CHAPTER 1
THE ACCOUNTANT'S VITAL ROLE IN DECISION MAKING

SHORT-ANSWER QUESTIONS

1-1 Management accounting measures, analyzes, and reports financial and nonfinancial information to internal managers making internal decisions to improve performance. The reporting and analyses are not restricted by generally accepted accounting principles (GAAP) based on either International Financial Reporting Standards (IFRS) or Canadian accounting standards.

Financial accounting measures, analyzes, and reports primarily financial information to external parties who own the corporate assets, such as investors, government agencies, and banks. Methods of identification and classification of business transactions, measurement of their economic effect, analyses, and reporting in financial statements must comply with standards set by the Canadian Institute of Chartered Accountants (CICA). The CICA participates in the production of IFRS and has the option to amend rather than adopt these standards.

Other differences include (1) management accounting emphasizes the future (not the past), and (2) management accounting is designed specifically to influence the behaviour of managers and other employees (rather than primarily reporting economic events).

1-2 In Canada, financial accounting is constrained by GAAP. Companies listed on stock exchanges must comply with IFRS. Other companies must comply with CICA standards when reporting to external parties. Management accounting is not restricted to these principles. The result is:

- management accountants can charge interest on owners' capital to help judge a division's performance, even though such a charge is not allowed under GAAP
- management accountants can classify, measure, and include the value of internally developed assets and liabilities not recognized under GAAP
- management accountants can use measurement methods of the value of assets or liabilities not permitted under GAAP
- management accountants can change the method of revenue and expense recognition, which is not permitted under GAAP, and
- management accountants assess the quality of information provided based on how well it reflects the economic reality of a real business process, not a standard.

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1-3 Management accountants help formulate strategy by identifying relevant information about the sources of competitive advantage—usually the cost, productivity, or efficiency advantage of their company relative to competitors. Alternatively, management accountants can analyze the benefits to customers and the costs to the company of adding features to further customize more distinctive products or services. These data will assist in setting an appropriate premium price for distinctive value-added attributes as determined by the customer.

1-4 The business functions in the value chain are

- *Research and development*—generating and experimenting with ideas related to new products, services, or processes.
- *Design of products, services, and processes*—the detailed planning and engineering of products, services, or processes.
- *Production*—acquiring, coordinating, and assembling resources to produce a product or deliver a service.
- *Marketing*—promoting and selling products or services to customers or prospective customers.
- *Distribution*—delivering products or services to customers.
- *Customer service*—providing after-sale support to customers.

1-5 The "supply chain" is a coordinated flow of goods, services, and information from each initial source of materials and services to the delivery of products to consumers, whether or not the supply activities occur in the purchasing or in other organizations.

Cost management is most effective when it integrates and coordinates activities across all suppliers in the supply chain as well as across each business function in the purchasing company's value chain. Business functions can be restructured to be more cost-effective.

1-6 This statement is wrong. Management accountants also analyze revenues from products, services, and customers relative to their costs to assess the profitability of types of products, services, and customers. Management accountants also examine the business environment and report relevant information on the intensity of competition. Cost information is only one part of the relevant internal and external information identified, analyzed, and reported by management accountants.

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1-7 Management accountants help a management team identify performance measures that are important to maintain or increase profitability. Important measures include features, quality, and timely delivery as determined by customers. For-profit companies use these data to evaluate the balance of costs and benefits—both financial and nonfinancial—and provide relative assurance that proposed changes will not impair profitability. Initiatives include TQM, relieving bottleneck constraints, or providing faster customer service.

1-8 The five-step decision-making process is (1) identify the problem and uncertainties, (2) obtain relevant information, (3) predict likely outcomes, (4) decide among alternatives, and (5) implement the decision, evaluate performance, and learn. Often the most important information required to provide certainty around predictions is missing, which is why rigorous and disciplined decision making is important to success.

1-9 Planning decisions include (a) selecting organization goals, (b) predicting results under various alternative ways of achieving those goals, (c) deciding how to attain the desired goals, and (d) communicating the goals and how to attain them to the entire organization. Good planning decisions indicate how rigorous and disciplined the management team is at making unbiased business decisions in the best interests of improving organizational profit.

