

Solutions for Chapter 1

Why Accounting is Important in Organizations

Analysis and Interpretation Problems

AIP 1.1 Using Accounting for Making Planning Decisions (10 minutes)

- a. Historical costs are not as useful in making planning decisions when the environment is changing rapidly. With changing products, processes, and prices, the historical cost is not a good approximation of the current value of a resource.
Historical costs, however, may be useful for control purposes. Historical costs provide information about the activities of managers and can be used as performance measures to evaluate managers.
- b. The purpose of accounting systems is to provide information for planning purposes and control. Historical costs are not generally appropriate for planning purposes.
Alternatively, additional measures are costly to implement. An accounting system should include additional measures if the benefits of improved decision making are greater than the costs of the additional information.

AIP 1.2 Goals of a Corporation (15 minutes)

Finance and economics textbooks traditionally state that the goal of a profit organization is the maximization of shareholder wealth. Managers are frequently presumed to act in the best interest of the shareholder, although recent finance literature recognizes that appropriate incentives are necessary to align manager interests with shareholder interests. The goal, however, remains the same: to maximize shareholder wealth. Finance textbooks, however, are not very clear on how maximizing shareholder wealth is achieved. Most finance textbooks focus on financing decisions and not on the use of assets and dealing with customers.

Marketing's goal of satisfying customers recognizes that customers are the source of revenues for the organization. Customers are the means through which shareholder value is increased. Customer satisfaction as the sole goal of the organization, however, does not recognize the need to satisfy other stakeholders in the organization, including the shareholders. Customers will be very satisfied if you give them products free of charge, but that won't increase shareholder wealth.

In summary, achieving customer value is necessary to create shareholder wealth, but is not sufficient.

AIP 1.3 Accounting and Control (15 minutes)

- a. Two possible roles exist for the monthly report: facilitating planning decisions and control. Monthly reports provide more timely information than annual reports. With monthly reports, the president can identify problem areas more quickly and make corrective actions. The president also may use the monthly reports to evaluate the work of his administrators. The monthly reports provide information about whether managers are performing well or poorly.
- b. If the president of the university is not too familiar with accounting numbers, the finance director must adapt the monthly report to make it more understandable. She may even want to highlight areas in the report that might need attention.

AIP 1.4 Control and Internal Auditors (15 minutes)

- a. Internal auditors serve multiple roles. One role is to assist the decentralized managers in following directives from central administration. The internal auditors are also often used to evaluate the performances of the managers. If internal auditors are viewed as performance evaluators, managers will be very careful in how they interact with the internal auditors and how much information to release.

- b. One solution to this problem is to have internal auditors perform only one of the tasks described in (a). If managers could be convinced that internal auditors would have no impact on their performance evaluation, they would be much more open to working with internal auditors to achieve the organization's goals.

AIP 1.5 Financial Reporting and Ethics (15 minutes)

- a. The reported profit of the company can be improved at the end of the year by making sure that all the orders get shipped before the end of the year so that the revenue from those orders can be recognized. The profit figure also can be affected by accounting estimates and accounting methods. For example, by assuming fewer uncollectible accounts receivable, profit is improved. A change to straight-line depreciation from accelerated depreciation also will generally improve profits. Any accounting estimate or method changes, however, must be acceptable to the external auditor.
- b. The controller should consider all the stakeholders in responding to the president. Stockholders and bondholders may be harmed if the controller manipulates financial reports. The controller should look to the code of ethics for guidance and explain to the president any criminal implications of distorting reported profit figures.

AIP 1.6 One Cost System Isn't Enough (15 minutes)

The first part of the quote describes the tension (and conflict) that arises when a single accounting system is used for multiple purposes. This part of the statement is an accurate description of practice. However, the quote has a couple of problems, including:

- While the quote describes the costs of using a single system ('a single system ... can't perform important managerial functions adequately'), the quote does not describe the benefits derived from using a single system (lower bookkeeping costs, a single audit, less confusion).
- Because the quote ignores the benefits of a single system, it ignores the concept of economic Darwinism. It does not address the question of how surviving (successful) companies can compete if a single system 'can't perform important managerial functions adequately.'
- Also, the quote assumes that managers are bound to their internal accounting systems and no other alternative information sources are available. Often managers develop

their own ad hoc, 'offline' information systems for decision making. These systems include PC-based spreadsheets, index cards, informal observation, and 'walking around'.

