

CHAPTER 1

INTRODUCTION TO COST ACCOUNTING

QUESTIONS

1. Management accounting stresses the informational needs of internal users over those of external users (the focus of financial accounting). Because of this perspective, management accounting provides information in a format that is flexible and relevant to a particular manager's usage. Financial accounting, on the other hand, must provide some uniformity in the manner in which information is presented for it to be comparable among companies and in compliance with generally accepted accounting principles.
2. It is more important to have legally binding cost accounting standards for defense contractors than for other manufacturers because government contracts are often awarded on a low-bid basis. Without legally binding cost accounting standards, different bidders could include costs in different categories, making the bids noncomparable. With specified cost accounting standards, there is a higher probability (although not absolute certainty) that comparison among bids is consistent. Although contracts for non-government manufacturers may be awarded on a bid basis, it is more common in this arena to consider a wide variety of factors in addition to cost.
3. Operating in a global environment means that more decision and control variables must be tracked. For example, a firm operating in many countries must track variables such as national rules of income taxation, national corporate governance laws, sets of local laws of commerce, production and sourcing sites, and currencies. In addition, the multinational firm must monitor markets in many countries, deal with a multitude of local cultures and customs, and communicate in several languages.

Some other valuable information for the global firm would be: currency exchange rates; national inflation rates; details of import/export laws; prices for commodities in likely sourcing sites; distribution costs for various modes of moving goods, components, equipment, and materials; political issues in all relevant markets; and competitors' prices in all markets. These types of information are important to generate an optimal return on capital.

4. A mission statement is important to an organization because it provides a clearly worded view of what the organization wants to accomplish and how the organization uniquely meets its targeted customers' needs with products and services. Without a mission statement an organization may veer away from its "view of itself" and find that it is engaging in activities that are not, and can never be, part of what it wants to do.
5. Organizational strategy is the link between a firm's goals and objectives and its operational plans. Strategy is therefore a specification of how a firm intends to compete and survive. Each organization will have a unique strategy because it has unique goals, objectives, opportunities, and constraints.
6. Core competencies are the special proficiencies possessed and valued by an organization. If a particular strategy requires core competencies that are not possessed by a firm, executing such a strategy would be very difficult. For example, a strategy of diversification would be impossible to execute in a firm that does not possess core competencies in mergers, acquisitions, and constraints.
7. There are many self-serving reasons to be a nonpolluter. For example, a proactive strategy to reduce pollution may attract environmentally conscious consumers. Further, such an approach may avoid subsequent regulation of operations by government and may avoid legal entanglements caused by retroactive application of new laws. Current research is indicating that being "green" can be profitable to a business.
8. Authority is the right, generally because of position or rank, to use resources to accomplish a task or achieve an objective. Responsibility is the obligation to accomplish a task or achieve an objective. Authority can be delegated, but responsibility must be assumed and maintained by the person to whom it is assigned. However, sufficient authority must accompany responsibility or the assignment of responsibility cannot endure.
9. This statement is false. All firms have capital constraints, although the constraints are more binding for some firms than others. For any firm, as the amount of capital raised through either stock or bond offerings increases, the perceived riskiness of the offerings also rises. The perceived risk rises because there is greater uncertainty associated with the new investment relative to the firm's existing investments. As the perceived risk rises, the rate of return required by the investors also rises. At some point, the rate of return required by the investors will exceed the return that the firm can generate with the new funds.

10. Workforce diversity may affect organizational culture because the work ethic of individual workers may be less homogeneous, communication may become more difficult, and observation of different religious holidays may create difficulties or new patterns of absenteeism. As diversity of the workforce increases, organizational culture must change to reflect the diversity.

Some potential benefits of having workforce diversity include an opportunity to reduce prejudices, having workers who prefer different holiday schedules (minimizing the need for closure for specific holidays), and having workers who have different workplace characteristics (for example, some cultures may prefer to work in groups; other alone).

