

Managerial Accounting: Tools for Decision Making

LEARNING OBJECTIVES

- LO1** Contrast financial and managerial accounting and explain how managerial accounting is used by internal decision makers. (p. 4)
- LO2** Explain how an organization's mission, goals, and strategies affect managerial accounting. (p. 7)
- LO3** Discuss the factors determining changes in the nature of business competition. (p. 13)
- LO4** Differentiate among structural, organizational, and activity cost drivers. (p. 14)
- LO5** Explain the nature of the ethical dilemmas managers and accountants confront. (p. 16)

MISSIONS, GOALS, AND STRATEGIES

The automobile industry is experiencing some rough times. With fuel costs increasing, sales sagging, profits crashing, and auto plants closing this hardly seems like the time to start a new automobile company. Nevertheless, newly organized **Carbon Motors Corporation** is revving up to fill their stated *mission* of building “the world’s first purpose-built law enforcement patrol vehicle.” By following a *strategy* focused on the needs of this narrow market segment or niche, marketing directly to government agencies, and utilizing innovative manufacturing approaches, management believes Carbon Motors can accomplish its profitability *goal* with an annual sales volume between 10,000 and 80,000 units.

According to Carbon Motors Chief Executive Officer (CEO) William Santana Li, current police cars are basically “a retail passenger car with some lights on it” purchased through a local car dealer and then modified with between \$5,000 and \$35,000 of aftermarket equipment that was not designed, engineered, or manufactured by an automaker. Starting from scratch, Carbon Motors developed a set of criteria they believe reflects the needs and wants of the law enforcement personnel. They then designed a product to meet 95 percent of these criteria.

To achieve profitability at their anticipated scale of operations with competitive pricing, they plan to contain costs by selling directly to law



Courtesy of Carbon Motors Corporation

enforcement agencies (rather than through dealers) and avoid inventory carrying costs by building only to fill customer orders. Management believes that direct sales to government agencies will also allow Carbon Motors to avoid major media advertising costs required for sales to the general public. Also avoided are the costs of annual “face-lifts” that are the norm for passenger vehicles. And, to the extent possible, Carbon Motors plans to minimize investments in manufacturing facilities and all of the issues associated with operating such facilities. Instead, the production of many of the components included in completed vehicles will be accomplished by contract manufacturing. Carbon Motors will then assemble the final product at facilities under development near Atlanta, Georgia.

Although CEO Li and other members of the top-management team have many years of experience at established automobile companies, they are sober about the challenges they face. Fortunately, given the company’s stage of development and lack of current sales, Carbon Motors Corporation is a privately held company without public stock. Being privately held relieves management of many issues related to shareholder expectations, such as current profits. Management must still, of course, meet the expectations of private investors and use accounting concepts as tools to accomplish the mission of Carbon Motors. We start this chapter by considering how companies use financial and managerial accounting and by examining the all important mission, goals, and strategies that provide broad guidelines for all members of the management team.¹

¹ Gary S. Vasilash, “Creating a New Car Company,” *Fleet Owner*, December 2007, p.96; Gary S. Vasilash, Creating a New Car Company. *Automotive Design and Production*, May 2006, pp.46-47; John Toon, “First Responders: Carbon Motors and Georgia Tech to Collaborate on Development of World’s First “Purpose-Built” Law Enforcement Vehicle,” <http://gtresearchnews.gatech.edu/newsrelease/carbon.htm>, April 21, 2006; www.carbonmotors.com.

CHAPTER ORGANIZATION



This chapter provides an overview of the factors that make managerial accounting increasingly important to successful businesses. We begin by distinguishing between financial and managerial (also called *management*) accounting and by investigating how competitive strategy affects the way organizations, such as **Carbon Motors**, use managerial accounting information. Next, we explore how the emergence of global competition and changes in technology have increased the need to understand managerial accounting concepts. We also provide an overview of factors that influence costs in an organization and how these factors have changed in recent years. Finally, we examine the interrelationships among measurement, management, and ethics.

INTERNAL USES OF ACCOUNTING INFORMATION

Financial Accounting

LO1 Contrast financial and managerial accounting and explain how managerial accounting is used by internal decision makers.

Financial accounting is an information-processing system that generates general-purpose reports of financial operations (income statement and statement of cash flows) and financial position (balance sheet) for an organization. Although financial accounting is used by decision makers inside and outside the firm, financial accounting typically emphasizes external users, such as security investors, analysts, and lenders. Adding to this external orientation are external financial reporting requirements determined by law and generally accepted accounting principles.

Financial accounting is also concerned with keeping records of the organization's assets, obligations, and the collection and payment of cash. An organization cannot survive without converting sales into cash, paying for purchases, meeting payroll, and keeping track of its assets.

The **income statement** is a summary of economic performance during a period of time, showing the revenues generated by operations, the expenses matched to those revenues, and any gains and losses attributed to the period. The **statement of cash flows** is a summary of resource inflows and outflows stated in terms of cash. This statement summarizes cash flows from operating, investing, and financing activities. The **balance sheet** is a picture of the economic position of an organization at a specific time, showing the organization's assets and the claims on those assets. Complete financial statements also include a **statement of owners' equity** that summarizes changes in owner's equity and detailed footnotes summarizing accounting policies. These financial statements, typically prepared quarterly and annually, report on the past activities of the organization.

Equity investors, creditors, and others rely on financial statements to help evaluate the amount, timing, and uncertainty of future cash flows. These statements also provide a basis for interested parties to contract on audited financial numbers. For instance, creditors may use financial statements to design loan covenants, owners may use the statements for determining performance-based pay for their managers, and franchisors may assess royalties from franchisees on these numbers. Thus, financial accounting information helps create value by aiding firms in accessing outside funding and in contracting with interested parties.

Managers often use income statements and balance sheets as a starting point in evaluating and planning the firm's overall activities. Managers learn a great deal by performing a comparative analysis of their firm and competing firms. Corporate goals are often stated using financial accounting numbers such as net income, or ratios such as return on investment and earnings per common share. However, internal decision makers often find the information provided in financial statements of limited value in managing day-to-day operating activities. They often complain that financial accounting information is too aggregated, prepared too late, based on irrelevant past costs, and not action oriented. For example, the costs of all items produced and sold or all services rendered are summarized in a single line in most financial statements, making it impossible to determine the costs of individual products or services. Financial accounting procedures, acceptable for costing inventories as a whole, often produce misleading information when applied to individual products. Even when they are accurately determined, the costs of individual products or services are rarely detailed enough to provide the information needed for decisions concerning the factors that influence costs. Financial accounting reports, seldom prepared more than once a month, are not timely enough for use in the management of day-to-day activities that cause excess costs. Finally, financial accounting reports are mainly based on historical costs rather than on current or future costs. Managers are more interested in future costs than in historical costs such as last year's depreciation. While financial accounting information is useful in making some management decisions, its primary emphasis is not on internal decision making.

Managerial Accounting

Managers are constantly faced with the need to understand and control costs, make product decisions, coordinate resources, and guide and motivate employees. **Managerial accounting** provides an information framework to organize, evaluate, and report proprietary data in light of an organization's goals. This information is directed to managers and other employees within the organization. Managerial accounting reports can be designed to meet the information needs of internal decision makers. Top management may need only summary information prepared once a month for each business unit. An engineer responsible for hourly production scheduling may need continuously updated and detailed information concerning the cost of alternative ways of producing a product.

Because of the intensity of competition and the shorter life cycles of new products and services, managerial accounting is crucial to an organization's success. All managers must understand the financial implications of their decisions. While accountants are available to assist in obtaining and evaluating relevant information, individual managers are responsible for requesting information, analyzing it, and making the final decisions. The increased use of accounting information is further examined in the Research Insight box that follows.