AIP 1.7 Tax Reporting and Accounting Systems (15 minutes)

The internal accounting system supports multiple uses, including: financial reporting, taxes, contracting (debt and management compensation), internal decision making, and internal control. Because multiple purposes are served, trade-offs must be made among the competing demands. When more emphasis is placed on one purpose (taxes), the less consideration can be given to other uses (internal planning and control). By linking taxes to external reporting, Japanese firms' financial reports will be based on accounting procedures that give more weight to tax considerations. In the UK, Canada, and the US, companies can keep two sets of books, one for taxes and the other for financial reporting. Thus, in these jurisdictions, there is more of a separation of taxes and everything else. Except for the additional bookkeeping costs of producing the two separate sets of reports, tax considerations are predicted to have less influence on the choice of internal (and thus external) accounting procedures in the UK, Canada, and the US than in Japan.

The question is raised as to why firms use the same accounting procedures for internal reports as they do for external reports. Or, for that matter, why tax laws and external financial reporting considerations have any effect on internal accounting procedures? Why don't firms maintain multiple sets of accounts, one for each purpose (e.g., financial reporting, internal decision making, and internal control)? Clearly additional bookkeeping costs exist in maintaining multiple sets of accounts. Also, there are confusion costs (costs that result from having multiple sets of accounts, maintaining them, and going from one to the other, often leading to errors and their related costs) that arise and, in many instances, firms explicitly link senior executive compensation to externally reported financial statements. Such explicit linkage of executive pay to externally reported net profit presumably exists to control agency costs between management and shareholders. Once senior management performance and rewards are linked to external reports, the internal reporting system will become linked to the external reports and less consideration will be given to choosing accounting procedures that aid in internal decision making and internal control.

In Japan, the firm's accounting systems are less likely to be used for internal uses (planning and control) than in the UK, Canada, and the US. They cannot rely as much on their accounting systems for internal uses (because more weight is placed on using accounting procedures to

reduce taxes); thus, Japanese managers are more likely to use non-accounting-based systems for internal decision making and control.

AIP 1.8 Making Planning Decisions and Financial Reporting (10 minutes)

The method of accounting for external reports should not necessarily dictate how accounting is performed for internal use. The CEO may decide that including research and development and selling costs in the product cost is important for making planning decisions, even though those costs are not part of product costs for external reporting.

AIP 1.9 The Function of the Divisional Controller (25 minutes)

- a. Line activities are those that are primary to the purposes of the organization. They create and distribute the goods and services of the organization. Line reporting refers to the reporting relation between different hierarchical management levels in line activities, e.g., the reporting relation between the general supervisor and the plant managers.

Staff activities are services provided by departments in the organization in support of its line activities. The role of the division controller in the division is an example of a staff activity. The reporting relationship between the division controller and the division manager is an example of a staff reporting relationship.

Functional activity is the collection of all the similar specialized support services in an organization. The controllership activity, spread throughout the company and directed by the corporate controller's office, is an example of functional activity. The reporting relationship between the division controller and the corporate controller is an example of functional reporting.

- b.
 - i. The division controller is responsible to both the corporate controller and the division manager, i.e., a dual relationship. The corporate controller assigns the division controller to the division and has final responsibility for promotion and salary. Thus, the division controller is an employee of the controller's department and reports to the corporate controller. At the same time, the division controller also serves as a staff resource to the division manager. The division controller is required to file an independent commentary on the

division's financial results, which could well differ from the division manager's commentary. The division manager does evaluate the division controller's performance and makes salary and promotion recommendations.

- ii. The motivation of the division controller would be affected by this dual reporting relationship. The division controller is evaluated by two people whose responsibilities are not always congruent. What one person may consider good performance may be considered unsatisfactory by the other. Thus, the division controller will have difficulty knowing what factors influence his progress in the company. The circumstances described in the problem do not provide positive motivation for the division controller.

AIP 1.10 Responsibilities, Information, and Performance Measures (15 minutes)

- a. Steve has the best information about the likelihood of the retail shops paying their bills. By giving Steve the responsibility to make the decision, the wholesaler is more likely to make correct credit decisions.
- b. If Steve is not given the responsibility to make the credit decision, he should not be held responsible for failure of customers to pay. A possible performance measure for Steve could be total sales at the time of delivery rather than at the time of payment.
- c. If Steve is given the responsibility to make credit decisions, he is responsible for both sales and customer payments. Therefore, a possible performance measure is total sales less losses from non-payment by customers.
- d. The appropriate performance measure depends on Steve's responsibilities. If Steve makes the credit decision, then the performance measure should include uncollectible accounts receivable. Without the responsibility for credit decisions, increased sales is a better performance measure.

AIP 1.11 Global Competition (15 minutes)

As long as Peter Jensen can distinguish his guitars from those of his competitors, Peter can maintain his present style of business. But guitar construction is a business that is not very costly to enter, so Peter should expect competition in handcrafted guitars in the near future. If these

guitars are made in countries with low labour costs but highly skilled craftsmen, Peter is likely to find himself in a poor competitive position. At a minimum, Peter should follow closely the quality of the guitars of his competitors.

