting**

**Difficulty: 2**

1. Management accounting reports could include information about:

A) customer complaints.

B) net income for the year on budgeted income statement.

C) total assets on budgeted balance sheet.

D) All of the above are correct.

Answer: D

**LO1**

**Terms: Management accounting**

**Difficulty: 2**

1. The person *most* likely to use management accounting information is a(n):

A) banker evaluating a credit application.

B) shareholder evaluating a stock investment.

C) governmental taxing authority.

D) assembly department supervisor.

Answer: D

**LO1**

**Terms: Management accounting**

**Difficulty: 2**

1. Which of the following is NOT a function of a management accounting system?

A) strategic development

B) financial reporting

C) control

D) product costing

Answer: B

**LO1**

**Terms: Financial accounting**

**Difficulty: 1**

1. Financial accounting:

A) focuses on the future and includes activities such as preparing next year's operating budget.

B) does not need to comply with GAAP (generally accepted accounting principles).

C) is primarily oriented to external stakeholders, such as investors, creditors, regulators and tax authorities.

D) is prepared for the use of department heads and other employees.

Answer: C

**LO1**

**Terms: Financial accounting**

**Difficulty: 2**

1. The person MOST likely to use ONLY financial accounting information is a:

A) factory shift supervisor.

B) vice president of operations.

C) current shareholder.

D) department manager.

Answer: C

**LO1**

**Terms: Management accounting**

**Difficulty: 2**

1. Historically, management accounting innovations have been developed by:

A) the International Accounting Standards Board.

B) the Cost Accounting Standards Board.

C) Academic accountants.

D) Managers.

Answer: D

**LO1**

**Terms: Management accounting**

**Difficulty: 2**

1. In general, it was not until the 1970s that management accounting systems:

A) were improved because of demands by the FASB and the SEC.

B) stagnated and proved inadequate.

C) started to develop innovations in costing and performance-measurement systems due to intense pressure from overseas competitors.

D) started to address the decision-making needs of managers.

Answer: C

**LO1**

**Terms: Financial accounting**

**Difficulty: 2**

1. Financial accounting information:

A) provides a signal that something is wrong.

B) identifies what is wrong.

C) explains what is wrong.

D) simply summarizes information but does not indicate whether anything is wrong.

Answer: D

**LO1**

**Terms: Management accounting**

**Difficulty: 1**

1. Management accounting information is BEST described as:

A) providing a signal that something is wrong.

B) identifying and helping to explain what is wrong.

C) simply summarizing information, but giving no indication that anything is wrong.

D) measuring overall organizational performance.

Answer: B

**LO1**

**Terms: Management accounting**

**Difficulty: 1**

1. Which of the following statements is *not* true about management accounting?
2. Management accounting follows strict reporting rules.
3. Management accounting can sometimes report nonfinancial information.
4. Management accounting reports can include estimated costs or revenues.
5. Management accounting information is seldom provided to people outside the organization.

Answer: A

**LO1**

**Terms: Strategy**

**Difficulty: 1**

1. Which of the following statements is *not* true about strategy?
2. Strategy is about making choices about what decisions to make and not to make.
3. Strategy is about choosing the best fit between the organization’s resources and its opportunities.
4. Strategy is about finding ways to achieve the organization’s objectives.
5. Organizations are required to report their chosen strategy in their financial

Answer: D

**LO1**

**Terms: Roles of management accounting**

**Difficulty: 1**

1. Which of the following organization levels is most likely to find detailed information about the cost of a particular component of a product most useful?
2. The board of directors.
3. The organization’s chief operating officer.
4. The organization’s chief financial officer.
5. A production supervisor.

Answer: D

**LO1**

**Terms: Management accounting and financial accounting differences**

**Difficulty: 1**

1. Which of the following statements does your text suggest is *true*?
2. Financial accounting information tends to be backward looking and management accounting information forward looking
3. Financial accounting focuses on financial numbers while management accounting focuses on both financial numbers and non-financial numbers
4. Financial accounting reporting is driven by rules developed by standard setters while management accounting reporting is driven by the needs of decision makers
5. The text suggests that all these statements are true

Answer: D

**LO1**

**Terms: Management accounting and financial accounting differences**

**Difficulty: 1**

1. Which of the following statements is *false* about management accounting?
   1. Management accounting includes both financial and non-financial information.
   2. Management accounting information often includes estimates about future revenues and costs.
   3. Management accounting information must obey the strict rules developed by accounting authorities.
   4. Management accounting is prepared for decision makers inside the organization.