RESEARCH INSIGHT

Managerial Accounting Is a Key to Success

After studying several highly competitive, world-class companies, noted managerial accounting guru Robin Cooper observed that "with the emergence of the lean enterprise and increased global competition, companies must learn to be more proactive in the way they manage costs. For many, survival is dependent upon their abilities to develop sophisticated cost management systems that create intense pressure to reduce costs." He also observed that "as cost management becomes more critical to a company's survival, two trends emerge. First, new forms of cost management are required, and second, more individuals in the firm become actively involved in the cost management process." Cooper suggests that with the growing number of managers involved in the cost management process, there is an increased need for managerial accounting information (and people who know how to use it).²

Managerial accounting information exists to serve the needs of management. Hence, it is subject to a cost-benefit analysis and should be developed only if the perceived benefits exceed the costs of development and use. Also, while financial measures are often used in managerial accounting, they are not used to the exclusion of other measures. Money is simply a convenient way of expressing events in a form suitable to summary analysis. When this is not possible or appropriate, nonfinancial measures are used. Time, for

² Robin Cooper, "Look Out, Management Accountants," *Management Accounting*, May 1996, pp. 20–26.

example, is often an important element of quality or service. Hence, many performance measures focus on time, for example:

- Internet vendors such as **Amazon.com** and **Netflix** track delivery time.
- Fire departments and police departments measure the response time to emergency calls.
- Airlines, such as **United Airlines** as well as the Federal Aviation Administration monitor the number of on-time departures and arrivals.

No external standards (such as requirements of the Securities and Exchange Commission) are imposed on information provided to internal users. Consequently, managerial accounting information may be quite subjective. In developing a budget, management is more interested in a subjective prediction of next year's sales than in an objective report on last year's sales. The significant differences between financial and managerial accounting are summarized in Exhibit 1.1.

EXHIBIT 1.1		Differences Between Financial and Managerial Accounting	
Financial Accounting		Managerial Accounting	
Information for internal <i>and</i> external users	General-purpose financial statements	Information for internal users	Special-purpose information and reports
Statements are highly aggregated	Relatively long reporting periods	Information is aggregated or detailed, depending on need	Reporting periods are long or short, depending on need
Report on past decisions	Follows generally accepted accounting principles	Oriented toward current and future decisions	Not constrained by generally accepted accounting principles
Must conform to external standards	Emphasizes objective data	No external standards	Encourages subjective data, if relevant

Strategic Cost Management

Most businesses are under constant pressure to reduce costs to remain competitive. A 2007 study by the accounting firm **KPMG** reported that more than 80 percent of survey participants viewed an efficient cost structure as a source of long-term competitive advantage.³

During recent years, the rapid introduction of improved and new products and services has shortened the market lives of products and services. Some products, such as personal computers, can be obsolete within two or three years after introduction. At the same time, the increased use of complex automated equipment makes it difficult to change production procedures after production begins. Combining short product life cycles with automated production results in an environment where most costs are determined by decisions made before production begins (decisions concerning product design and production procedures).

In response to these trends, a strategic approach to managerial accounting, referred to as *strategic cost management* has emerged. Strategic cost management is a blending of three themes:

1. **Strategic position analysis**—an examination of an organization's basic way of competing to sell products or services.
2. **Cost driver analysis**—the study of factors that cause or influence costs.
3. **Value chain analysis**—the study of value-producing activities, stretching from basic raw materials to the final consumer of a product or service.⁴

We define **strategic cost management** as making decisions concerning specific cost drivers within the context of an organization's business strategy, internal value chain, and position in a larger value chain stretching from the development and use of resources to final consumers. Strategic position analysis is considered in this chapter as part of an organization's strategy. Cost driver analysis is also introduced in this chapter and examined further in Chapter 2. Value chain analysis is discussed in Chapter 8.

³ Rethinking Cost Structures: Creating a Sustainable Cost Advantage, KPMG, 2007, p. 60.

⁴ John K. Shank, "Strategic Cost Management: New Wine, or Just New Bottles?" *Journal of Management Accounting Research*, Fall 1989, p. 50.

ORGANIZATIONS: MISSIONS, GOALS, AND STRATEGIES

An organization's **mission** is the basic purpose toward which its activities are directed. **Carbon Motors'** current mission is to build "the world's first purpose-built law enforcement patrol vehicle." **Starbucks'** mission is to "establish Starbucks as the premier purveyor of the finest coffee in the world while maintaining our uncompromising principles while we grow."⁵ Organizations vary widely in their missions. One benefit of a mission statement is to help focus all the activities of an organization. For instance, the former chairman and CEO of Coca-Cola stated that the mission of **The Coca-Cola Company** is "to create value over time for the owners of our business." He went on to say:

Our society is based on democratic capitalism. In such a society, people create specific institutions to help meet specific needs. Governments are created to help meet social needs. . . . Businesses such as ours are created to meet economic needs. The common thread between these institutions is that they can flourish only when they stay focused on the specific need they were created to fulfill. When institutions try to broaden their scope beyond their natural realms, when for example they try to become all things to all people, they fail.⁶

The CEO of Coca-Cola believed that Coca-Cola best contributes to society and helps government and other organizations fulfill their missions by staying focused on shareholder value. He believed focusing on economics keeps a company financially healthy, and a healthy company fills its responsibilities. Conversely, a bankrupt company is incapable of paying taxes, employing people, serving customers, supporting charitable institutions, or making other contributions to society.

We frequently distinguish between organizations on the basis of profit motive. **For-profit organizations** have profit as a primary objective, whereas **not-for-profit organizations** do not have profit as a primary objective. Clearly, the Coca-Cola Company is a for-profit organization, whereas the **City of Chicago** and the **Red Cross** are not-for-profit organizations. (The term *nonprofit* is frequently used to refer to what we have identified as not-for-profit organizations.) Regardless of whether a profit motive exists, organizations must use resources wisely. Every dollar **United Way** spends for administrative salaries is a dollar that cannot be used to support charitable activities. Not-for-profit organizations, including governments, can go bankrupt if they are unable to meet their financial obligations. All organizations, for-profit and not-for-profit, should use managerial accounting concepts to ensure that resources are used wisely.

A **goal** is a definable, measurable objective. Based on the organization's mission, management sets a number of goals. For-profit organizations have some measure of profitability or shareholder value as one of their stated or implicit goals. The mission of a paper mill located in a small town is to provide quality paper products in order to earn a profit for its owners. The paper mill's goals might include earning an annual profit equal to 10 percent of average total assets, maintaining annual dividends of \$2 per share of common stock, developing a customer reputation for above-average quality and service, providing steady employment for area residents, and meeting or exceeding environmental standards.

A clear statement of mission and well-defined goals provides an organization with an identity and unifying purpose, thereby ensuring that all employees are heading in the same direction. Having developed a mission and a set of goals, employees are more apt to make decisions that move the organization toward its defined purpose.

A **strategy** is a course of action that will assist in achieving one or more goals. Much of this text will focus on the financial aspects of selecting strategies to achieve goals. For example, if an organization's goal is to improve product quality, possible strategies for achieving this goal include investing in new equipment, implementing additional quality inspections, prescreening suppliers, reducing batch size, redesigning products, training employees, and rearranging the shop floor. Managerial accounting information will assist in determining which of the many alternative strategies for achieving the goal of quality improvement are cost effective. The distinction between mission, goals, and strategies is illustrated in Exhibit 1.2.

LO2 Explain how an organization's mission, goals, and strategies affect managerial accounting.

⁵ www.starbucks.com

⁶ Roberto Goizueta, "Why Shareholder Value?" *CEO Series Issue No. 13*, February 1997, Center for the Study of American Business, Washington University in St. Louis, p. 2.

EXHIBIT 1.2 Mission, Goals, and Strategies	
Mission	Basic purpose toward which activities are directed, typically ongoing and not precisely measurable. For example, achieving a monetary profit by providing outdoor mountain adventures is the mission of a mountain guide.
Goals	Definable, measurable targets or objectives based on the organization's mission. One goal of a mountain guide might be for his or her clients to reach the peak of a notable mountain.
Strategies	Courses of action that will assist in achieving one or more goals. The mountain guide needs to select a safe and cost-effective strategy to reach the peak.

Strategic Position Analysis

In competitive environments, managers must make a fundamental decision concerning their organization's goal for positioning itself in comparison to competitors. This goal is referred to as the organization's **strategic position**. Much of the organization's strategy depends on this strategic positioning goal. Michael Porter, a highly regarded expert on business strategy, has identified three possible strategic positions that lead to business success:⁷

1. Cost leadership
2. Product or service differentiation
3. Market niche

According to Porter, cost leadership

requires aggressive construction of efficient-scale facilities, vigorous pursuit of cost reductions from experience, tight cost and overhead control, avoidance of marginal customer accounts, and cost minimization in areas like R&D [research and development], service, sales force, advertising, and so on. A great deal of managerial attention to cost control is necessary to achieve these aims. Low cost relative to competitors becomes the theme running through the entire strategy, though quality, service, and other areas cannot be ignored.⁸

Achieving cost leadership allows an organization to achieve higher profits selling at the same price as competitors or by allowing the firm to aggressively compete on the basis of price while remaining profitable. One of the first companies to successfully use a cost leadership strategy was **Carnegie Steel Company**.