AIP 1.12 The Role of Managers (10 minutes)

- a. Planning.
- b. Control.
- c. Planning.
- d. Control.
- e. Planning.
- f. Control.
- g. Planning.
- h. Planning.
- i. Control.

AIP 1.13 Six Sigma (10 minutes)

Six Sigma is not solely about having the highest quality product. In fact, under Six Sigma a quality product is not necessarily the most expensive product, but the product that most closely meets the customer's demand. Customers may prefer a cheaper and simpler product.

Six Sigma is also about the process of continually working to improve the product and customer service. Six Sigma is a team effort focused on building quality into a product rather than identifying defective products through inspection.

AIP 1.14 Computer-Aided Manufacturing (CAM) (10 minutes)

The main advantage of a CAM welding machine is the ability to reprogram the machine to make different types of welds for different products. Machines that only have to make the same welds over and over again do not have to be programmed. Mechanical welding machines can be made at a lower cost to perform repetitive tasks.

AIP 1.15 Just-In-Time (JIT) (15 minutes)

JIT can also be used in service organizations. Service organizations do not have the problem of excess inventory, but do have customers that expect to be served in a timely manner. Service organizations should examine the way they serve their customers to minimize waiting periods between the demand for the service and the provision of the service.

Hospitals must deal with an uneven flow of patients throughout a typical week. Friday and Saturday evenings tend to be busy times because alcohol- and drug-related injuries occur more frequently. But, sometimes extra patients arrive at the hospital at unexpected times. To accomplish JIT, the hospital must carefully schedule health care workers for expected peaks in patient flow and to have contingency plans for unexpected patient flows. Having doctors 'on call' is one way of forming contingency plans. The hospital should also consider redeployment of health care personnel during emergencies.

Hospitals do have some inventories such as medicines and supplies for patients. Hospitals should be sure that these items are resupplied on a timely basis.

AIP 1.16 Computer-Integrated Manufacturing (CIM) (10 minutes)

Any change in an organization needs the support of both top-level and lower-level managers. The top-level managers can offer leadership and motivation in making any change. The lower-level managers must implement the change. If one group is reluctant to make a change, the change is unlikely to be successful.

AIP 1.17 International and Domestic Differences (10 minutes)

It is certainly true that purely domestic companies face multiple taxing authorities, languages, and cultures. However, there is a difference of degree. While multiple languages are spoken in Milan, Italian is still the official language in which all business contracts are written. Each

European country has its own tax system, even if they are patterned closely after regulations established by the European Union.

Just because a company can successfully compete domestically does not automatically mean that they have the knowledge and expertise to solve the more complicated problems that they will encounter internationally.

Exchange rate fluctuations affect all managers the same in any given time period. But exchange rate differences can cause some managers' performance to be improved and others harmed in the same time period. Again, fluctuating exchange rates is a more serious and therefore potentially more difficult problem to solve than inflation.

Extended Analysis and Interpretation Problems

AIP 1.18 Ethical Behavior (20 minutes)

- a. Richardson's considerations are determined largely by his position as a cost accountant, with responsibilities to FulRange Inc., others in the company, and himself. Richardson's job involves collecting, analyzing and reporting operating information. Although not responsible for product quality, Richardson should exercise initiative and good judgment in providing management with information having a potentially adverse economic impact.

Richardson should determine whether the controller's request violates his professional or personal standards or the company's code of ethics, should FulRange have such a code. As Richardson decides how to proceed, he should protect proprietary information and should not violate the chain of command by discussing this matter with the controller's superiors.

- b.
 - i. The controller has reporting responsibilities and should protect the overall company interests by encouraging further study of the problem by those in his department, by informing his superiors in this matter, and by working with others in the company to find solutions.
 - ii. The quality control engineer has responsibilities for product quality and should protect the overall company interests by continuing to study the quality of

reworked rejects, informing the plant manager and his staff in this matter, and working with others in the company to find solutions.

- iii. The plant manager and his staff have responsibilities for product quality and cost and should protect the overall company interests by exercising the stewardship expected by them. Plant management should be sure that products meet quality standards. Absentee owners need information from management, and the plant manager and his staff have a responsibility to inform the board of directors elected by the owners of any problems that could affect the well-being of FulRange.

- c. Richardson needs to protect the interests of FulRange, others in the company, and himself. Richardson is vulnerable if he conceals the problem and it eventually surfaces. Richardson must take some action to reduce his vulnerability. One possible action that Richardson could take would be to obey the controller and prepare the advance material for the board without mentioning or highlighting the probable failure of reworks. Because this differs from his long-standing practice of highlighting information with potential adverse economic impact, Richardson should write a report to the controller detailing the probable failure of reworks, the analysis made by him and the quality control engineer, and the controller's instructions in this matter.