Answer: C

**LO1**

**Terms: Cost object**

**Difficulty: 2**

1. Which of the following is a potential cost object in management accounting?
   1. A unit of production.
   2. A product line.
   3. A production department.
   4. All the above.

Answer: D

**LO1**

**Terms: Management accounting and financial accounting differences**

**Difficulty: 1**

1. Which of the following statements is *true*?
   1. Management accounting and financial accounting both focus exclusively on financial information.
   2. Management accounting and financial accounting both follow strict reporting rules that are laid down by accounting regulators.
   3. Management accounting is primarily internally focused while financial accounting is primarily externally focused.
   4. Managers inside organizations rely heavily on both management accounting and financial accounting when making operating decisions such as what to produce.

Answer: C

**LO1**

**Terms: Role of management accounting**

**Difficulty: 1**

1. Which of the following items would not usually be part of the focus of management accounting?
   1. The cost of production.
   2. The quality of production.
   3. Providing information to support developing the organization’s strategy.
   4. Tracking the company’s share price.

Answer: D

**LO2**

**Terms: Evolution of management accounting**

**Difficulty: 2**

1. The first modern industry in the United States to develop and use large quantities of financial statistics to assess and monitor organizational performance was:

A) steel companies.

B) lumber companies.

C) the railroads.

D) automobile companies.

Answer: C

**LO3**

**Terms: Financial and nonfinancial information**

**Difficulty: 2**

1. Managers of service departments need all of the following information, *except*:

A) efficiency data on work performance.

B) quality data on work performance.

C) profitability data of the whole company.

D) profitability data of the service department.

Answer: C

**LO3**

**Terms: Financial and nonfinancial information**

**Difficulty: 2**

1. A law firm would use management accounting information for all of the following decisions *except*:

A) staffing needs.

B) performance evaluation of staff.

C) budgeted purchases of supplies.

D) location of annual holiday party.

Answer: D

**LO3**

**Terms: Management accounting**

**Difficulty: 2**

1. Management accounting can play a critical role in the service industry because of all the following reasons, *except*:

A) firms must be especially sensitive to the timeliness and quality of customer service.

B) many employees have very little contact with customers.

C) customers immediately notice defects and a delay in service.

D) dissatisfied customers may never return.

Answer: B

**LO3**

**Terms: Nonfinancial information**

**Difficulty: 2**

1. For improving operational efficiencies and customer satisfaction, nonfinancial information is:

A) critical.

B) moderate.

C) infrequently used.

D) unnecessary.

Answer: A

**LO3**

**Terms: Nonfinancial information**

**Difficulty: 2**

1. Nonfinancial information might be used for all of the following *except*:

A) improve product quality.

B) reduce cycle times.

C) satisfy customers' needs.

D) All of the above are used.

Answer: D

**LO4**

**Terms: Performance measurement systems**

**Difficulty: 1**

1. The roles of performance measurement systems in organizations include all the following *except*:

A) motivate employees to help the organization achieve its strategic objectives.

B) help managers with resource allocation.

C) create value from intangible assets as well as their physical and financial assets.

D) communicate the company's strategic objectives.

Answer: C

**LO4**

**Terms: Intangible assets**

**Difficulty: 2**

1. Many intangible assets:

A) do not appear on the balance sheet since it is difficult to place a reliable financial value on them.

B) should be evaluated with return on investment and other performance measures.

C) can be measured and managed with current financial control systems.

D) are unimportant because they have no physical substance.

Answer: A

**LO4**

**Terms: Intangible assets**

**Difficulty: 1**

1. Intangible assets that are currently reported on the balance sheet include:

A) loyal and profitable customer relationships.

B) organizational culture.

C) employee skills and motivation.

