LEARNING OBJECTIVES

LO1 Contrast financial and managerial accounting and explain how managerial accounting is used by internal decision makers. (p. 4)

LO2 Explain how an organization’s mission, goals, and strategies affect managerial accounting. (p. 7)

LO3 Discuss the factors determining changes in the nature of business competition. (p. 14)

LO4 Differentiate among structural, organizational, and activity cost drivers. (p. 14)

LO5 Explain the nature of the ethical dilemmas managers and accountants confront. (p. 18)

MISSIONS, GOALS, AND STRATEGIES

Recent years have seen rough times for the automobile industry with government bail-outs required to stabilize GM and Chrysler as a result of sagging sales and mounting losses. Despite this bleak environment for the automobile industry, a new start-up company, Carbon Motors Corporation, is revving up to fill their stated mission of building “the world’s first purpose-built law enforcement patrol vehicle.” By following a strategy focused on the needs of this narrow market segment or niche, marketing directly to government agencies, and utilizing innovative manufacturing approaches, management believes Carbon Motors can accomplish its profitability goal with an annual sales volume between 10,000 and 80,000 units.

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

To achieve profitability at their anticipated scale of operations with competitive pricing, they plan to contain costs by selling directly to law enforcement agencies (rather than through dealers) and avoid inventory carrying costs by building only to fill customer orders. Management believes that direct sales to government agencies will also allow Carbon Motors to avoid major media advertising costs required for sales to the general public. Also avoided are the costs of annual “face-lifts” that are the
norm for passenger vehicles. And, to the extent possible, Carbon Motors plans to minimize investments in manufacturing facilities and all of the issues associated with operating such facilities. Instead, the production of many of the components included in completed vehicles will be accomplished by contract manufacturing. Carbon Motors will then assemble the final product at facilities in Connersville, Indiana.

The CEO and other members of the top-management team have many years of experience at established automobile companies, but they are sober about the challenges they face. Even though Carbon Motors is a privately held company, its lenders expect to receive interest and loan principal payments as provided for in the lending contracts, and its private investor shareholders expect to eventually receive a healthy return on their investment in exchange for their willingness to take on the risk of investing in a start-up company. Financial accounting deals with the content and analysis of financial statements of organizations for which a primary objective is to provide an appropriate return to their stockholders and lenders. Managerial accounting provides tools that managers in organizations use to fulfill the expectations of stockholders and lenders.

We begin this chapter by considering how companies use financial and managerial accounting, and by examining the mission, goals, and strategies that provide broad guidelines for all members of the management team. We also discuss the relationships between organizational management and cost drivers to managerial accounting. We end this chapter with a discussion of ethics in managerial accounting.
This chapter provides an overview of the factors that make managerial accounting increasingly important to successful businesses. Managerial accounting is defined as the activities carried out in a firm to provide its managers and other employees with financial and related information to help them make strategic, organizational, and operational decisions. We begin by distinguishing between financial and managerial (also called management) accounting and by investigating how competitive strategy affects the way organizations, such as Carbon Motors, use managerial accounting information. Next, we explore how the emergence of global competition and changes in technology have increased the need to understand managerial accounting concepts. We also provide an overview of factors that influence costs in an organization and how these factors have changed in recent years. Finally, we examine the interrelationships among measurement, management, and ethics.

USES OF ACCOUNTING INFORMATION

Financial Accounting

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

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

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

**Managerial Accounting**

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

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

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**Research Insight**  Managerial Accounting Is a Key to Success

After studying several highly competitive, world-class companies, noted managerial accounting guru Robin Cooper observed that “with the emergence of the lean enterprise and increased global competition, companies must learn to be more proactive in the way they manage costs. For many, survival is dependent upon their abilities to develop sophisticated cost management systems that create intense pressure to reduce costs.” He also observed that “as cost management becomes more critical to a company’s survival, two trends emerge. First, new forms of cost management are required, and second, more individuals in the firm become actively involved in the cost management process.” Cooper suggests that with the growing number of managers involved in the cost management process, there is an increased need for managerial accounting information (and people who know how to use it). \(^1\)

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

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

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

Globalization of Accounting Standards

As indicated in Exhibit 1.1, a major difference between financial accounting and managerial accounting is that financial accounting must conform to a set of generally accepted accounting principles (GAAP), whereas managerial accounting is not subject to any external standards. The creation of financial accounting standards in the United States, referred to as U.S. GAAP, is the purview of the Financial Accounting Standards Board (FASB), although the ultimate legal authority for accounting standards for publicly traded companies in the U.S. is held by the U.S. Securities and Exchange Commission (SEC). Over the past 25 years, a strong set of international accounting standards (referred to as IFRS, or International Financial Reporting Standards) has been developed by the International Accounting Standards Board (IASB), which is based in the UK. With the emergence of IFRS, many countries, including all European Union countries, have adopted IFRS as a replacement of their domestic accounting standards for publicly traded companies.