AIP 1.19 Strategies, Organizational Goals, and Management Accounting (60 minutes)

- a. External Forces

Technological Change. The popularity of the Internet and e-commerce posed a threat to Mr. Aldo's record store businesses. Consumers were more willing to purchase skateboards and other merchandise through the web. Retail prices on the web were equal to, if not less than, prices of merchandise sold in bricks-and-mortar stores. Virtual stores such as Amazon.com also provided quick, door-to-door delivery to their customers. The Internet also presented an opportunity to Albo; anyone with a computer and modem was a potential customer for the virtual store.

By acquiring the SkateBDS.com web site, Albo was able to combine his company's experience in selling skateboards, and his extensive inventory, with the virtual store's convenience and market coverage.

Globalization. The Internet opened up a global market for online businesses. In one respect, companies could save money by not having to establish bricks-and-mortar stores all over the world. Second, international consumers might be lured to the website

because of the favorable currency exchange rate. However, the low barrier to entry would increase the threat of new competitors, in particular, large American companies with vast resources.

Mr. Aldo maintained both bricks-and-mortar stores and the virtual store. He benefitted from economies of scope—experience and customer data in record selling were transferable to the virtual store. Second, he could use the web to attract customers who did not live in North America.

Customer Needs. In order to meet the changing demands of a teen-driven big city market, Aldo would need an alternative strategy to operating stores in small Canadian cities. Lower inventories and building costs allowed such companies as Amazon.com to pass along the savings to their customers, in the form of lower prices.

Aldo had to integrate all components of the value chain in order to offer customers the products they wanted, at the price they wanted, at the time they wanted, no matter where they lived.

Strategies

Quality of Service. SkateBDS.com adds value through a large selection of products, speed of delivery, competitive pricing, convenience, and access to technical specialists in maintaining and tuning skateboards. The company's physical stores and warehouses provide a large selection of boards and components, all of which are listed in the catalogue and on the web. A large selection increases the likelihood that a customer will find the specific product she wants. All products are priced at the same level on the web as in the bricks-and-mortar stores. This reduces the risk of cannibalization of the bricks-and-mortar stores by the virtual store and makes the product more attractive to customers from other countries where the currency exchange rate is favorable. Finally, the virtual store offers convenience to the customer—she can order and receive products without leaving her home.

By adding value to the service it provides, SkateBDS.com intends to receive sufficient resources (in the form of sales) in order to achieve the goals of the company and benefit its stakeholders.

- b. Management accounting provides information to assist in planning decisions and control. In the case of SkateBDS.com, the company would have to make decisions about service design, production and delivery, and customer service. In addition, SkateBDS.com must have a system for measuring performance and rewarding the

employees. Management accounting would provide both financial and non-financial information to the managers. The following information would help managers to achieve the company's strategies – a large selection of products, speed of delivery, competitive pricing, and convenience.

SkateBDS.com cannot offer all of the skateboard components and accessories produced in the world. However, it can try to offer a large enough selection of merchandise to satisfy the majority of its regular customers. Accounting can provide information on revenues by product category (e.g., long boards, short boards, wheels, helmets), by manufacturer, by title, by region (where customers live), and by season. Managers can use this information to identify the best sellers and to predict future sales. Second, information on wholesale costs can help the managers to identify the most profitable units. Accounting can also provide information on inventory, warehouse costs, percentage of returned products, and the costs associated with processing those returns. Managers can use this information to reduce unwanted inventory and free up resources to order other, more popular products.

In order to evaluate the delivery process, SkateBDS.com can use such information as delivery costs, time to delivery, and frequency of deliveries. Second, SkateBDS.com must evaluate the feasibility of maintaining the website. Information such as number of visits to the web site, and sales generated from the web site, would be useful. SkateBDS.com must also compare the costs of running a bricks-and-mortar store with the costs of running a virtual store. Accounting can provide costs of leasing and owning store buildings, costs of utilities, costs of warehouses, labor costs, property taxes, maintenance costs, and so on. The website has its own costs, such as Internet service, hardware, software, technical support staff, utilities, and security.

The quality of customer service can be measured by number of repeat customers, number of complaints received, number of returns, and other data provided by in-store and online surveys. Since the cost of acquiring new customers is much greater than the cost of retaining old customers, information about customer service quality is extremely useful.

SkateBDS.com also requires information about employee performance. Marketing and sales staff could be evaluated by measures of sales and profitability. Delivery staff could be evaluated by the number of on-time deliveries, and cost per delivery. Website staff could be evaluated by the amount of traffic to the site and revenue generated by the site. The company would try to reduce costs in non-value-adding departments such as warehousing and administration.

Finally, the company should implement a system of rewards in order to encourage employees to work for the company's goals. Rewards should be connected to the

performance of the company as a whole. Information about sales and profits of each division, costs attributable to each division, customer satisfaction, and customer retention would assist the company to reward employees for working toward company goals.