Control decisions require the assessment of actual compared to planned or predicted outcomes and include (a) identifying performance outcomes and how to measure them, (b) obtaining timely and high-quality feedback, (c) assessing how to improve actual performance, and (d) acting differently to improve the implementation of planning decisions. Good control decisions indicate how well a management team learns from its actual experience.

1-10 The three guidelines for management accountants are

1. Employ a cost–benefit approach.
2. Recognize behavioural and technical considerations.
3. Identify relevance and understand that decisions require "different costs for different purposes."

1-11 Agree. A successful management accountant requires general business skills (such as understanding the strategy of an organization) and people skills (such as motivating other team members) as well as technical skills (such as computer

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knowledge, calculating costs of products, and supporting planning and control decisions).

1-12 The new controller could reply in one or more of the following ways:

(a) Demonstrate to the plant manager how he or she could make better decisions if the plant controller was viewed as a resource rather than a busybody. The plant controller is the best person to show how the plant manager will benefit because his or her time and resources can be saved by bringing the plant controller into the decision-making process.

(b) Demonstrate to the plant manager a good knowledge of the technical aspects of the plant. This approach often requires research on customer preferences, potential for growth in demand, plant-specific production or service processes, people, and suppliers. It certainly will involve spending time on the plant floor speaking to plant personnel to learn from their practical experience.

(c) Show the plant manager examples of the new plant controller's past successes in working with line managers in other plants. Examples could include:

- assistance in reducing the plant manager's time to prepare the budget,
- assistance in analyzing problem situations and evaluating financial and nonfinancial aspects of different alternatives, and
- assistance in submitting successful capital budget requests.

(d) Seek assistance from the corporate controller to highlight to the plant manager the importance of many tasks undertaken by the new plant controller. This approach is a last resort but may be necessary in some cases.

1-13 Steps to take when established written policies provide insufficient guidance are

(a) Discuss the problem with the immediate superior (except when it appears that the superior is involved).

(b) Clarify relevant ethical issues by confidential discussion with an impartial adviser.

(c) Discuss the situation with an adviser from the professional accounting organization you are a member of (CA, CGA, or CMA).

(d) Consult your own lawyer about legal obligations and rights arising from ethical conflicts.

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EXERCISES

1-14 (10 min.) Terminology.

1. timely, reliable
2. technical
3. Control
4. ethical guidelines
5. Management accounting
6. cost–benefit
7. Strategy
8. Value chain
9. Corporate social responsibility

1-15 (10 min.) Cost, management, and financial accounting.

1. Once a transaction has occurred, financial accountants classify the transaction according to CICA standards and GAAP. This information is then communicated to external parties in a standardized way.

   Management accountants use financial accounting information, knowing the relevance and reliability of these data. The basic financial accounting information can be analyzed and reported by management accountants using a variety of techniques most appropriate to the management decision being made. These analyses will filter relevant costs and inform an internal decision maker.

2. All accountants are members of a profession and are bound by professional duty to act with integrity. Their duty is to report estimates of the financial outcomes from doing business, which do not materially misstate the economic value of the company.

1-16 (10 min.) Strategy.

1. Managers assess the internal strengths and weaknesses of their company relative to their competitors. In addition, managers also gather relevant information about other external parties upon whom the company depends, such as customers, suppliers, financing, and the existence of substitute products. The purpose is to evaluate how a management team can control and deploy internal resources to best counter external threats from its environment and profit from external opportunities. By matching the

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intensity of competition in the environment with the unique competitive strengths of a company, management teams can select the best strategy.

2. Strategy requires managers to examine how the company and its goals fit with the external environment over which the company has no control. Strategic decisions are made for the long-term guidance and coordination of activities. Operating decisions are made with a focus on internal strengths and weaknesses. Operating decisions are made in the short term to achieve expected performance levels.

1-17 (15 min.) **Value chain and classification of costs, fast food restaurant.**

1. Production
2. Distribution
3. Marketing
4. Marketing
5. Marketing
6. Production
7. Design of products, services, or processes
8. Customer service

1-18 (15 min.) **Value chain and customer expectations.**

1. Design
2. Marketing
3. Customer service
4. Research and development
5. Marketing
6. Production
7. Marketing
8. Distribution

1-19 (10 min.) **Planning and control decisions.**

1. Planning
2. Control
3. Control
4. Planning
5. Planning

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1-20 (15 min.) **Five-step decision-making role of relevant accounting information.**

1. Obtain information.
2. Predict likely future outcomes.
3. Identify the problem and uncertainties.
4. Implement the decision, evaluate performance, and learn.
5. Predict likely future outcomes (again).
6. Identify and decide among alternatives.
7. Obtain information.