Some potential difficulties of having workforce diversity include the possibility of different work ethics (for example, some cultures may perform at different “speeds,” desire different workplace “formats” such as afternoon siesta, or view communication within the workplace about outside activities differently). There may also be less tolerance if one employee group demands a greater number of religious holidays than another or a lack of understanding of why a particular employee (or employee group) does not believe in the need for a specific holiday that the majority observes.

11. A change in laws or regulations may remove a constraint to competition or to a particular strategy. For example, the cost of labor has traditionally been much less expensive in Mexico than elsewhere in North America. However, tariffs and taxes have historically constrained the extent to which American and Canadian businesses could exploit that labor cost advantage. With the implementation of NAFTA, these costs have been dramatically reduced. Consequently, American and Canadian businesses moved some labor-intensive businesses to Mexico rather than to parts of Asia.
12. The value chain of an organization is the set of processes that converts inputs into products and services for the firm’s customers. The value chain includes both internal and supplier processes, and it creates the foundation of strategic resource management (SRM) which involves the deployment of organizational resources. The linkage between SRM and the value chain is that optimizing value is the objective of SRM. Thus, value chain effects are the concern of managers in the strategic deployment of organizational resources.

13. The balanced scorecard is a framework that restates an organization's strategy into clear and objective performance measures. The balanced scorecard is used to evaluate performance from four perspectives: learning and growth, internal business, customer values, and financial. These perspectives include financial, quantitative, lead and lag indicators, short run and long run measures. Managers choosing to apply the balanced scorecard are demonstrating a belief that traditional financial performance measures, such as ROI, alone are insufficient to assess how the firm is doing and what specific actions must be taken to improve performance.
14. The purpose of this question is to get students to think about the role of laws and ethics in conducting business. Among the important points that should be made in the position papers include: whether the laws in the firm's home country or local foreign law should govern the actions of firms; whether ethics or law should be the standard governing actions in foreign jurisdictions; and the extent to which "being competitive" should be a criterion in choosing a business course of actions.

EXERCISES

15. a. The bank would want information about the firm's ability to repay the loan. Potentially, the loan could be repaid from either of two sources: (1) by liquidating an asset that is not crucial to business operations or (2) from future operating cash flows. Useful information for the bank would allow the loan officer to evaluate the probability that the firm could repay the loan from either of these sources. Consequently, the most useful items of information would be a balance sheet, income statement, statement of cash flows, and perhaps a cash budget. The balance sheet provides information about the types of assets owned by the firm and the cash commitments for debt repayments and payments to suppliers. The income statement is useful for assessing profitability and projecting future cash flows. The statement of cash flows and the cash budget provide information about the sources and uses of cash.

Information about accounts receivable turnover, or the average time to collect accounts receivable, can be determined by examining the history of accounts receivable collections. How readily accounts receivable can be collected can be assessed by determining the extent to which the accounts receivable are past due.

A trend for supplier price and labor cost increases can be assessed by examining purchases and salaries over time. Reading *Journal of Accountancy* and *Strategic Finance* will provide information about salary trends. Prices of specific, routine inputs can be obtained from supplier invoices and purchase order data.

Qualitative information that would interest the bank might include the borrower's character, his or her history in handling borrowed funds, management skills in the firm, stability of business conditions, work backlog, financial strength of large-volume customers, and supplier willingness to provide favorable credit terms on purchases.

- b. An example of accumulating the information to address customers' complaints regarding delays in completing the audit, financial planning and tax jobs can be found on the customer order documents. The customer order document should be designed to capture the promised time of completion of the job and also to capture the actual completion time. The time variance can be accumulated systematically on a log or, alternatively, can be determined by inspection of the customer order documents. In this way, these documents, that comprise part of the accounting system, can be used to track such non-financial data.

Price changes are usually justified by management on the basis of one or more of the following: (1) competitor price changes; (2) willingness by customers to pay higher prices on the basis of quality or other types of differentiation of products and services; (3) governmental regulations or requirements; and (4) Changes in the prices of material, labor, or other costs such as utilities, taxes, and insurance. Information regarding the first three justifications must usually be obtained from sources outside the accounting system. However, changes of prices and therefore costs of the factors of production described in justification (4) can be found from accounting records and documents.