For the past several years, the FASB and the IASB have cooperated to minimize the number of differences between U.S. GAAP and IFRS. In 2007, the SEC adopted a policy that allows non-U.S. companies that are traded on U.S. stock exchanges to present their financial statements to the SEC based on IFRS. In 2008, the SEC issued a “road map” document outlining steps that, by 2014, would lead to the use of IFRS instead of U.S. GAAP for all U.S. publicly traded companies. It remains to be seen what impact this convergence of U.S. GAAP and IFRS will have on the financial reporting for privately owned companies. The American Institute of CPAs has called for the creation of a separate board or committee that would continue to issue accounting standards for privately held U.S. companies.

Even though there is no existing regulation of managerial accounting systems, financial accounting standards invariably have some impact on managerial accounting. For example, in accounting for inventory costs, many companies use the same cost systems for both financial and managerial accounting purposes. One of the major differences between U.S. GAAP and IFRS is related to the accounting for inventory costs. It is widely anticipated in the financial accounting community that as the two sets of standards are harmonized further, some of the current inventory cost methods available under U.S. GAAP will no longer be acceptable for financial reporting purposes. This change will likely affect both the financial and managerial reporting systems in many companies.

The direct impact on managerial accounting of the convergence of U.S. GAAP and IFRS is expected to be rather limited. However, managers still need to be aware of major changes in financial accounting standards, because these standards affect how the results of their internal managerial decisions are reported to shareholders and other external constituencies. Financial reporting of managerial decisions affects earnings and earnings per share, and often affects stock valuations.

Strategic Cost Management

Most businesses are under constant pressure to reduce costs to remain competitive. A 2007 study by the accounting firm KPMG reported that more than 80 percent of survey participants viewed an efficient cost structure as a source of long-term competitive advantage.2

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

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

1. **Strategic position analysis**—an examination of an organization’s basic way of competing to sell products or services.

2. **Cost driver analysis**—the study of factors that cause or influence costs.

3. **Value chain analysis**—the study of value-producing activities, stretching from basic raw materials to the final consumer of a product or service.3

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

**ORGANIZATIONS: MISSIONS, GOALS, AND STRATEGIES**

An organization’s mission is the basic purpose toward which its activities are directed. Carbon Motors’ current mission is to build “the world’s first purpose-built law enforcement patrol vehicle.” Starbucks’ mission is to “establish Starbucks as the premier purveyor of the finest coffee in the world while maintaining our uncompromising principles while we grow.”4 Organizations vary widely in their missions. One benefit of a mission statement is to help focus all the activities of an organization. For instance, the former chairman and CEO of Coca-Cola stated that the mission of The Coca-Cola Company is “to create value over time for the owners of our business.” He went on to say:

Our society is based on democratic capitalism. In such a society, people create specific institutions to help meet specific needs. Governments are created to help meet social needs. . . Businesses such as ours are created to meet economic needs. The common thread between these institutions is that they can flourish only when they stay focused on the specific need they were created to fulfill. When institutions try to broaden their scope beyond their natural realms, when for example they try to become all things to all people, they fail.5

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


4 [www.starbucks.com](http://www.starbucks.com)


**LO2** Explain how an organization’s mission, goals, and strategies affect managerial accounting.
We frequently distinguish between organizations on the basis of profit motive. **For-profit organizations** have profit as a primary objective, whereas **not-for-profit organizations** do not have profit as a primary objective. Clearly, the Coca-Cola Company is a for-profit organization, whereas the **City of Chicago** and the **Red Cross** are not-for-profit organizations. (The term **nonprofit** is frequently used to refer to what we have identified as not-for-profit organizations.) Regardless of whether a profit motive exists, organizations must use resources wisely. Every dollar **United Way** spends for administrative salaries is a dollar that cannot be used to support charitable activities. Not-for-profit organizations, including governments, can go bankrupt if they are unable to meet their financial obligations. All organizations, for-profit and not-for-profit, should use managerial accounting concepts to ensure that resources are used wisely.

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

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

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

### EXHIBIT 1.2 Mission, Goals, and Strategies

<table>
<thead>
<tr>
<th>Mission</th>
<th>Basic purpose toward which activities are directed, typically ongoing and not precisely measurable. For example, achieving a monetary profit by providing reliable, high-quality voice and data services to customers would be the mission of a cell phone provider.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goals</td>
<td>Definable, measurable targets or objectives based on the organization’s mission. One goal of a cell phone provider might be to expand service coverage to 75% of the country.</td>
</tr>
<tr>
<td>Strategies</td>
<td>Courses of action that will assist in achieving one or more goals. The cell phone provider will adopt cost-effective plans for building new cell towers and expanding coverage to specific geographic areas.</td>
</tr>
</tbody>
</table>