1-21 (15 min.) **Five-step decision-making process, service firm.**

1. Obtain information.
2. Identify the problem and uncertainties.
3. Predict likely future outcomes.
4. Implement the decision, evaluate performance, and learn.
5. Predict likely future outcomes.
6. Obtain information.
7. Identify and decide among alternatives.

PROBLEMS

1-22 (20 min.) **Strategic decisions and management accounting.**

1. The strategies the companies are following in each case are:
   a Low-price strategy
   b. Differentiated-product strategy
   c. Low-price strategy
   d. Differentiated-product strategy

2. Examples of information the management accountant can provide for each strategic decision follow.
   a. Cost to manufacture and sell the cell phone
      Productivity, efficiency, and cost advantages relative to competition
      Prices of competitive smart mobile devices

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Sensitivity of target customers to price and quality
The production capacity of Yello Phones relative to its competitors

b. Cost to develop, produce, and sell new software
Premium price that customers would be willing to pay due to product uniqueness
Price of basic software
Price of closest competitive software
Cash needed to develop, produce, and sell new software

c. Cost of producing the "store brand" lip gloss
Productivity, efficiency, and cost advantages relative to competition
Prices of competitive products
Sensitivity of target customers to price and quality
How the market for lip gloss is growing

d. Cost to produce and sell new line of gourmet bologna
Premium price that customers would be willing to pay due to product uniqueness
Price of basic meat product
Price of closest competitive product

1-23 (15 min.) **Planning and control decisions.**

The plan or budget communicates the financial goals the organization will achieve, while control arises from feedback on how well the plan has been achieved and reasons why the plan has not been achieved.

a. Annual financial statements communicate what was achieved. The annual report is a standardized control report on financial performance. It is feedback on what the organization accomplished.
b. Internal periodic reports of financial performance are control reports.
c. The report of losses suffered from a storm is a financial report that is a control report. Externally the insurer will use the report to estimate the amounts it will reimburse Softmoc according to the insurance contract. Internally the managers will use the report to modify their plan and generate the most appropriate response to an unanticipated event. The actual event will also initiate review of the adequacy of the insurance coverage relative to its cost. These new data will be used in subsequent plans for future insurance coverage and its cost.
d. Weekly reports of the total quantity of particular shoes sold are feedback. They are control reports internally because a comparison can be made with the plan to

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determine if the plan was achieved and if not, why not. They are control reports for the supplier for the same reasons.

e. Studies of new business development opportunities communicate planned costs and revenue.

1-24 (30 min.) **Accountants' guidelines and roles in a company.**

This problem raises plenty of thought-provoking questions. There are no easy answers. Generalizing is impossible, based on the unique facts of this case.

1. It appears that Whisler mistrusts the performance analyses. However, the important thing seems to be that Whilser has no confidence in the accountants who seem intrusive and unqualified to identify and measure performance for two stated reasons:
   (a) the responsibility is Whisler's, not the accountants'; and
   (b) Whisler has experienced problems in performance first hand. He understands the complexity of a real situation. Whisler has maintained a day-to-day relationship with line personnel in Division C.

2. Bergstrom needs to establish trust now, not later, that the work being done by his performance-analysis staff will reflect the economic reality of Whisler's performance. It may be that different performance measures will improve their relationship and the benefits to Whisler from using the reports. Then Whisler can concentrate on remedies with confidence they are likely to work. Bergstrom can help Whisler understand that performance measurement and analysis is a support, not a line function, intended to relieve Whisler of routine tasks. Centralizing performance measurement will help standardize, simplify, and predict the likely outcomes of any remedies Whisler implements. Bergstrom can also let Whisler know the benefits of appropriate standardization of performance measures across divisions when strategic decisions must be made. Whisler needs reassurance that his job security and remuneration is protected when uncontrollable factors cause performance shortfalls.