For example, by examining labor time and costs over time, one can assess trends in time to complete specific types of jobs and labor cost increases. Labor cost data may be obtained by examining personnel and payroll records of partners, managers, and staff accountants. Analysis of labor costs may indicate that staff accountants could be used in place of partners to significantly reduce costs on some jobs.

Prices of specific, routine inputs can be obtained from supplier invoices and purchase order data. Examining and comparing invoices and tax reports may indicate a trend in utilities, insurance, and tax costs over time.

- c. Most of the data can be gathered directly from the accounting records or from the documents that support the accounting records such as original transaction documents (invoices, payroll time cards, shipping records, etc.). However, none of the qualitative data could be obtained from the accounting records. The bank would have to acquire this information from other sources such as character references, suppliers and customers.

- 16. a. Each student will have a different answer; however the following items may be mentioned:

Then

“Number cruncher”
Staff member with limited responsibilities
Controller of costs
Provider of internal reports
Impediment to change
Provider of data
Work in relative isolation

Accountant
Reactive

Now

Decision support specialist
“Business partner”

Analyst of costs
Developer of models
Implementer of change
Provider of information
Member of cross-functional teams

Member of the finance function
Proactive

- b. Each student will have a different answer; however, the following items may be mentioned: interpersonal skills, communication skills, technological skills, critical thinking and analysis skills, planning and decision-making skills, broad-based learning, performance measurement and evaluation skills, and knowledge of the international marketplace.

Profit maximization has been the goal of companies over the past ten years and the skills required to achieve this goal have not changed. International merger and acquisition activities have been burgeoning since the 1960s, but the knowledge and skills needed to be competitive in a global economy have not changed.

- 17. Each student will have a different answer. No solution is provided.
- 18.
 - a. The IMA guidelines focus on competence, confidentiality, integrity, and credibility. Competence means that individuals will develop and maintain the skills needed to practice their profession including ongoing professional education. Confidentiality means that the cost accountant will refrain from disclosing company information to inappropriate parties or using such information to generate an illegal or unethical advantage. Integrity means that individuals will not participate in activities that would discredit the profession or violate the company's corporate governances. Credibility means that the cost accountant will provide full, fair, and timely disclosure of all relevant information that may affect a user's decision.
 - b. The management accountant should document which regulation is believed to have been violated and then research and record the appropriate actions that should have been taken. Document the research findings as evidence of violations found. This information should be kept confidential and reported and discussed with a superior who is not involved in the altercation. If the immediate superior is involved, then it may be necessary to communicate with someone higher up the corporate ladder (possibly up to the audit committee). Again, it is important to document each communication and finding throughout the process. If the management accountant cannot resolve the matter, then he or she should resign. The management accountant should consult legal council before reporting the matter to regulatory authorities.
- 19. Each student will have a different answer. No solution is provided.
- 20. Each student will have a different answer. No solution is provided.

21. a. A mission statement adds strength to an organization's strategic planning process by providing a clear view of what the organization wants to accomplish and how it uniquely meets customers' needs with products and services. Without a mission statement, an organization may find that it is engaging in activities that are not, or never can be, part of what it wants to do or is able to do.
- b. A mission statement should be developed using input from everyone involved in the value chain within the organization. This will help to insure that the statement will become internalized by the members of the organization and become part of the organizational culture.
- c. In developing a mission statement, organization members need to consider the organization's strengths (including core competencies) and weaknesses, opportunities for growth, customer base (current and desired), competition, constraints (physical, financial, technological, etc.), profitability, and employees' skills (current and those that can be acquired through training or hiring).
- d. Each student will have a different answer. No solution is provided.
22. a. Every organization does not have to have a mission statement. However, having one aids the organization by providing a clear statement of what the organization wants to accomplish and how it uniquely meets customers' needs. Without a mission statement, an organization may find that it is engaging in activities that are not part of what it wants to do or is able to do well.
- b. A mission statement can help an organization encourage ethical behavior by establishing ethical values as an organizational characteristic. By promoting ethical behavior in the mission statement, the organization is reinforcing ethical behavior as a distinct and critical part of the organizational culture.
- c. A mission statement can help an organization strive for a higher level of product quality and customer service in much the same way that it helps promote ethics in the organization – it reinforces these concepts as part of organizational culture and, thus, “demands” the organization to aspire to continual improvement.
23. Each student will have a different answer. No solution is provided.