D) the cost of a patent giving exclusive rights to a process.

Answer: D

**LO4**

**Terms: Balanced scorecard**

**Difficulty: 1**

1. The use of multiple-performance measures in the balanced scorecard would be expected to lead to all of the following *except*:

A) more extensive use of financial measures such as cost and profit.

B) employees recognizing the various dimensions of their work.

C) the use of new performance measures such as customer satisfaction and employee morale.

D) group-level performance measures.

Answer: A

**LO4**

**Terms: Balanced scorecard**

**Difficulty: 1**

1. The balanced scorecard is said to be "balanced" because it measures:

A) short-term and long-term objectives.

B) financial and nonfinancial objectives.

C) internal and external objectives.

D) All of the above are correct.

Answer: B

**LO4**

**Terms: Balanced scorecard**

**Difficulty: 1**

1. \_\_\_\_\_\_\_\_ translate(s) an organization's mission, vision, and strategy into a comprehensive set of performance measures that provide the framework for implementing its strategy.

A) Critical success factors

B) The value proposition

C) Objectives

D) The balanced scorecard

Answer: D

**LO4**

**Terms: Financial perspective**

**Difficulty: 2**

1. The \_\_\_\_\_\_\_\_ perspective of the balanced scorecard asks, "How is success measured by our shareholders?"

A) learning and growth

B) customer

C) financial

D) shareholder

Answer: C

**LO4**

**Terms: Customer perspective**

**Difficulty: 1**

1. The \_\_\_\_\_\_\_\_ perspective of the balanced scorecard focuses on creating value for customers.

A) Value

B) Financial

C) Stakeholder

D) Customer

Answer: D

**LO4**

**Terms: Learning and growth perspective**

**Difficulty: 1**

1. Measures of employees' skills and capabilities are included in the \_\_\_\_\_\_\_\_ perspective of the balanced scorecard.

A) financial

B) internal

C) customer

D) learning and growth perspective

Answer: D

**LO5**

**Terms: Nonfinancial information**

**Difficulty: 2**

1. The act of simply measuring and reporting information on certain processes:

A) focuses the attention of employees on those processes that are being measured.

B) diverts the employee's attention to other activities that are not being measured.

C) disproves the saying "What gets measured gets managed."

D) has no effect on employee behavior.

Answer: A

**LO5**

**Terms: Financial information, nonfinancial information**

**Difficulty: 2**

1. Which statement below is *false*?

A) "What gets measured gets managed."

B) People react to measurements.

C) Employees spend more attention on those variables that are not getting measured.

D) "If I can't measure it, I can't manage it."

Answer: C

**LO5**

**Terms: Nonfinancial information**

**Difficulty: 1**

1. When a change is introduced, employees tend to:

A) embrace the change.

B) be indifferent to the change.

C) exhibit no change in behavior.

D) resist the change.

Answer: D

**LO5**

**Terms: Nonfinancial information**

**Difficulty: 2**

1. The introduction of a new management accounting system is MOST likely to motivate UNWANTED employee behavior when it is used for:

A) evaluation.

B) planning.

C) decision making.

D) coordinating individual efforts.

Answer: A

**LO5**

**Terms: Financial information, nonfinancial information**

**Difficulty: 2**

1. Managers are MOST likely to feel outside pressure to influence the numbers favorably when the information is used for:

A) budgeting.

B) compensation and promotions.

C) continuous improvement.

D) product costing.

Answer: B

**LO5**

**Terms: Nonfinancial information, Hawthorne study**

**Difficulty: 2**

1. The Hawthorne study revealed that:

A) individuals alter their behavior when they know they are being studied.

B) groups alter their behavior when they know they are being studied.

C) People react when they are being measured.

D) All of the above are correct.

Answer: D

**Exercises, Problems & Short Answer**

**LO1**

**Terms: Management accounting, financial accounting**

**Difficulty: 2**

**1.** Compare and contrast the users and uses of management accounting and financial accounting.

Answer:

Management accounting provides information to internal decision makers of the business such as line supervisors, division managers and top executives. Its purpose is to help managers plan, organize, control and make operating decisions by predicting future results and evaluating performance.