Carnegie's operating strategy was to push his own direct costs below his competitors so that he could charge prices that would always ensure enough demand to keep his plants running at full capacity. This strategy prompted him to require frequent information showing his direct costs in relation to those of his competitors. Possessing that information and secure in the knowledge that his costs were the lowest in the industry, Carnegie then mercilessly cut prices during economic recessions. While competing firms went under, he still made profits. In periods of prosperity, when customers' demands exceeded the industry's capacity to produce, Carnegie joined others in raising prices.⁹

Southwest Airlines and **Dell** are current examples of successful businesses competing with a strategy of cost leadership. Although **Amazon.com** uses the Internet to differentiate itself from traditional book-sellers, its primary strategic position is price leadership.

Conversely, while an organization might compete primarily on the basis of price, management must take care to ensure their product or service remains attuned to changing customer needs and preferences. In the early twentieth century, **General Motors** employed a differentiation strategy, focusing on the rapid

⁷ Michael E. Porter, *Competitive Strategy* (New York: The Free Press, 1980), p. 35.

⁸ Porter, p. 35.

⁹ H. Thomas Johnson and Robert S. Kaplan, *Relevance Lost: The Rise and Fall of Management Accounting* (Boston: Harvard Business School Press, 1987), pp. 33–34.

introduction of technological change in new automobile designs to overcome the market dominance of the Model T produced by **Ford Motor Company**. While successfully following a cost leadership strategy for years, Ford made the mistake of excluding other considerations such as vehicle performance and customer desires for different colors.¹⁰ The following Business Insight box reports on **Corning Corporation**'s strategy of product differentiation to achieve a competitive advantage.

BUSINESS INSIGHT**A Century of Innovation Sets Corning Apart**

Corning Incorporated, whose mission is to be “the world leader in specialty glass and ceramics,” is a textbook example of a successful company with a strategy of product differentiation based on researching, developing, and manufacturing innovative products. The lengthy list of new products developed by Corning scientists and engineers include: A glass envelope for Thomas Edison’s light bulb in 1870; heat-resistant Pyrex glass in 1915; processes for mass-producing television tubes in 1947; low-loss fiber optic cable in 1970; ceramic bases for automotive catalytic converters in 1972; LCD glass for flat-panel displays in 1984; and aluminum titanate filters for diesel vehicles in 2005.

To facilitate their product differentiation strategy Corning employs 1,700 scientists to work on hundreds of exploratory projects and is investing \$300 million to refurbish and expand its research labs near Corning, New York. According to UBS analyst Nikos Theodosopoulos, “they’re not afraid to invest and lose money for many years.” Corning avoids outsourcing and owns dozens of factories producing thousands of different products. Its executives believe that retaining control of research and manufacturing provides a competitive advantage. Their strategy is to keep an array of products in the pipeline and, once a market develops, to quickly produce in volumes that keep rivals from getting traction.

Corning’s strategy has produced major winners. The company is the world’s largest producer of liquid-crystal-display glass used in flat-panel televisions and computers, which produced more than 90 percent of Corning’s 2007 profit of \$2.2 billion. Corning’s strategy also carries risks. Its investments in the development and production of optical fiber placed the company in financial difficulty after the dot com collapse of the early 2000s. Looking ahead, predicting the market for diesel filters will reach \$2 billion by 2011, Corning is ramping up production to profitably fill that anticipated demand. Oh yes, Corning still produces fiber-optic cable and the company’s development of bendable fiber-optic cable was cited by *Time Magazine* as one of the best inventions of 2007.¹¹

The third possible strategic position according to Porter, focuses on a specific market niche such as a buyer group, segment of the product line, or geographic market and

rests on the premise that the firm is thus able to serve its narrow strategic target more effectively or efficiently than competitors who are competing more broadly. As a result, the firm achieves either differentiation from better meeting the needs of the particular target, or lower costs in serving the target, or both. Even though the focus strategy does not achieve low costs or differentiation for the market as a whole, it does achieve one or both of these positions vis-à-vis its narrow market target.¹²

Carbon Motors is following a market niche strategy. Other examples of organizations successfully following a market niche strategy include regional breweries that cater to local tastes and **Learjet**, which follows a focused strategy in designing and building corporate aircraft, leaving the market for larger passenger aircraft to firms such as **Boeing** and the market for smaller private planes to firms such as **Piper Aircraft**.

The Research Insight box on the following page considers cost leadership and product or service differentiation among the working principles for twenty-first century corporations.

¹⁰ William J. Abernathy and Kenneth Wayne, “Limits of the Learning Curve,” *Harvard Business Review*, September–October 1974, pp. 109–119

¹¹ Sara Silver, “Corning’s Biggest Bet Yet? Diesel-Filter Technologies,” *The Wall Street Journal*, March 7, 2008, pp. B1-B2; Nancy Kelly, “Corning’s Renaissance,” *American Ceramic Society Bulletin*, February 2008; “Best Inventions of The Year,” *Time Magazine*, November 12, 2007, www.corning.com.

¹² Porter, pp. 38–39.

RESEARCH INSIGHT Working Principles for Corporations

A *Business Week* editorial reinforced the importance of competing on the basis of a business strategy of price or differentiation. However, recognizing the transitory nature of differentiation in a competitive environment, the editorial used the term “innovation” in place of “differentiation.” According to *Business Week*, the first three working principles of the twenty-first century corporation follow:¹³

1. *Everything gets cheaper faster.* “The Net destroys corporate pricing power. It allows customers, suppliers, and partners to compare prices from 100 or 1,000 sources, not just two or three, and erases market inefficiencies. It rapidly commoditizes all that is new, reducing prices fast.”
2. *Cutting costs is the answer.* “In an economic universe of downward pressure on margins, one path to profitability will be to reduce expenses.”
3. *Innovation builds profits.* “There is one way for corporations to circumvent principle No. 1 and raise prices. In an information economy, companies can gain an edge through new ideas and products.” This advantage is temporary, so corporations following this strategy must innovate rapidly and continuously.

The editorial asserts that human capital is the only asset. In a twenty-first century corporation, creativity is the sole source of growth and wealth. Consequently, the “value of education rises exponentially in an economy based on ideas and analytic thinking.”

Managerial Accounting and Goal Attainment

A major purpose of managerial accounting is to support the achievement of goals. Hence, determining an organization’s strategic position goal has implications for the operation of an organization’s managerial accounting system.

Careful budgeting and cost control with frequent and detailed performance reports are critical with a goal of cost leadership. When the product is difficult to distinguish from that of competitors, price is the primary basis of competition. Under these circumstances, everyone in the organization should continuously apply managerial accounting concepts to achieve and maintain cost leadership. The managerial accounting system should constantly compare actual costs with budgeted costs and signal the existence of significant differences. A simplified version of a *performance report* for costs during a budget period is as follows:

Budgeted (planned) Costs	Actual Costs	Deviation from Budget	Percent Deviation
\$560,000	\$595,000	\$35,000 unfavorable	6.25

Frequent and detailed comparisons of actual and budgeted costs are less important when a differentiation strategy is followed. This is especially true when products have short life cycles or production is highly automated. In these situations, most costs are determined before production begins and there is little opportunity to undertake cost reduction activities thereafter.

With short product lives or automated manufacturing, exceptional care must go into the initial design of a product or service and the determination of how it will be produced or delivered. Here, detailed cost information assists in design and scheduling decisions. A simplified version of the predicted costs of producing a specialty product is as follows:

Engineering and scheduling (12 hours @ \$70)	\$ 840
Materials (detail omitted)	3,500
Equipment setup (2.5 hours @ \$100)	250
Machine operation (9.5 hours @ \$90)	855
Materials movement	150
Packing and shipping	675
Total	<u>\$6,270</u>

¹³ Based on “The Twenty-First Century Corporation,” *Business Week*, August 28, 2000, p. 278.

