Chapter 1

Managerial Accounting and the Business Environment

Solution to Discussion Case

Benefits to employees of having a code of conduct:

* Creates clarity as to how *all* employees are expected to behave. This should help employees avoid behaviours that the company prohibits.
* Provides protection for employees when dealing with superiors given the guidelines related to protection from discrimination and harassment.
* Establishes guidelines for workplace safety, which should help protect the health of employees.
* Provides information on the consequences of code violations, which will help understand employees understand the outcomes of prohibited behaviours, if detected.
* Provides guidance as to what employees should do if they witness a violation of the code and protects those employees who do report an incident.

Disadvantages to CIBC of having a code of conduct:

* May create the impression among employees that they are not trusted by senior management to act appropriately.
* The obligation to report violations could create a culture of suspicion and mistrust among employees.
* Enforcing the code may be costly and time consuming in large organizations such as CIBC. For example, investigations of possible violations could take weeks.

Solutions to Questions

**1-1** In contrast to financial accounting, ma-nagerial accounting: (1) focuses on the needs of managers rather than outsiders; (2) emphasizes decisions affecting the future rather than the financial consequences of past actions; (3) emphasizes relevance rather than objectivity and verifiability; (4) emphasizes timeliness rather than precision; (5) emphasizes the segments of an organization rather than summary data concerning the entire organization; (6) is not go-verned by GAAP; and (7) is not mandatory.

**1-2** Managers carry out four major activities in an organization: planning, directing and motivating, controlling and decision-making. Planning involves establishing a basic strategy, selecting a course of action, and specifying how the action will be implemented. Directing and motivating involves mobilizing people to carry out plans and run routine operations. Controlling involves ensuring that the plan is actually carried out and is appropriately modified as circumstances change. Decision-making involves selecting a course of action from among two or more alternatives.

**1-3**  A budget is a quantitative plan for the acquisition and use of financial and other resources over a specified future time period.

**1-4** Customer value propositions fall into three broad categories—customer intimacy, operational excellence, and product leadership. A company with a customer intimacy strategy attempts to better understand and respond to its customers’ individual needs than its competitors. A company that adopts an operational excellence strategy attempts to deliver products fas-ter, more conveniently, and at a lower price than its competitors. A company that has a product leadership strategy attempts to offer higher quality products than its competitors.

**1-5** The Planning and Control Cycle involves formulating plans, implementing plans, measuring performance, and evaluating differences between planned and actual performance.

**1-6** The controller is responsible for many of the technical aspects of the accounting and finance functions in an organization. The controller also often works with other managers and provides consulting and business analysis services. Controllers are often key members of cross-functional teams involved in a variety of activities including developing budgets, analyzing project proposals and targeting processes for improvement.

**1-7** A person in a line position is directly involved in achieving the basic objectives of the organization. A person in a staff position provides services and assistance to other parts of the organization, but is not directly involved in achieving the basic objectives of the organization.

**1-8** Decentralization involves the delegation of decision-making throughout an organization by giving managers at different operating levels the authority to make decisions related to their areas of responsibility.

**1-9**  The six business functions that make the value chain are: (1) research and develop-ment; (2) product design; (3) manufacturing; (4) marketing; (5) distribution; and (6) customer service.

**1-10**  Examples of things socially responsible organizations should provide for their employees include: (1) safe working conditions; (2) fair compensation; (3) job-training; (4) opportunities for advancement; (5) the right to file grievances; and (6) adequate time off.

**1-11** An enterprise system is supposed to overcome the problems that result from having separate, unintegrated software applications that support specific business functions. It does this by integrating data across an organization in a single software system that enables all employees to have simultaneous access to a common database.

**1-12**  Having a good ethical reputation is important to companies in maintaining good relations with suppliers, employees and customers. Companies with a poor ethical reputation will likely have trouble finding suppliers for their raw materials, will have difficulty attracting and retaining employees, and will not be attractive to potential customers. Thus, in the long-run having good relations with each of these stakeholder groups is critical to a company’s survival.

**1-13** Companies prepare a code of conduct to demonstrate their morals and values system, often in part to demonstrate corporate social responsibility. The code of ethics indicates what is expected of all employees and directors in their dealings with various stakeholders.

 **1- 14** Four key aspects of the Sarbanes Oxley Act of 2002 are: (1) requires CFO and CEO to certify the financial statements; (2) gives audit committee the power to hire, compensate and terminate the auditor; (3) restricts the nature and extent of non-auditing services that can be provided by public accounting firms; and (4) requires the company’s annual report to contain in internal control report that is certified by management.