24. a. You might want to have information on the average age of your primary customers, their food preferences, what your competitors offer (quality and price), and the skills of your cook.
- b. The average age of your customer is important because spicy chicken wings would probably be more favorably received by younger customers, and quiche would probably be preferred by more weight-conscious customers. Competitors' offerings would indicate whether you would be able to compete on quality and price and whether quiche and/or spicy chicken wings were currently available at your competitors' restaurants (product differentiation). Your cook's talent is crucial because, regardless of preference or need, if the cook is unable to prepare the dish properly, customers will not purchase it.
25. Each student will have a different answer. No solution is provided.
26. Each student will have a different answer. No solution is provided.
27. Each student will have a different answer. No solution is provided; however, it is essential that students realize that computer software piracy is an illegal as well as unethical activity. Piracy is theft.
28. a. Such a law change would reduce costs in the short run. All of the costs of complying with current environmental laws and policies would be eliminated. However, in the long term, it could be argued that costs would rise well above current levels. Higher costs would be reflected in health care; permanent environmental damage to recreational lands, fisheries, and agricultural land; and contamination of surface waters and aquifers. The consequences of this pollution would be dire in the long run and would include the social costs of loss of life and loss of health. There could also be backlash from the environmentally concerned sector of the consumers of the output of U.S. production.
- b. Each student will have a different answer. No solution is provided.
- c. Each student will have a different answer. No solution is provided.
29. Each student will have a different answer. No solution is provided.
30. Each student will have a different answer. No solution is provided.

31. Each student will have a different answer, but the following items may be mentioned:
- Employees might be empowered to decide which clients they will advise, how often these clients need to be contacted, what activities need to be performed to provide high-quality financial planning, and what resources are needed to provide these services. Employees are in a much better position to judge these issues than an absentee owner.
 - As the owner, you may retain the billing process as well as the marketing function. You would also probably want to verify customer satisfaction through surveys or telephone calls. These matters will be essential to your business profitability and longevity, and the employees may not have the expertise or ability to handle these matters.
32. Each student will have a different answer. However, the following items may be mentioned:
- The upstream value chain would include shareholders/bondholders, parts suppliers, transportation companies, equipment manufacturers, and so forth.
 - Internal activities would include purchasing, receiving, automobile design, manufacturing, and so forth.
 - The downstream value chain would include distributors, transportation companies, market research, advertising firms, customers, and so forth.
33. a. A strategic alliance would be considered illegal in the United States when it interfered with free trade such as a collusion of organizations to fix prices.
- b. Each student will have a different answer, but the following issues may be mentioned: establishment of a consistent supply chain (both in quantity and quality), a strong customer base, integration of activity (such as airline, hotel, and car rental alliances), and so forth.
- c. Each student will have a different answer. No solution is provided.
34. a. A Balanced Scorecard is used to:
- clarify or update a business's strategy;
 - link strategic objectives to long-term targets and annual budgets;
 - track the key elements of the business strategy;
 - incorporate strategic objectives into resource allocation processes;
 - facilitate organizational change;
 - compare performance of geographically diverse business units;
 - increase companywide understanding of the corporate vision and strategy.

- b. The majority of value in many modern businesses rests in their intangible assets, namely their people, and the knowledge those people have. Also, modern companies recognize that mission success (or competitiveness) is primarily driven by the ideas and innovations that come from people. Older management practices, that are focused solely on financial metrics and production activities, are not appropriate in this new environment. Financial metrics are lagging indicators that tell what happened in the past. Knowledge workers communicate and create in complex ways. Managers need a new way to assess how well their organization is functioning, how to predict future performance, and how to align the organization toward new strategies to achieve breakthrough performance.

The balanced scorecard (BSC) has evolved to support strategic planning and management in this new work environment. The BSC changes the strategic plan from passive document into organizational “marching orders.” It provides a framework that provides performance measurements and helps planners identify what should be measured. It enables executives to truly execute their strategies.