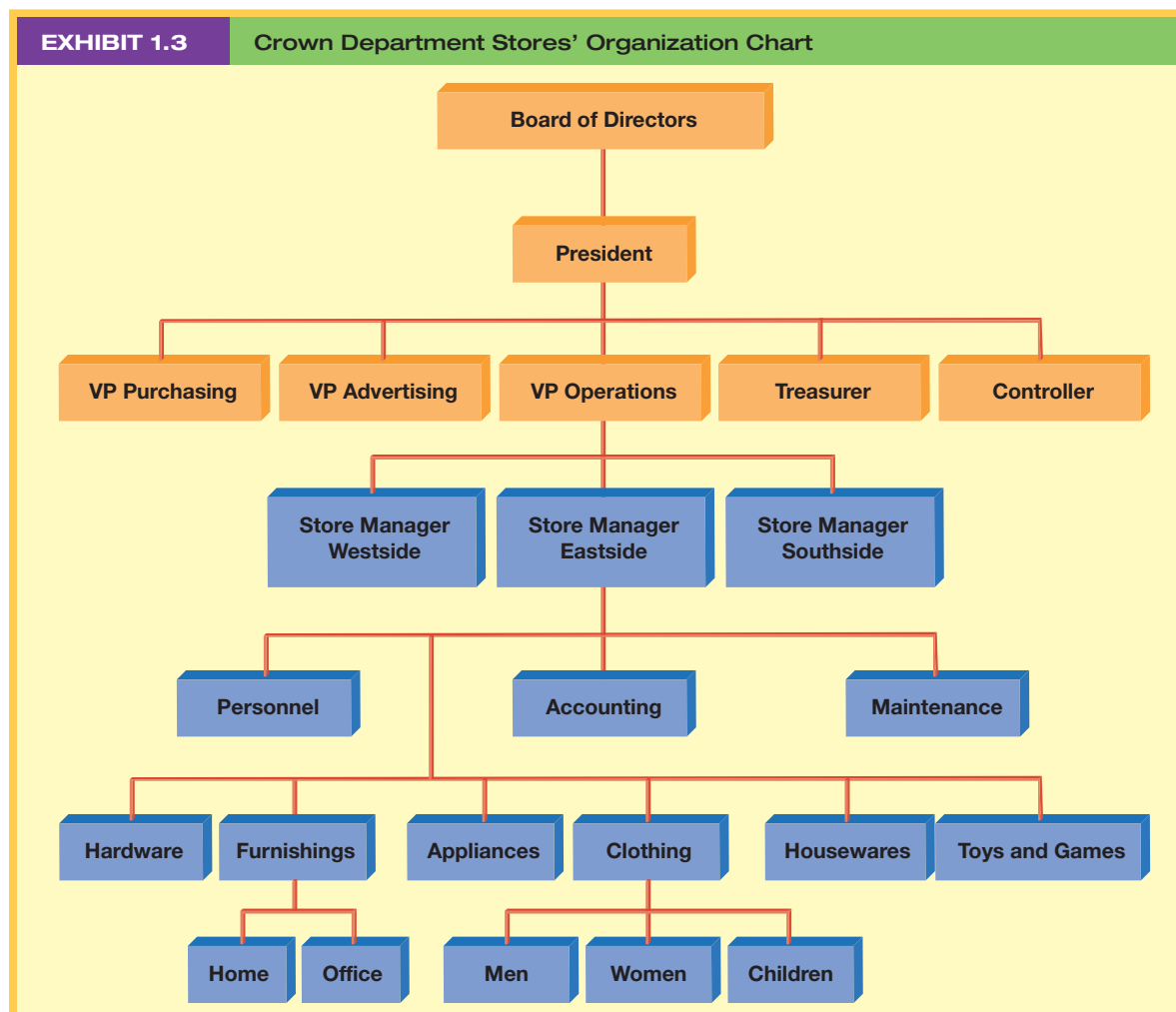
When a differentiation strategy is followed, it often pays to work closely with customers to find ways to enhance the perceived value of a product or service. This leads to an analysis of costs from the customer's viewpoint. The customer may not want a costly feature. Alternatively, the customer may be willing to pay more for an additional feature that will reduce subsequent operating costs.

In designing its 777 aircraft, **Boeing** invited potential customers to set up offices in Boeing plants and to work with Boeing employees designing the aircraft. Many design changes were made to reduce customer costs. **United Airlines**, for example, convinced Boeing to move the location of the 777's fuel tanks to reduce servicing costs.

Planning, Organizing, and Controlling

The process of selecting goals and strategies to achieve these goals is often referred to as **planning**. The implementation of plans requires the development of subgoals and the assignment of responsibility to achieve subgoals to specific individuals or groups within an organization. This process of making the organization into a well-ordered whole is called **organizing**. In organizing, the authority to take action to implement plans is delegated to other managers and employees.

Developing an **organization chart** illustrating the formal relationships that exist between the elements of an organization is an important part of organizing. An organization chart for Crown Department Stores is illustrated in Exhibit 1.3. The blocks represent organizational units, and the lines represent relationships between the units. Authority flows down through the organization. Top management delegates authority to use resources for limited purposes to subordinate managers who, in turn, delegate to their subordinates more limited authority for accomplishing more structured tasks. Responsibility flows up through the organization. People at the bottom are responsible for specific tasks, but the president is responsible for the operation of the entire organization.



A distinction is often made between line and staff departments. *Line departments* engage in activities that create and distribute goods and services to customers. *Staff departments* exist to facilitate the activities of line departments. In Exhibit 1.3, we see that Crown Department Stores has two levels of staff organizations—corporate and store. The corporate staff departments are Purchasing, Advertising, Treasurer, and Controller. Staff departments at the store level are Personnel, Accounting, and Maintenance. All other units are line departments. A change in plans can necessitate a change in the organization. For example, Crown’s plan to discontinue the sale of hardware and add an art department during the coming year will necessitate an organizational change.

Controlling is the process of ensuring that results agree with plans. A brief example of a performance report for costs was presented previously. In the process of controlling operations, actual performance is compared with plans.

With a cost leadership strategy and long-lived products, if actual results deviate significantly from plans, an attempt is made to bring operations into line with plans, or the plans are adjusted. The original plan is adjusted if it is deemed no longer appropriate because of changed circumstances.

With a differentiation strategy and short-lived products, design and scheduling personnel will consider previous errors in predicting costs as they plan new products and services. Hence, the process of controlling feeds forward into the process of planning to form a continuous cycle coordinated through the management accounting system. This cycle is illustrated in Exhibit 1.4.



MID-CHAPTER REVIEW

The previous discussion has focused on understanding the difference between financial and managerial accounting and the broader context of managerial accounting within a company.

Required:

Identify the statements and phrases from the following list that are primarily relevant to managerial accounting, as opposed to financial accounting:

1. Preparing periodic financial statements
2. A company’s strategic position
3. Calculates earnings per share for stockholders
4. Summarizes information about past events
5. Is not based on generally accepted accounting principles
6. Must conform to external standards
7. Helping managers make decisions is its primary purpose
8. Encourages use of selective data, if relevant
9. Is tailored to the needs of the company and its managers
10. Cost driver analysis

Solution

2, 5, 7, 8, 9, and 10

Competition and Its Key Dimensions

The move away from isolated national economic systems toward an interdependent global economic system has become increasingly pronounced. International treaties, such as the North American Free Trade Agreement and the General Agreement on Tariffs and Trade, merely recognize an already existing and inevitable condition made possible by advances in telecommunications (to move data), computers (to process data into information), and transportation (to move products and people).

The labels of origins on goods (Japan, Germany, Canada, Taiwan, China, and so forth) only scratch the surface of existing global relationships. Behind labels designating a product's final assembly point are components from all over the world.

The move toward a global economy has heightened competition and reduced selling prices to such an extent that there is little or no room for error in managing costs or pricing products. Moreover, customers are not just looking for the best price. Well-informed buyers routinely search the world for the product or service that best fits their needs on the three interrelated dimensions of price/cost, quality, and service; hence, these are the three key dimensions of competition.

To customers, *price/cost* includes not only the initial purchase price but also subsequent operating and maintenance costs. To compete on the basis of price, the seller must carefully manage costs. Otherwise, reduced prices might squeeze product margins to such an extent that a sale becomes unprofitable. Hence, price competition implies cost competition.