**1-15** Enterprise risk management is a process used by organizations to actively identify and manage foreseeable risks. Theses risks can to employee theft, financial reporting or even strategic decision making.

**1-16**  Some examples of common business risks include: (1) losing market share to competitors; (2) Web site malfunctioning; (3) employees stealing assets or accessing unauthorized information; and (4) inaccurate budget estimates causing operational problems such as excessive inventory levels or inventory shortages.

**Exercise 1-1** (20 minutes)

1. Developing sales estimates of a product for use in the annual budget for a product is a *planning* activity since doing so will establish a goal for sales levels in the coming year.
2. The review of the monthly quality control reports is a *controlling* activity aimed at determining whether production processes are operating as planned. Identifying the team members to investigate the problem is a *directing and motivating* activity since it involves assigning tasks to specific individuals. The selection of team members is also a *decision-making activity* since the manager will need to determine which employees are best suited (e.g., which ones have the necessary skills, the time available, etc.) to conduct the investigation
3. Choosing from the two design alternatives for the speakers is a *decision-making activity*. It could also be argued that this is a *planning activity* since it will affect which speaker design the company decides to offer to its customers in future periods.
4. Reviewing the monthly performance report is a *controlling* activity. Determining the production schedule in the coming months is both a *planning* and *directing and motivating* activity since it involves the future scheduling of day-to-day activities related to manufacturing the televisions. Evaluating how to motivate retailers to improve sales is also a *directing and motivating* activity and has an element of *planning* as well assuming changes are going to be made to the current incentive system. The evaluation also involves *decision-making* with respect to continuing or discontinuing the plasma television line, and *planning* activities such as setting budgets for future sales of plasma televisions if the product continues to be offered.

**Exercise 1-2** (15 minutes)

1. Primarily financial accounting since it involves the preparation of an income statement for use by the tax authorities (Canada Revenue Agency), an outside body.
2. Primarily managerial accounting since it involves the use of information for specific internal purposes related to resource allocations, marketing and production scheduling.
3. Primarily financial accounting since the information is being used to develop an account balance (allowance for doubtful accounts) for use in the year-end financial statements.
4. Primarily management accounting since the information is being used to evaluate customer satisfaction. Preparing this information is not a financial reporting requirement but it could be useful for internal decision-making purposes regarding pricing of products, product enhancements, etc.
5. Primarily management accounting since the information will be used to determine possible changes to credit terms offered to major customers. Note that essentially the same information is being used in item iii above but in this case the use is entirely for internal decision-making purposes, not for purposes of preparing the financial statements.

**Exercise 1-3** (15 minutes)

1. Customer service (protects the privacy of customer information).
2. Manufacturing (reduces the likelihood of quality issues in the manufacturing process).
3. Distribution (controls who is authorized to distribute (sell) the company’s products).
4. Research and development (prevents leakage of sensitive information about possible new products).
5. Marketing (reduces the likelihood of ineffective ads being run).
6. Product design (ensures products are designed to be in compliance with safety standards).

**Problem 1-4** (30 minutes)

 1. Several aspects of the code of professional ethics shown in Exhibit 1-7 potentially come into play here such as:

* 1(b): fairness and loyalty to employer.
* 1(c): high ideals of personal honour and professional integrity.
* 2(a): maintain independence of thought and action.
* 2(c): financial reports (budget is an example thereof) should not be misleading.

Developing a budget that is intentionally misstated (“conservative”) in order to increase the likelihood of earning a bonus would violate 1(b) and 1(c) since doing so would be unfair to the owner of Baden Foods (who pays the bonus) and would be inconsistent with the ideal of professional integrity (i.e., it is lying!). Also, the “conservative budget” would be misleading since it sets targets for operating income each month that Brigley knows are not realistic, thus violating 2(c). Arguably, allowing his (or the CFO’s) desire to earn a bonus to influence the development of the budget would also violate 2(a) since Brigley should be acting in an independent and objective fashion, as opposed to a self-interested fashion, when formulating the budget.

2. As a start, Brigely should approach Robson and clearly express his concerns about intentionally misstating the budget and explain how it violates the code of professional ethics that guides the behaviour of professional accountants. It may be that his concerns were not fully appreciated by Robson during their Friday afternoon phone call. If this fails to convince Robson to allow Brigley to submit a budget that reflects “reasonable expectations” then the situation becomes more complicated. From what we know of the organization chart at Baden Foods, the most appropriate course of action for Brigley would likely be to approach James Davis (President) directly to explain his concerns. However, some organizations will have policies in place to follow when an employee wants to “whistle-blow” about something he or she believes violates either the company'’ code of conduct, or in this case, the professional code of ethics under which Brigley’s behaviour is guided. These policies may require all incidents to be reported through either corporate legal counsel, or the head of human resources.