3. Two approaches within the existing organization reporting relationships would be:
   (a) Placing higher priority on having his performance-analysis staff view the division personnel as important customers and actively seeking out ways to increase customer satisfaction.
   (b) Encouraging greater use of teams in which division personnel and corporate control personnel are members. Hopefully, mutual respect will increase by this

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close interaction. A more extreme approach would be to change the organization's reporting relationships and staff assignments. For example, each division manager could have his or her own performance-analysis staff member as part of the plant controller's group. Or, a matrix reporting relationships could be implemented.

1-25 (35 min.) **Professional ethics and end-of-year actions.**

1. The possible motivations for the snack-foods division president wanting to take end-of-year actions include:
   - Management incentives. Gourmet Foods may have a division bonus scheme based on one-year reported division earnings. Efforts to front-end load revenue into the current year or transfer costs into the next year can increase this bonus.
   - Promotion opportunities and job security. Top management of Gourmet Foods likely will view those division managers that deliver high reported earnings growth rates as being the best prospects for promotion. Division managers who deliver "unwelcome surprises" may be viewed as less capable.
   - Retain division autonomy. If top management of Gourmet Foods adopts a "management by exception" approach, divisions that report sharp reductions in their earnings growth rates may attract a sizable increase in top management oversight.

2. Several of the "end-of-year actions" clearly are in conflict and should be viewed as unacceptable by Taylor:
   (b) The fiscal year-end should be closed on midnight of December 31. "Extending" the close falsely reports next year's sales as this year's sales.
   (c) Altering shipping dates is falsification of the accounting reports.
   (f) Advertisements run in December should be charged to the current year. The advertising agency is facilitating falsification of the accounting records of Gourmet Foods as well as falsifying its own records.

   The other "end-of-year actions" occur in many organizations and may fall into the "grey" to "acceptable" area. However, much depends on the circumstances surrounding each one:

   (a) If the independent contractor does not do maintenance work in December, there is no transaction regarding maintenance to record. The responsibility for ensuring packaging equipment is well maintained is that of the plant manager. The division controller probably can do little more than observe the absence of a December maintenance charge.

(d) In many organizations sales are heavily concentrated in the final weeks of the fiscal year. If the double bonus is approved by the division marketing manager, the division controller can do little more than observe the extra bonus paid in December.

(e) If advertising is reduced in December, the advertising cost in December will be reduced. There is no record falsification here.

(g) Much depends on the means of "persuading" carriers to accept the merchandise. For example, if an under-the-table payment is involved, it is clearly unethical. If, however, the carrier receives no extra consideration and willingly agrees to accept the assignment, the transaction appears ethical.

Each of the (a), (d), (e), and (g) "end-of-year actions" may well disadvantage Gourmet Foods in the long run. The divisional controller is well advised to raise this issue in meetings with the division president. However, if Gourmet Foods has a rigid set of line/staff distinctions, the division president is the one who bears primary responsibility for justifying division actions to senior corporate officers.

3. If Taylor believes that Ryan wants her to engage in unethical behaviour, she should first raise her concerns directly with Ryan. If Ryan is unwilling to change his request, Taylor should discuss her concerns with the corporate controller of Gourmet Foods. She could also initiate a confidential discussion with an SMAC adviser, other impartial adviser, or her own lawyer. Taylor also may well ask for a transfer from the snack foods division if she perceives that Ryan is unwilling to listen to pressure brought by the corporate controller, CFO, or even president of Gourmet Foods. In the extreme, she may want to resign if the corporate culture of Gourmet Foods is to reward division managers who take "end-of-year actions" that Taylor views as unethical and possibly illegal.

1-26 (35 min.) **Professional ethics and earnings management.**

1. The possible motivations for Harvest Day Corporation's CEO to "manage" earnings include:
   - Manage the stock price. Harvest Day's CEO wants to meet the forecasted earnings number of $1.34 per share because the CEO believes that the stock price will drop if actual earnings fall short of the forecast.

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- Job security. The CEO may be concerned that the board of directors may have a poor view of him if he delivers "unwelcome surprises." Depending on how much the stock falls, they may even consider dismissing him.
- Management incentives. The bonuses of top management and the CEO may be based on earnings. If earnings decrease, smaller or no bonuses may be paid. If top management and the CEO have stock options, the value of these options will be adversely affected if the stock price falls.