Quality refers to the degree to which products or services meet the customer's needs. *Service* includes things such as timely delivery, helpfulness of sales personnel, and subsequent support. The Business Insight box below takes a look at how **Federal Express** and **United Parcel Service** compete on the basis of quality, service, and price.

LO3 Discuss the factors determining changes in the nature of business competition.

BUSINESS INSIGHT

FedEx and UPS Stage Battle—Customer Is Sure to Win

To increase customer service in the express delivery business, Federal Express introduced a personal computer-based system that lets even its smallest customers go online to order pickups, print shipping labels, and track deliveries. “We have to stay ahead of the competition” was the theme of remarks describing this service by FedEx's chief information officer. Almost immediately, United Parcel Service announced a similar service. Responding to a reporter's question, the vice president of marketing at UPS, commented, “There's no question we track FedEx, just like they track us.”

Both companies invest heavily in equipment and infrastructure to continue to meet increasingly tight delivery deadlines. This includes sorting hubs for air shipments and investments in new aircraft. FedEx even entered into an arrangement with the U.S. Postal Service to ship some USPS packages while the USPS placed FedEx boxes in selected Post Office buildings. A recent article in *Business Week* reports that UPS gained at least a temporary advantage by utilizing information technology to integrate its traditional strengths in ground transportation with its overnight air transportation system. According to the article, “UPS, like FedEx, still uses planes to make most (overnight) deliveries. But in the past two years, its logisticians have also figured out how to make quick mid-distance deliveries—as far as 500 miles in one night—by truck, which is much less expensive than by air.” While both companies battle to improve or at least maintain profitability, customers benefit from continuously improving quality and service at lower and lower costs.¹⁴

Managers of successful companies know they compete in a global market with instant communications. Because the competition is hungry and always striving to gain a competitive advantage, world-class companies must continuously struggle to improve performance on these three interrelated dimensions: price/cost, quality, and service. Throughout this text, we examine how firms successfully compete on these three dimensions.

¹⁴ Based on David Greising, “Watch Out for Flying Packages,” *Business Week* (November 14, 1994), p. 40; and Charles Haddad, “Ground Wars: UPS's Rapid Ascent Leaves FedEx Scrambling,” *Business Week*, May 21, 2001.

COST DRIVERS

LO4 Differentiate among structural, organizational, and activity cost drivers.

An **activity** is a unit of work. To serve a customer at a restaurant such as **Outback Restaurants**, a waiter or waitress might perform the following units of work:

- Seat customer and offer menu
- Take customer order
- Send order to kitchen
- Bring food to customer
- Serve and replenish beverages
- Determine and bring bill to customer
- Collect money and give change
- Clear and reset table

Each of these is an activity, and the performance of each activity consumes resources that cost money. To manage activities and their costs, it is necessary to understand how costs respond to **cost drivers**, which are the factors that cause or influence costs.

The most basic cost driver is customer demand. Without customer demand for products or services, the organization cannot exist. To serve customers, managers and employees make a variety of decisions and take numerous actions. These decisions and actions, undertaken to satisfy customer demand, drive costs. While these cost drivers may be classified in a variety of ways, we believe that dividing them into the three categories of structural, organizational, and activity cost drivers, as summarized in Exhibit 1.5, provides a useful foundation for the study of managerial accounting.

EXHIBIT 1.5	Structural, Organizational, and Activity Cost Drivers
Structural Cost Drivers	Fundamental choices about the size and scope of operations and technologies employed in delivering products or services to customers. For example, Apple Computer's decision to enter the online music distribution business.
Organizational Cost Drivers	Choices concerning the organization of activities and the involvement of persons inside and outside the organization in decision making. Authorizing lower-level employees to make decisions to solve problems is an example of an organizational cost driver.
Activity Cost Drivers	Specific units of work (activities) performed to serve customer needs that consume costly resources. Assembling a product is an example of an activity cost driver.

Structural Cost Drivers

The types of activities and the costs of activities performed to satisfy customer needs are influenced by an organization's size, its location, the scope of its operations, and the technologies used. Decisions affecting structural cost drivers are made infrequently, and once made, the organization is committed to a course of action that will be difficult to change. For a chain of discount stores such as **Target**, possible structural cost drivers include:

- *Determining the size of stores.* This affects the variety of merchandise that can be carried and operating costs.
- *Determining the type of construction.* While a lean warehouse type of construction is less expensive, it is not an appropriate setting for selling high-fashion clothing.
- *Determining the location of stores.* Locating in a shopping mall can cost more and subject the store to mall regulations but provides for more customer traffic and shared advertising.

- *Determining types of technology to employ in stores.* A computerized system for maintaining all inventory and sales data requires a large initial investment and fixed annual operating costs while providing more current information. However, the computerized inventory and sales systems can be less expensive at high sales volumes than a less costly system relying more on clerks taking physical inventory.

Organizational Cost Drivers

Like structural cost drivers, organizational cost drivers influence costs by affecting the types of activities and the costs of activities performed to satisfy customer needs. Decisions that affect organizational cost drivers are made within the context of previous decisions affecting structural cost drivers. In a manufacturing organization, previous decisions about plant, equipment, and location are taken as a given when decisions impacting organizational cost drivers are made. Examples of organizational cost drivers at a manufacturing organization such as **Harley-Davidson** include making decisions regarding:

- *Working closely with a limited number of suppliers.* This can help achieve proper materials in the proper quantities at the optimal time. Developing linkages with suppliers can also result in suppliers' initiatives that improve the profitability of both organizations.
- *Providing employees with cost information and authorizing them to make decisions.* This helps improve decision speed and reduce costs while making employees more customer oriented. Production employees may, for example, offer product design suggestions that reduce manufacturing costs or reduce defects.
- *Reorganizing the existing equipment in the plant so that sequential operations are closer.* This more efficient layout reduces the cost of moving inventory between workstations.
- *Designing components of a product so they can fit together only in the correct manner.* This can reduce defects as well as assembly time and cost.
- *Manufacturing a low-volume product on low-speed, general-purpose equipment rather than high-speed, special-purpose equipment.* Assuming the special-purpose equipment is more difficult and costly to set up for a new job, this decision can increase operating time and operating cost while reducing setup time and setup cost.

Activity Cost Drivers

Activity cost drivers are specific units of work (activities) performed to serve customer needs that consume costly resources. Several examples of activities in a restaurant were mentioned previously. The customer may be outside the organization, such as a client of an advertising firm, or inside the organization, such as an accounting office that receives maintenance services. Because the performance of activities consumes resources and resources cost money, the performance of activities drives costs.

The basic decisions concerning which available activities will be used to respond to customer requests precede the actual performance of activities. At the activity level, execution of previous plans and following prescribed activities are important. All of the examples of structural and organizational cost drivers involved making decisions. In the following list of activity cost drivers for a manufacturing organization, note the absence of the decision-oriented words.

- *Placing a purchase order for raw materials*
- *Inspecting incoming raw materials*
- *Moving items being manufactured between workstations*
- *Setting up a machine to work on a product*
- *Spending machine time working on a product*
- *Spending labor time working on a product*
- *Hiring and training a new employee*
- *Packing an order for shipment*
- *Processing a sales order*
- *Shipping a product*

In managing costs, management makes choices concerning structural and organizational cost drivers. These decisions affect the types of activities required to satisfy customer needs. Because different types of activities have different costs, management's decisions concerning structural and organizational cost drivers ultimately affect activity costs and profitability. Good decision making at the level of structural and organizational cost drivers requires an understanding of the linkages among the types of cost drivers and the costs of different activities.

MANAGERIAL DECISION

You are the CEO

How can you use information about structural, organizational, and activity cost drivers to help you in implementing the organization's strategy? [Answer, p. 18]

ETHICS IN MANAGERIAL ACCOUNTING

LO5 Explain the nature of the ethical dilemmas managers and accountants confront.

Ethics deals with the moral quality, fitness, or propriety of a course of action that can injure or benefit people. Ethics goes beyond legality, which refers to what is permitted under the law, to consider the moral quality of an action. Because situations involving ethics are not guided by well-defined rules, they are often subjective.