**Problem 1-5** (20 minutes)

Some possible examples for each activity:

*Planning activities*:

1. Estimating the advertising revenues for a future period.
2. Scheduling the designated broadcast time slot for games, special programming, news shows, etc.
3. Estimating total expenses for future periods including salaries of news desk anchors, play-by-play analysts, researchers, camera crew personnel, etc.

*Directing and motivating activities*:

1. Scheduling news desk anchors for each day’s news broadcasts.
2. Assigning camera crew employees to cover specific events (e.g., games, press conferences, etc.).
3. Reviewing scripts used by news desk anchors for accuracy, clarity, etc.
4. Providing performance incentives for news anchors based on viewership numbers.

*Controlling activities*:

1. Contrasting the actual number of viewers for each show or game with its viewership projections.
2. Comparing the actual costs of producing a broadcast of a sporting event (e.g., hockey game) to its budget.
3. Comparing the advertising revenues earned from broadcasting a sporting event to the costs incurred to broadcast that event.

*Decision-making activities*:

1. Determining which news anchor personnel to sign to contracts.
2. Identifying which news items to include in the daily news broadcast and the order in which to present them.
3. Determining which specific games to broadcast in each sport carried by the network.

**Problem 1-6** (30 minutes)

 1. Williams has an ethical responsibility to take some action in the matter of GroChem Inc. and the dumping of toxic wastes. Elements of the code of professional ethicsthat apply are as follows:

 • The code of professional ethics (1a in Exhibit 1-7) states that members should act with “responsibility for and fidelity to the public needs.” GroChem’s dumping of toxic waste is clearly not in the best interests of the public.

 • Also, item 1c in Exhibit 1-7 states that members are expected to act with “high ideals of personal honour and professional integrity.” Knowing that GroChem is engaging in an illegal activity and doing nothing would not be inconsistent with this element of the code.

 Given that the dumping of toxic wastes is illegal, there is a clear responsibility to bring this issue to the attention of management.

 2. As noted in the code of professional ethics in Exhibit 1-7 (3a), members are not to disclose confidential information about their employer’s affairs to outside parties unless “acting in the course of his or her duties” or unless involved in legal proceedings of some sort.

 The first alternative being considered by Williams, seeking the advice of her boss is appropriate. Discussing the problem with the immediate superior will not result in a breach of confidentiality and it does not appear that Williams’ boss is involved in the illegal activity.

 Communication of confidential information to anyone outside the company is inappropriate unless there is a legal obligation to do so (Exhibit 1-7, 3a). If it turns out that there is a legal obligation to report the activity, Williams should contact the proper law enforcement authorities, not the local newspaper.

 3. Williams should report the problem to successively higher levels of management until it is satisfactorily resolved. There is no requirement for Williams to inform her immediate superior of this action because the superior is involved in the conflict. If the conflict is not resolved after exhausting all courses of internal review, Williams probably should consult his own attorney regarding her legal obligations and rights.

 (CMA Unofficial Solution, adapted)

**Problem 1-7** (20 minutes)

 1. Numerous stakeholder groups have likely been negatively affected such as:

* Customers who have vehicles that were recalled face the inconvenience of needing to take their vehicle to a dealer. Also, customers who suffered personal injury because their vehicles experienced problems (e.g., rapid acceleration) caused by the defect.
* Toyota employees who were laid off because of reduced production resulting from lower demand for the product.
* Toyota employees whose compensation (salary or bonus) declined as the result of Toyota’s reduced profitability caused by the recalls.
* Shareholders who suffered investment losses as the result of the drop in Toyota’s share price.
* Suppliers of parts and raw materials used in the production of Toyota’s vehicles. As Toyota’s production levels dropped, so too would demand for parts and raw materials.
* Companies to whom Toyota had outsourced production for some aspect of their vehicles (e.g., accelerator pedals).
* Regulators and government agencies who participated in the parliamentary hearings involving Toyota. Although such participation is part of their jobs, it would have reduced the time or attention these individuals could give to other important issues.