2. Several of the "end-of-year actions" clearly are in conflict and should be viewed as unacceptable:

   (a) Subscriptions cancelled in December should be recorded in December itself and not delayed until January.

   (c) Subscription revenue received in December in advance for magazines that will be sent out in January is a liability. Showing it as revenue falsely reports next year's revenue as this year's revenue.

   (d) Office supplies purchased in December should be recorded as an expense of the current year and not as an expense of the next year.

   (e) Booking advertising revenues that relate to January in December falsely reports next year's revenue as this year's revenue.

   The other "end-of-year actions" occur in many organizations and may fall into the "grey" to "acceptable" area. However, much depends on the circumstances surrounding each one:

   (b) If the software on office computers is not updated until January, there is no transaction or expense to record in December. The responsibility for ensuring that the software is updated is that of the chief information technology officer. The controller can do little more than observe the absence of a December software update and question whether this will have an adverse long-term impact on Harvest Day.

   (f) If building repairs are not done in December, there is no transaction to record in December. There is no record falsification here. The decision regarding when to do building repairs is made by the operations manager.

   (g) Many companies switch their depreciation policy from one method to another. Harvest Day could argue that straight-line depreciation better represents the decrease in the economic value of the asset compared to the declining-balance method. Straight-line depreciation may also be more in line with what its competitors do. If, however, Harvest Day changes to straight-line depreciation

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with the sole purpose of reducing expenses to meet its earnings goal, such behaviour would be unacceptable. The standards of ethical behaviour require management accountants to communicate information fairly and objectively, and to carry out duties ethically.

3. Harvest Day's controller should directly raise these concerns with the CEO. If the CEO refuses to change his request, the controller should raise these issues with the audit committee and the board of directors. The controller could also initiate a confidential discussion with an SMAC adviser, other impartial adviser, or his/her own attorney. In the extreme, the controller may want to resign if the corporate culture of Harvest Day is to reward executives who take "end of fiscal year actions" that the controller views as unethical and possibly illegal. It was precisely actions along the lines of (a), (c), (d), and (e) that caused Betty Vinson, an accountant at WorldCom, to be indicted for falsifying WorldCom's books and misleading investors.

1-27 (10 min.) **Professional ethics and corporate governance.**

1. Segato's ethical responsibilities are well summarized in the CMA's "Code of Professional Ethics." The key area related to Segato's current dilemma is integrity. Segato should refuse to book the $240,000 of sales until the goods are shipped. Both financial accounting and management accounting principles maintain that sales are not complete until the title is transferred to the buyer. The job of the accountant is to report in a way that reflects the economic reality of what has actually happened.

2. Segato should refuse to follow Maloney's orders. If Maloney persists, the incident should be reported to the corporate controller. Support for line management should be wholehearted, but it never requires unethical conduct.

1-28 (30 min.) **Professional ethics and corporate governance.**

1. Companies with "codes of conduct" frequently have a "supplier clause" that prohibits their employees from accepting "material" (in some cases, any) gifts from suppliers. The motivations include:
   - Integrity/conflict of interest. Suppose Michaels recommends that a Horizon 1-2-3 product subsequently be purchased by SXSW. His recommendation could be because he felt he owed Horizon an obligation as his trip to the Cancun conference was fully paid by Horizon.
   - The appearance of a conflict of interest. Even if the Horizon 1-2-3 product is the superior one at that time, other suppliers likely will have a different opinion.

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They may believe the way to sell products to SXSW is via "fully paid junkets to resorts." Those not wanting to do business this way may downplay future business activities with SXSW even though SXSW may gain much from such activities. Some executives view the meeting as "suspect" from the start given the Caribbean location and its "rest and recreation" tone.

2. Pros of attending the user meeting include:
   - Able to interact with other current users as well as possible purchasers and obtain their opinions.
   - Able to influence the future product development plans of Horizon in a way that will benefit SXSW. An example is Horizon's subsequently developing software modules tailored to food-product companies.
   - Saves SXSW money. Visiting suppliers and their customers typically costs money whereas Horizon is paying for the Cancun conference.
   - Able to learn more about the software products of Horizon.

   Cons of attending the user meeting include:
   - The ethical issues raised in requirement 1.
   - Negative morale effects on other SXSW employees who do not get to attend the Cancun conference. These employees may reduce their trust and respect for Michaels's judgment, arguing he has been on a "supplier-paid vacation."