Although some actions are clearly ethical (working a full day in exchange for a full day's pay) and others are clearly unethical (pumping contaminants into an underground aquifer used as a source of drinking water), managers are often faced with situations that do not fall clearly into either category such as the following:

- Accelerating shipments at the end of the quarter to improve current earnings.
- Keeping inventory that is unlikely to be used so as to avoid recording a loss.
- Purchasing supplies from a relative or friend rather than seeking bids.
- Basing a budget on an overly optimistic sales forecast.
- Assigning some costs of Contract A to Contract B to avoid an unfavorable performance report on Contract A.

Many ethical dilemmas involve actions that are perceived to have desirable short-run consequences and highly probable undesirable long-run consequences. The ethical action is to face an undesirable situation now to avoid a worse situation later, yet the decision maker prefers to believe that things will work out in the long run, be overly concerned with the consequences of not doing well in the short run, or simply not care about the future because the problem will then belong to someone else. In a situation that is clearly unethical, the future consequences are known to be avoidable and undesirable. In situations involving questionable ethics, there is some hope that things will work out:

- Next year's sales will more than make up for the accelerated shipments.
- The obsolete inventory can be used in a new nostalgia line of products.
- The relative or friend may charge more but provides excellent service.
- A desire to have more confidence in the sales staff.
- Making up for the cost shift by working extra hard and more efficiently with the remaining work on Contract B.

When forced to think about the situation, most employees want to act in an ethical manner. The problem faced by personnel involved in measurement and reporting is that while they may question the propriety of a proposed action, and the arguments may be plausible, they want to be team players, and their careers can be affected by "whistle-blowing." Of course, careers are also affected when individuals are identified as being involved in unethical behavior. The careers of people who fail to point out unethical behavior are also affected, especially if they have a responsibility for measurement and reporting.

Major ethical dilemmas often evolve from a series of small compromises, none of which appears serious enough to warrant taking a stand on ethical grounds. **WorldCom** is such a case, in which managers deferred expenses inappropriately over several periods to meet profit forecasts, expecting to recognize them at later time when sales improved. Unfortunately, these small compromises establish a pattern of

behavior that is increasingly difficult to reverse. The key to avoiding these situations is recognizing the early warning signs of situations that involve questionable ethical behavior and taking whatever action is appropriate.

Codes of ethics are developed by professional organizations to increase members' awareness of the importance of ethical behavior and to provide a reference point for resisting pressures to engage in actions of questionable ethics. These professional organizations include the American Bar Association, the American Institute of Certified Public Accountants, the American Medical Association, and the Institute of Management Accountants (IMA).

Many corporations have established codes of ethics. **General Motors Corporation's** code of ethics, "Winning with Integrity" is presented in the following Business Insight box. One of the important goals of corporate codes of ethics is to provide employees with a common foundation for addressing ethical issues. An addendum to its code of ethics, a basic rule of thumb used by **General Motors** is that employees should never do anything they would be ashamed to explain to their families or to see in the front page of the local newspaper.

BUSINESS INSIGHT

GM Code of Ethics: "Winning with Integrity":

- GM hires, promotes, trains and pays based on merit, experience, or other work-related criteria and strives to create work environments that accept and tolerate differences while promoting productivity and teamwork.
- GM endeavors to protect the health and safety of each employee by creating and maintaining a healthy, injury-free work environment.
- All GM employees have an obligation to protect GM's assets, including information, and to ensure their proper use.
- Providing false or misleading information in any GM business record is strictly prohibited.
- As a general rule, GM employees should accept no gift, entertainment, or other gratuity from any supplier to GM or bidder for GM's business.
- GM employees must immediately disclose any situation that could result in an actual or potential conflict of interest, involving the employee or any member of his household, such as investing in a supplier, dealer, customer, or competitor.
- GM and all its employees must comply with all laws, including the U.S. Foreign Corrupt Practices Act, competition laws, and export control laws.
- To protect GM's reputation for integrity, it must communicate clearly and accurately to the public.¹⁵

CHAPTER-END REVIEW

Classify each of the following as a structural, organizational, or activity cost driver.

- a. Meals served to airplane passengers aboard **Northwest Airlines**.
- b. **General Motors'** decision to manufacture the Saturn[®] automobile in completely new facilities.
- c. **Zenith's** decision to sell its computer operations and focus on the core television business.
- d. Number of tax returns filed electronically by **H&R Block**.
- e. Number of passenger cars in a **Via** train.
- f. **Coors'** decision to expand its market area east from the Rocky Mountains.
- g. **Boeing's** decision to invite airlines to assist in designing the model 777 airplane.
- h. **DaimlerChrysler's** decision to use cross-disciplinary teams to design a new automobile.
- i. **St. Jude Hospital's** decision to establish review committees on the appropriateness and effectiveness of medical procedures for improving patient care.
- j. **Harley-Davidson's** efforts to restructure production procedures to reduce inventories and machine setup times.

¹⁵ http://www.gm.com/corporate/responsibility/reports/05/300_company/3_thirty/331.html.

Solution

- a. Activity cost driver
- b. Structural cost driver
- c. Structural cost driver
- d. Activity cost driver
- e. Activity cost driver
- f. Structural cost driver
- g. Organizational cost driver
- h. Organizational cost driver
- i. Organizational cost driver
- j. Organizational cost driver

GUIDANCE ANSWER

MANAGERIAL DECISION

You are the CEO

It is important that an organization's cost structure be aligned with its strategy. If your goal is to be a cost leader (such as Wal-Mart or Costco), you will want to make sure that the structural cost drivers, such as the type of buildings acquired and the displays used are consistent with this strategy. As the CEO of Wal-Mart you would not permit many of the costs that would be incurred in an organization such as Tiffany or Nordstrom.

DISCUSSION QUESTIONS

- Q1-1.** Contrast financial and managerial accounting on the basis of user orientation, purpose of information, level of aggregation, length of time period, orientation toward past or future, conformance to external standards, and emphasis on objective data.
- Q1-2.** What three themes are a part of strategic cost management?
- Q1-3.** Distinguish between a mission and a goal.
- Q1-4.** Describe the three strategic positions that Porter views as leading to business success.
- Q1-5.** Distinguish between how managerial accounting would support the strategy of cost leadership and the strategy of product differentiation.
- Q1-6.** Why are the phases of planning, organizing, and controlling referred to as a *continuous cycle*?
- Q1-7.** Identify three advances that have fostered the move away from isolated national economic systems toward an interdependent global economy.
- Q1-8.** What are the three interrelated dimensions of today's competition?
- Q1-9.** Differentiate among structural, organizational, and activity cost drivers.
- Q1-10.** What is the link between performing activities and incurring costs?
- Q1-11.** How can top management establish an ethical tone in an organization?
- Q1-12.** Describe how pressures to have desirable short-run outcomes can lead to ethical dilemmas.

MINI EXERCISES

M1-13. Management Accounting Terminology (L01-5)

Match the following terms with the best descriptions. Each description is used only once.

Terms

- | | |
|--------------------------------|-------------------------------|
| 1. Ethics | 9. Organizational cost driver |
| 2. Mission | 10. Financial accounting |
| 3. Controlling | 11. Activity cost driver |
| 4. Goal | 12. Structural cost driver |
| 5. Not-for-profit organization | 13. Managerial accounting |
| 6. Quality | 14. Resources |
| 7. Balance sheet | 15. Product differentiation |
| 8. Income statement | |

Description

- a. Designing components so they are easily assembled
- b. The Starlight Foundation raising money to grant wishes for terminally ill children
- c. Prepared as of a point in time
- d. Accounting for external users
- e. Increase year 2008 sales by 10 percent over year 2007 sales
- f. Shows the results of operations for a period of time
- g. Packing an order for shipment
- h. Deciding to build a factory away from a highway but near a railroad
- i. The degree to which a new television meets a buyer's expectations
- j. Used internally to make decisions
- k. Consumed by activities
- l. The propriety of taking some action
- m. Reduces customer price sensitivity
- n. Basic purpose toward which activities are directed
- o. Comparing the budget with the actual results

M1-14. Financial and Managerial Accounting (LO1)

Indicate whether each phrase is more descriptive of financial accounting or managerial accounting.