2. Effective corporate governance provides proper incentives for top management to pursue objectives that are in the best interests of shareholders and it should also establish effective monitoring of performance. For example, a proper incentive system would not place undue emphasis on corporate goals for growth and profitability at the expense of product quality and safety. Also, performance reporting is not limited to financial statements. Good corporate governance also involves monitoring key non-financial measures such as quality, employee safety, customer satisfaction, etc. Finally, a key aspect of effective governance is to limit the likelihood of key business risks being either unrecognized or uncontrolled. Companies must constantly be vigilant in identifying and controlling risks.

**Problem 1-8** (30 minutes)

 1. Line positions are in the direct chain of command and are directly responsible for the achievement of the basic objectives of an organization. These positions involve a direct relationship to the organization’s product or service.

 Staff positions are intended to provide expertise, advice, and support for line positions, being only indirectly related to the achievement of the basic objectives of the organization.

 2. Reasons for conflict between line and staff positions include the following.

 • Line managers perceive staff managers as threats to their authority, especially when staff persons have functional authority.

 • Line managers may become uncomfortable when they grow depen-dent on staff expertise and knowledge.

 • Line managers may perceive staff managers as overstepping their authority, having a narrow perspective, or stealing credit. Staff managers, on the other hand, may perceive line managers as not utilizing their expertise, not giving staff enough authority, or resisting staff’s ideas.

* Line managers may perceive staff managers as interfering when the line managers are being held responsible for results.
* Staff mangers may see line managers as unappreciative and uncooperative in supplying information and using results of analyses.

**Problem 1-8** (continued)

 3. a. and b. Listed below are the identification, explanation, and potential problems that could arise for each position described in the text.

 **Jere Feldon–Staff Liaison to the Chairperson**. Feldon has a staff position as he is not in the direct line of activities. Feldon has a potential conflict between his two superiors because he reports directly to the chairperson yet he also works for the president.

 **Lana Dickson–Director of Self-Study Programs**. Dickson’s position is a line position as her job provides educational opportunities to members. Her potential problems include the marketing of the courses and acquisition of outside or accounting services because she needs to rely on the services of individuals from different departments where she has no line authority.

 **Jess Paige–Editor of Special Publications**. This is a line function because the publication of educational materials and the sale of monographs are part of the organization’s objectives. Paige’s potential problems include difficulties he may experience in working with the Research Department as he has no authority over this department but is dependent on its work.

 **George Ackers–Manager of Personnel**. Ackers has a staff position that provides services across the entire organization. Ackers’ potential problems include being ignored due to his position being lower than the vice-president level in the organization, and attempting to take more authority than he is entitled.

(CMA Unofficial Solution, adapted)

**Problem 1-9** (30 minutes)

1. Benefits and challenges of performing value chain analysis:

Benefits:

* Provides a complete picture of product profitability since it incorporates all major functions of the value chain involved in developing, manufacturing and servicing products.
* Can lead to the identification of the most and least profitable products. This could result in actions taken to improve less profitable products such as reducing manufacturing costs, increasing advertising or improving customer service.
* Could lead companies to allocate resources to more profitable products (e.g., increased marketing or customer service) to further enhance their performance.
* Could lead to the discontinuation of unprofitable products if management concludes that cost reductions across the value chain are not possible or feasible.

Challenges:

* Some costs may be difficult to separately track for each major product line. For example, marketing costs often relate to advertising campaigns for a company’s products as a whole rather than for individual products (e.g., BMW advertisements are often for the brand rather than a specific model).
* The timing of some value chain costs will occur in different periods than the related product revenues. For example, research and development costs will be incurred before a product is brought to market and customer service costs will be incurred after the product has been sold. Therefore to accurately assess product profitability using value chain analysis, managers will have to conduct the analysis on a long-term basis over multiple reporting periods (years) to fully match revenues with the related costs.

**Problem 1-9** (continued)

* Could lead managers to reduce costs in certain areas such as customer support that could improve product profitability in the short-run but would have negative consequences longer-term if product quality or customer service levels suffer as a result. Note, a good control system would mitigate this behavior by rewarding managers in part based on the longer-term performance of the company.

2. Change in value chain costs over the life of a product:

* Research and development costs are primarily incurred before a product is brought to market and so will be low or non-existent for more mature products.
* Product design costs will be considerably lower as a product matures but some may continue to be incurred such as design changes aimed at improving quality or functionality.
* Manufacturing costs may decline on a per unit basis for more mature products as a result of improvements to production activities or because higher volumes are produced allowing for greater economies of scale (e.g., lower unit costs for raw materials).
* Marketing costs will likely be higher for new products but decrease as products mature since customers will be aware of their existence and features. Marketing costs could also increase as a product matures in response to increased competition.
* Distribution costs may increase as a product matures as managers seek new markets in which to increase sales.