Financial accounting provides information to external decision makers such as investors and creditors. Its purpose is to present a fair picture of the financial condition of the company for use by these parties in making investing and credit decisions.

**LO1**

**Terms: Management accounting**

**Difficulty: 2**

**2.** What are the main roles of management accounting?

Answer:

Management accounting gathers short-term and long-term financial and nonfinancial information to help managers plan, coordinate, motivate, improve, control, and evaluate success factors of an organization. Management accounting converts data into usable information that supports planning, organizing, and control decision making.

**LO2**

**Terms: Evolution of management accounting**

**Difficulty: 3**

**3.** What role has the increasingly competitive business environment played in the development of management accounting?

Answer:

The competitive environment has changed dramatically. The deregulation movement in North America and Europe during the 1970s and 1980s changed the ground rules under which service companies operate. In addition, organizations encountered severe competition from overseas companies that offered high-quality products at low prices. This led to an improvement of operational control systems such that information is more current and provided more frequently. Employees need better management accounting information and accurate and timely information to improve the activities they perform and to make decisions. Employees also want innovations in management accounting information. Nonfinancial information has become a critical feedback measure. Finally, the focus of many firms is now on measuring and managing activities.

**LO3**

**Terms: Financial and nonfinancial information**

**Difficulty: 2**

**4.** Why has the role of management accounting expanded to include both financial and nonfinancial information?

Answer:

Decision makers involved in strategic information have begun to use nonfinancial information as leading indicators or to explain financial results--for example, to determine whether customer or employee satisfaction measures affect financial results such as sales and costs.

**LO3**

**Terms: Financial accounting, Management accounting**

**Difficulty: 3**

**5.** Is financial accounting or management accounting more useful to an operations manager? Why?

Answer:

Management accounting is more useful to an operations manager because management accounting reports operating results by department or unit rather than for the company as a whole, it includes financial as well as nonfinancial data such as the number or percent of on-time deliveries and cycle times, and it includes quantitative as well as qualitative data such as the type of rework that was needed on defective units. It also provides information to control operations; it measures and evaluates existing systems to identify problems.

**LO3**

**Terms: Financial information, nonfinancial information**

**Difficulty: 3**

**6.** Give two examples of financial information and nonfinancial information.

Answer: Financial information includes amounts that can be expressed in dollar amounts such as sales, net income, and total assets. It also includes ratios prepared using financial information such as the percentage increase in sales, return-on-sales, and return-on-investment.

Nonfinancial information includes measures that are not expressed in dollar amounts. For example, nonfinancial measures of customer satisfaction include the number of repeat customers or ranked estimates of satisfaction levels. Nonfinancial measures of production quality include percent of on-time deliveries, the number of defects, and production yield.

**LO4**

**Terms: Financial and nonfinancial information**

**Difficulty: 2**

**7.** How does the balanced scorecard identify the role of the importance of measuring an organization’s intangible resources?

Answer:

By identifying the roles of the learning and growth, process, and customer perspectives in driving the organization’s objectives, the balanced scorecard identifies the need for organizations to measure, and thereby manage, their intangible assets, such as organization knowledge reflected in the design of operating systems, employee skills and attitudes, and the organization’s customer franchise.

**LO4**

**Terms: Intangible assets**

**Difficulty: 2**

**8.** Give at least two examples of intangible assets. Are intangible assets critical for success? Explain.

Answer:

Yes, business has moved from the industrial age into the information age where knowledge-based intangible assets create value and are critical for success. Examples include loyal and profitable customer relationships, high-quality processes, innovative products and services, employee skills and motivation, and database and information systems.

**LO5**

**Terms: Performance evaluation**

**Difficulty: 3**

**9.** Discuss the potential behavior implications of performance evaluation.

Answer:

As measurements are made on operations and, especially, on individuals and groups, the behavior of the individuals and groups are affected.

People react to the measurements being made. They will focus on those variables or the behavior being measured and pay less attention to those that are not measured. Managers and employees may take unexpected and undesirable actions to influence their score on performance measures. For example, managers may skip discretionary expenses in order to increase their bonus.