- a. May be subjective
- b. Often used to state corporate goals
- c. Typically prepared quarterly or annually
- d. May measure time or customer satisfaction
- e. Future oriented
- f. Subject to cost-benefit analysis
- g. Keeps records of assets and liabilities
- h. Highly aggregated statements
- i. Must conform to external standards
- j. Special-purpose reports
- k. Decision-making tool
- l. Income statement, balance sheet, and statement of cash flows

M1-15. Missions, Goals, and Strategies (LO2)

Identify each of the following as a mission, goal, or strategy.

- a. Budget time for study, sleep, and relaxation
- b. Provide shelter for the homeless
- c. Provide an above-average return to investors
- d. Protect the public
- e. Locate fire stations so that the average response time is less than five minutes
- f. Overlap police patrols so that there are always police cars on major thoroughfares
- g. Achieve a 12 percent market share
- h. Lower prices and costs
- i. Select the most scenic route to drive between Las Vegas and Denver
- j. Graduate from college

M1-16. Line and Staff Organization (LO2)

Presented are the names of several departments often found in a merchandising organization such as **Kohl's Department Store**.

Kohl's Department Store (KSS)

- | | |
|---------------------|--------------------|
| a. Maintenance | d. Payroll |
| b. Home Furnishings | e. Human Resources |
| c. Store Manager | f. Advertising |

Required

Identify each as a line or a staff department.

M1-17. Line and Staff Organization (LO2)

Presented are the names of several departments often found in a manufacturing organization such as **Kimberly-Clark**.

Kimberly-Clark (KMB)

- | | |
|-----------------------|------------------------------|
| a. Manager, Plant 2 | d. Controller |
| b. Design Engineering | e. Property Accounting |
| c. President | f. Sales Manager, District 1 |

Required

Identify each as a line or a staff department.

M1-18. Classifying Cost Drivers (LO4)

Classify each of the following as structural, organizational, or activity cost drivers.

Xerox Corporation
(XRX)
Canon (CAJ)

Toyota (TM)

- Oneida Silversmiths reorganizes production facilities from a layout in which all similar types of machines are grouped together to one in which a set of machines is designated for the production of a particular product and that set of machines is grouped together.
- A cable television company decides to start offering telephone service.
- Xerox Corporation decides to stop making personal computers.
- Canon decides to start making high-volume photocopy equipment to compete head-to-head with Xerox.
- The number of meals a cafeteria serves.
- The number of miles a taxi is driven.
- A company eliminates the position of supervisor and has each work group elect a team leader.
- Toyota empowers employees to halt production if a quality problem is identified.
- The number of tons of grain a ship loads.
- Crossgate Mall decides to build space for 80 additional stores.

M1-19. Classifying Cost Drivers (LO4)

Mesa Construction managers provide design and construction management services for various commercial construction projects. Senior managers are trying to apply cost driver concepts to their firm to better understand Mesa's costs.

Required

Classify each of the following actions or decisions as structural, organizational, or activity cost drivers.

- The decision to be a leader in computer-assisted design services.
- The decision to allow staff architects to follow a specific project through to completion.
- The daily process of inspecting the progress on various construction projects.
- The process of conducting extensive client interviews to assess the exact needs for Mesa services.
- The decision to expand the market area by establishing an office in another state.
- The decision to begin building projects with Mesa staff rather than relying on subcontractors.
- The process of receiving approval from government authorities along with appropriate permits for each project.
- The decision to organize the workforce into project teams.
- The decision to build a new headquarters facility with areas for design and administration as well as storage and maintenance of construction equipment.
- The process of grading building sites and preparing forms for foundations.

EXERCISES**E1-20. Financial and Managerial Accounting (LO1)**

Procter & Gamble
(PG)

Assume Michelle Jones has just been promoted to product manager at Procter & Gamble. Although she is an accomplished sales representative and well versed in market research, her accounting background is limited to reviewing her paycheck, balancing her checkbook, filing income tax returns, and reviewing the company's annual income statement and balance sheet. She commented that while the financial statements are no doubt useful to investors, she just doesn't see how accounting can help her be a good product manager.

Required

Based on her remarks, it is apparent that Michelle's view of accounting is limited to financial accounting. Explain some of the important differences between financial and managerial accounting and suggest some ways managerial accounting can help Michelle be a better product manager.

E1-21. Developing an Organization Chart (LO1)

Develop an organization chart for a three-outlet bakery chain with a central baking operation and deliveries every few hours. Assume the business is incorporated and that the president has a single staff assistant. Also assume that the delivery truck driver reports to the bakery manager.

E1-22. Identifying Monetary and Nonmonetary Performance Measures (LO2)

Identify possible monetary and nonmonetary performance measures for each of the following situations. One nonmonetary measure should relate to quality, and one should relate to time.

Cornell University
Cook County
Hospital

- Cornell University wishes to evaluate the success of last year's graduating class.
- Cook County Hospital wishes to evaluate the performance of its emergency room.

- c. **L.L. Bean** wishes to evaluate the performance of its telephone order–filling operations.
- d. **Hilton Hotels** wishes to evaluate the performance of registration activities at one of its hotels.
- e. **United Parcel Service** wishes to evaluate the success of its operations in Knoxville.

L.L. Bean
Hilton Hotels (HLT)
United Parcel Service (UPS)

E1-23. Identifying Monetary and Nonmonetary Performance Measures (LO2)

Identify possible monetary and nonmonetary performance measures for each of the following situations. One nonmonetary measure should relate to quality, and one should relate to time.

- a. **AOL**'s evaluation of the performance of its Internet service in Huntsville.
- b. **Time Warner Cable**'s evaluation of the performance of new customer cable installations in Rochester.
- c. **Dell Computer**'s evaluation of the performance of its logistical arrangements for delivering computers to residential customers.
- d. **Amazon.com**'s evaluation of the performance of its Web site.
- e. **Emory University**'s evaluation of the success of its freshman admissions activities.

AOL
Time Warner Cable (TWTC)
Dell Computer (DELL)
Amazon.com (AMZN)
Emory University

E1-24. Identifying Information Needs of Different Managers (LO2)

Jerry Damson operates a number of auto dealerships for **Acura** and **Honda**. Identify possible monetary and nonmonetary performance measures for each of the following situations. One nonmonetary measure should relate to quality, and one should relate to time.

- a. An individual sales associate.
- b. The sales manager of a single dealership.
- c. The general manager of a particular dealership.
- d. The corporate chief financial officer.
- e. The president of the corporation.

Acura
Honda (HMC)

E1-25. Activities and Cost Drivers (LO4)

For each of the following activities, select the most appropriate cost driver. Each cost driver may be used only once.

Activity	Cost Driver
1. Pay vendors	a. Number of different kinds of raw materials
2. Evaluate vendors	b. Number of classes offered
3. Inspect raw materials	c. Number of tables
4. Plan for purchases of raw materials	d. Number of employees
5. Packaging	e. Number of operating hours
6. Supervision	f. Number of units of raw materials received
7. Employee training	g. Number of new customers
8. Clean tables	h. Number of vendors
9. Machine maintenance	i. Number of checks issued
10. Opening accounts at a bank	j. Number of customer orders

CASES

C1-26. Goals and Strategies (LO2)

- a. What is your instructor's goal for students in this course? What strategies has he or she developed to achieve this goal?
- b. What is your goal in this course? What strategies will help you achieve this goal?
- c. What is your goal for this semester or term? What strategies will help you achieve this goal?
- d. What is your employment goal? What strategies will help you achieve this goal?

C1-27. Product Differentiation (LO3)

You are the owner of **Lobster's Limited**. You have no trouble catching lobsters, but you have difficulty in selling all that you catch. The problem is that all lobsters from all vendors look the same. You do catch high-quality lobsters, but you need to be able to tell your customers that your lobsters are better than those sold by other vendors.

Required

- a. What are some possible ways of distinguishing your lobsters from those of other vendors?
- b. Explain the possible results of this differentiation.

C1-28. Ethics and Short-Term Borrowing (LO5)

Ethel, a secretary, is in charge of petty cash for a local law firm. Normally, about \$200 is kept in the petty cash box. When Ethel is short on cash and needs some for lunch or to pay her babysitter, she sometimes

takes a few dollars from the box. Since she is in charge of the box, nobody knows that she takes the money, and she always replaces it within a few days.