   Conditions on attending which SXSW might impose are:
   - Sizable part of time in Cancun has to be devoted to business rather than recreation.
   - Decision on which SXSW executive attends is not made by the person who attends (this reduces the appearance of a conflict of interest).
   - Person attending (Michaels) does not have final say on purchase decision (this reduces the appearance of a conflict of interest).
   - SXSW executives should only go when a new major purchase is being contemplated (to avoid the conference becoming a regular "vacation").

   A conference board publication on corporate ethics asked executives about a comparable situation:
   - 76% said SXSW and Michaels face an ethical consideration in deciding whether to attend.
   - 71% said Michaels should not attend as the payment of expenses is a "gift" within the meaning of a credible corporate ethics policy.

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3. Pros of having a written code. The Conference Board outlines the following reasons why companies adopt codes of ethics:
   a. Signals commitment of senior management to ethics.
   b. Promotes public trust in the credibility of the company and its employees.
   c. Signals the managerial professionalism of its employees.
   d. Provides guidance to employees as to how difficult problems are to be handled. If the code is adhered to, employees will avoid many actions that are unethical or appear to be unethical.
   e. Drafting of the policy (and its redrafting in the light of ambiguities) can assist management in anticipating and preparing for ethical issues not yet encountered.

   Cons of having a written code include:
   a. Can give appearance that all issues have been covered. Issues not covered may appear to be "acceptable" even when they are not.
   b. Can constrain the entrepreneurial activities of employees. Forces people to always "behave by the book."
   c. Cost of developing code can be "high" if it consumes a lot of employee time.

1-29 (40 min.) **Global company, ethical challenges.**

1. It is clear that bribes are illegal according to domestic laws. It is not clear from the case whether bribes are illegal in Vartan. However, knowledgeable people in global business would attest to the fact that it is virtually impossible to find any country in the world that specifically sanctions bribery. The major point, however, that deserves discussion is: Should ZenTel engage in any unethical activities even if they are not illegal?

   It is difficult to make a generalization about all shareholders of the company. It is, however, safe to assume that not all shareholders would want to keep their investment in a company that is engaged in unethical and/or illegal activities. There is historical evidence to substantiate this point: When apartheid laws were in effect in South Africa, many investors divested shares of companies doing business in South Africa.

   Apart from the ethical issues, it should also be noted that bribery can be very costly in some parts of the world. Bribes may not generate revenues sufficient enough to offset their cost.

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2. Apparently Hank thinks that local culture and common practice are one and the same. This, in fact, is not the case. There are many common practices in developing countries that are against the native culture.

   Specifically, bribery often leads to decisions that are not made on the basis of the merits of the alternative selected. This results in misallocation of meagre resources of the developing country. Misallocation of resources has adverse effects on the economy of a country and the living standard of its population. The negative impact is intensified in developing countries because they can least afford the misallocation of resources.

   As it applies to local common practice, multinational companies make some small allowances but draw a hard line against paying the $1 million “commission.” In 2010, the UK enacted legislation that requires multinational companies to prevent bribery and similar legislation also came into effect in the United States in January 2011 and in Canada in October of the same year.

3. ZenTel might have an articulated corporate policy against such payments to get the message across that regardless of laws, the top management would not tolerate any bribery payments made by its employees. A strong and consistent message from the top often has a noticeable effect on the corporate culture and employee behaviour.

4. If this contract is of great importance to ZenTel’s global strategy, it is likely that this kind of issue will come up again as ZenTel expands into very diverse cultures, and the company should tackle it head on and make a policy decision against offering bribes. Steve Cheng should discuss the situation with the top management at ZenTel and re-affirm his goal to get the Vartan contract by legal means. He could seek the help of the Canadian commercial attaché in Vartan to continue a dialogue with Vartan’s deputy minister of communications. He could propose other creative, legal changes to ZenTel’s bid, even at the cost of reducing the profitability of the current project. Concessions such as training programs, schools, and other public works projects may be legal, get the attention of the Vartan government, and raise ZenTel’s profile both at home and abroad. In the worst case, if the Vartan government does not agree to any of the creative, legal “extras” that ZenTel can provide in order to win the contract, Cheng should report this to ZenTel’s management and be willing to walk away from the Vartan project.

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