- c. There are always challenges associated with any innovative management idea or any effort that seeks to change the status quo in a large organization. A comprehensive BSC is somewhat difficult and time-consuming to implement, requiring sustained top-level support and commitment to develop and implement the system. If the organization does not have a high-ranking champion, does not have adequate funding, and is not ready to change, the BSC will be unsuccessful. In fact, in the Bain & Co. (consulting firm) 2007 survey on “popular” management tools in use, the number of dissatisfied users outweighed those who are extremely satisfied with the balanced scorecard. The survey showed respondent usage and satisfaction rates (on a 5-point scale) by region as follows:

N. America	Europe	Asia	L. America
62%	63%	71%	60%
3.80	3.82	3.32	4.02

(Source: http://www.bain.com/management_tools/Management_Tools_and_Trends_2007.pdf)

35. The purpose of this question is to get students to think about the role of laws and ethics in the conduct of business. Among the important points that should be made in the position papers include: whether the laws in the firm's home country or local foreign law should govern the actions of the firm; whether ethics or law should be the standard governing the actions in foreign jurisdictions; and the extent to which "being competitive" should be a criterion in choosing a business course of action.
36. a. If an organization's management accountant is, in fact, primarily dealing with internal accounting and finance matters, then it is more likely that the financial accountant would be more involved in earnings management situations.
- b. Each student will have a different answer. Some earnings management falls under the heading of normal business decision making, while "abusive" earnings management is viewed as intentional and material manipulation. Past-SEC Chairman Arthur Levitt criticized accounting tactics such as improper revenue recognition, unjustified restructuring charges, and 'cookie-jar reserves.' Accountants know all of these (and more) as 'accounting irregularities' – intentional misstatements in financial reports, which should often be regarded as the equivalent of fraud. Fraud is, of course, illegal and unethical. As Warren Buffett once said, "Managers who always promise to 'make the numbers' will at some point be tempted to 'make up' the numbers."
37. a. The CEO would be concerned about the earnings management if it were to be considered "abusive." Under the 2002 Sarbanes-Oxley Act, an organization's CEO and CFO are personally accountable for the accuracy of their company's financial reporting.
- b. Yes, whistleblowing managers in SEC-registered companies are protected from retaliation under Section 806 of the Sarbanes-Oxley Act. Covered disclosures include providing information or assistance in the investigation of conduct is believed to be a violation of securities laws or regulations. This section of the Act relates to providing information or assistance to law enforcement, Congressional members or committees, and to internal organization members with supervisory or investigative authority.
38. a. The quote indicates that the predominant concern of American businesses should be profit generation. There is nothing explicit or implied in the statement to indicate that profits must be derived from that set of activities that is legal within the local jurisdiction. Given that the pursuit of profit is constrained to legal activities, Friedman's statement is merely a pro-capitalism one.

- b. Ethically, one might feel that the pursuit of profit should be constrained such that profit is not pursued to the detriment of human life, human happiness, the environment, etc. In short, ethically, one might easily identify several objectives that managers should hold in preference to maximization of profits.
 - c. Taking a long-term view, it might be logical to argue that managers' profit-maximizing actions are those actions that are both legal and ethical. In the long run illegal actions draw fines, lawsuits, new regulations, and other costly sanctions; unethical acts tarnish business reputation and lose customers and market share. Hence, in the long run, there may be no conflict between Friedman's statement as to managers' obligations and the legal and ethical obligations of managers.
39. Toyota Motor Company lists on the Tokyo, Nagoya, Osaka, Fukuoka, Sapporo, London, and New York Stock Exchanges. When listing on multiple stock exchanges, the multinational must know and comply with the corporate governance rules of each stock exchange. What is permitted on one stock exchange may be illegal on another. For example, the Sarbanes-Oxley Act requires a CEO to sign off on the accuracy of financial reports, but this is not required in Japan or London. Sarbanes-Oxley also requires that a majority of the members of corporate boards of directors be independent from the company; such a requirement does not exist in Japan.