Required

- a. Is Ethel's behavior ethical?
- b. Assume that Ethel has recently had major problems meeting her bills. She also is in charge of purchasing supplies for the office from petty cash. Last week when she needed \$12 for the babysitter, she falsified a voucher for the amount of \$12. Is this behavior ethical?

C1-29. Ethics and Travel Reimbursement (LO5)

Scott takes many business trips throughout the year. All of his expenses are paid by his company. Last week he traveled to Rio De Janeiro, Brazil, and stayed there on business for five days. He is allowed a maximum of \$28 per day for food and \$100 per day for lodging. To his surprise, the food and accommodations in Brazil were much less than he expected. Being upset about traveling last week and having to sacrifice tickets he'd purchased to a Red Sox baseball game, he decided to inflate his expenses a bit. He increased his lodging expense from \$50 per day to \$75 per day and his food purchased from \$10 per day to \$20 per day. Therefore, for the five-day trip, he overstated his expenses by \$175 total. After all, the allowance was higher than the amount he spent.

Required

Assume that the company would never find out that he had actually spent less. Are Scott's actions ethical? Are they acceptable?

C1-30. Ethics and False Claims Act (LO5)

The U.S. Government passed the Federal False Claims Act to encourage persons to bring forward evidence of fraudulent charges on government contracts. Under the provisions of the Act, whistle-blowers receive up to 25 percent of any money recovered as a result of evidence they bring forth. To date, the largest settlement under the terms of the Act was a \$7.5 million reward to a former employee of a defense contractor who filed a suit after leaving his former employer to accept a position as a price analyst for the Department of Defense.

Required

Evaluate the likely impact of the Federal False Claims Act on corporations doing business with the U.S. government. Do you believe the Act is a good idea?

C1-31. Costs and Ethics of Unlimited Returns (LO5)

Is it possible to have too much emphasis on pleasing final customers? Many manufacturers of consumer electronics argue that the answer is yes. Many firms comment that there is an escalation of problems with returns, and they think of this as a joint problem of consumer and retailer ethics. Some companies are unhappy with the product return policies of some discount retail stores that guarantee a full refund, no questions asked, any time a product is returned, no matter how long since the date of purchase.

Generous return policies have resulted in televisions being returned the Monday after a Superbowl, camcorders being returned shortly after a wedding, and radar detectors being returned after a long trip. One supplier complained about receiving a two-year-old cordless telephone (that had obviously been chewed by a dog) from a retailer who gave the customer a complete refund. Thus, many returns to small manufacturers are not related to defective products.

In an attempt to reduce returns, many small companies are opening customer assistance phone numbers to supply the kind of technical expertise that is not available from sales personnel at discount stores. But, according to one expert, the cost of customer assistance services will ultimately be passed along to customers in the form of higher prices.

Required

- a. Does an unlimited return policy pose an ethical problem? Is it unethical to buy a product with the intention of returning it? Is it unethical to return a product that has been subject to abuse?
- b. Over an extended period of time, what are the likely consequences of unlimited returns on small manufacturers, small retail stores, large manufacturers, discount superstores, and customers?

C1-32. Ethical Issues with Supplier-Buyer Partnerships (LO5)

John Snyder was excited to learn of his appointment as Circuit Electronics Corporation's new vendor sales representative to Household Appliance, Inc. For the past four years, Circuit Electronics has supplied all of the electric switches used in Household's washers and dryers. As Circuit Electronics' vendor sales representative, John Snyder's job involves the following tasks.

1. Working with Household engineers to design electric switches that can be manufactured to meet Household's cost and quality requirements.
2. Assisting Household in resolving any problems related to electric switches.

3. Monitoring the inventory levels of electric switches at Household and placing orders for additional switches when appropriate.

This appointment will require John to move to Stuttgart, Germany, for two years. Although John has mixed feelings about the move, he is familiar with the success of the program in improving Circuit Electronics' financial performance. He is also very much aware of the fact that the two previous vendor sales representatives received promotions at the end of their appointments.

As John toured the Household factory in Stuttgart with his predecessor, Janet Smith, his excitement turned to concern. It became apparent that Circuit Electronics had not been supplying Household with the best available switches at the lowest possible costs. Although the switches were adequate, they were more likely to wear out after five or six years of use than would switches currently on the market (and being used by Household's competitors). Furthermore, when the switches in transit by ship from North America to Europe were counted, it also appeared that the inventory level of electric switches would soon be more than enough to satisfy Household's needs for the next four months.

Required

If you were John, what would you do?

C1-33. Expected Values of Questionable Decisions (LO5)

The members of the jury had to make a decision in a lawsuit brought by the State of Alabama against **Exxon Mobil**. The suit revolved around natural-gas wells that Exxon drilled in state-owned waters. After signing several leases obligating Exxon to share revenues with Alabama, company officials started questioning the terms of the agreement that prohibited deducting several types of processing costs before paying the state royalties.

Exxon Mobil (XOM)

During the course of the trial, a memo by an in-house attorney of Exxon Mobil came to light. The memo noted that **Royal Dutch/Shell**, which had signed a similar lease, interpreted it "in the same manner as the state." The memo then presented arguments the company might use to claim the deduction, estimated the probability of the arguments being successful (less than 50 percent), and proceeded to consider whether Exxon should obey the law using a cost-benefit analysis. According to the memo, "If we adopt anything beyond a 'safe' approach, we should anticipate a quick audit and subsequent litigation." The memo also observed that "our exposure is 12 percent interest on underpayments calculated from the due date, and the cost of litigation." Deducting the questionable costs did, indeed, result in an audit and a lawsuit. Source: *Business Week*.¹⁶

Royal Dutch/Shell (RDS-B)

Required

If you were a member of the jury, what would you do? Why?

C1-34. Management Decisions Affecting Cost Drivers (LO4)

An avid bicycle rider, you have decided to use an inheritance to start a new business to sell and repair bicycles. Two college friends have already accepted offers to work for you.

Required

- What is the mission of your new business?
- Suggest a strategic positioning goal you might strive for to compete with area hardware and discount stores that sell bicycles.
- Identify two items that might be long-range goals.
- Identify two items that might be goals for the coming year.
- Mention two decisions that will be structural cost drivers.
- Mention two decisions that will be organizational cost drivers.
- Identify two activity cost drivers.

C1-35. Success Factors and Performance Measurement (LO2)

Three years ago, Vincent Chow completed his college degree. The economy was in a depressed state at the time, and Vincent managed to get an offer of only \$35,000 per year as a bookkeeper. In addition to its relatively low pay, this job had limited advancement potential. Since Vincent was an enterprising and ambitious young man, he instead started a business of his own. He was convinced that because of changing lifestyles, a drive-through coffee establishment would be profitable. He was able to obtain backing from his parents to open such an establishment close to the industrial park area in town. Vincent named his business The Cappuccino Express and decided to sell only two types of coffee: cappuccino and decaffeinated.

As Vincent had expected, The Cappuccino Express was very well received. Within three years, Vincent had added another outlet north of town. He left the day-to-day management of each site to a manager and turned his attention toward overseeing the entire enterprise. He also hired an assistant to do the record keeping and other selected chores.¹⁷

¹⁶ Mike France, "When Big Oil Gets Too Slick," *Business Week*, April 9, 2001, p. 70.

¹⁷ Based on Chee W. Chow, "Instructional Case: Vincent's Cappuccino Express—A Teaching Case to Help Students Master Basic Cost Terms and Concepts Through Interactive Learning," *Issues in Accounting Education*, Spring 1995, pp. 173–190.

Required

- a. Develop an organization chart for The Cappuccino Express.
- b. What factors can be expected to have a major impact on the success of The Cappuccino Express?
- c. What major tasks must Vincent undertake in managing The Cappuccino Express?
- d. What are the major costs of operating The Cappuccino Express?
- e. Vincent would like to monitor the performance of each site manager. What measure(s) of performance should he use?
- f. If you suggested more than one measure, which of these should Vincent select if he could use only one?
- g. Suppose that last year, the original site had yielded total revenues of \$146,000, total costs of \$120,000, and hence, a profit of \$26,000. Vincent had judged this profit performance to be satisfactory. For the coming year, Vincent expects that due to factors such as increased name recognition and demographic changes, the total revenues will increase by 20 percent to \$175,200. What amount of profit should he expect from the site? Discuss the issues involved in developing an estimate of profit.