**Strategic Position Analysis**

In competitive environments, managers must make a fundamental decision concerning their organization’s goal for positioning itself in comparison to competitors. This goal is referred to as the organization’s **strategic position**. Much of the organization’s strategy depends on this strategic positioning
goal. Michael Porter, a highly regarded expert on business strategy, has identified three possible strategic positions that lead to business success:\textsuperscript{6}

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

According to Porter, cost leadership requires aggressive construction of efficient-scale facilities, vigorous pursuit of cost reductions from experience, tight cost and overhead control, avoidance of marginal customer accounts, and cost minimization in areas like R&D [research and development], service, sales force, advertising, and so on. A great deal of managerial attention to cost control is necessary to achieve these aims. Low cost relative to competitors becomes the theme running through the entire strategy, though quality, service, and other areas cannot be ignored.\textsuperscript{7}

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

\textbf{Carnegie's operating strategy was to push his own direct costs below his competitors so that he could charge prices that would always ensure enough demand to keep his plants running at full capacity. This strategy prompted him to require frequent information showing his direct costs in relation to those of his competitors. Possessing that information and secure in the knowledge that his costs were the lowest in the industry, Carnegie then mercilessly cut prices during economic recessions. While competing firms went under, he still made profits. In periods of prosperity, when customers' demands exceeded the industry's capacity to produce, Carnegie joined others in raising prices.}\textsuperscript{8}

\textbf{Southwest Airlines and Dell} are current examples of successful businesses competing with a strategy of cost leadership. Although Amazon.com uses the Internet to differentiate itself from traditional booksellers, its primary strategic position is price leadership.

Conversely, while an organization might compete primarily on the basis of price, management must take care to ensure their product or service remains attuned to changing customer needs and preferences. In the early twentieth century, \textbf{General Motors} employed a differentiation strategy, focusing on the rapid introduction of technological change in new automobile designs to overcome the market dominance of the Model T produced by \textbf{Ford Motor Company}. While successfully following a cost leadership strategy for years, Ford made the mistake of excluding other considerations such as vehicle performance and customer desires for different colors. The following Business Insight box reports on \textbf{Corning Corporation}'s strategy of product differentiation to achieve a competitive advantage.

\begin{itemize}
  \item Porter, p. 35.
\end{itemize}
BUSINESS INSIGHT  A Century of Innovation Sets Corning Apart

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

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

Corning’s strategy has produced major winners. The company is the world’s largest producer of liquid-crystal-display glass used in flat-panel televisions and computers, which produced 100 percent of Corning’s 2009 profit of $2.0 billion, offsetting losses in other divisions suffering during the recession. Corning’s strategy also carries risks. Its investments in the development and production of optical fiber placed the company in financial difficulty after the dot.com collapse of the early 2000s. Looking ahead, Corning’s new hit product is expected to be “Gorilla Glass,” a hard-to-break, scratch-resistant glass, developed for the eyeglass industry, that is now being used for the growing market in touch-screen devices.9

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

rests on the premise that the firm is thus able to serve its narrow strategic target more effectively or efficiently than competitors who are competing more broadly. As a result, the firm achieves either differentiation from better meeting the needs of the particular target, or lower costs in serving the target, or both. Even though the focus strategy does not achieve low costs or differentiation for the market as a whole, it does achieve one or both of these positions vis-à-vis its narrow market target.10

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

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

A Business Week editorial reinforced the importance of competing on the basis of a business strategy of price or differentiation. However, recognizing the transitory nature of differentiation in a competitive environment, the editorial used the term “innovation” in place of “differentiation.” According to Business Week, the first three working principles of the twenty-first century corporation are:11

1. **Everything gets cheaper faster.** “The Net destroys corporate pricing power. It allows customers, suppliers, and partners to compare prices from 100 or 1,000 sources, not just two or three, and erases market inefficiencies. It rapidly commoditizes all that is new, reducing prices fast.”

2. **Cutting costs is the answer.** “In an economic universe of downward pressure on margins, one path to profitability will be to reduce expenses.”

3. **Innovation builds profits.** “There is one way for corporations to circumvent principle No. 1 and raise prices. In an information economy, companies can gain an edge through new ideas and products.” This advantage is temporary, so corporations following this strategy must innovate rapidly and continuously.

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

### Managerial Accounting and Goal Attainment

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

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

<table>
<thead>
<tr>
<th>Budgeted (planned) Costs</th>
<th>Actual Costs</th>
<th>Deviation from Budget</th>
<th>Percent Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>$560,000</td>
<td>$595,000</td>
<td>$35,000 unfavorable</td>
<td>6.25</td>
</tr>
</tbody>
</table>

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

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

11 Based on “The Twenty-First Century Corporation,” Business Week, August 28, 2000, p. 278.
When a differentiation strategy is followed, it often pays to work closely with customers to find ways to enhance the perceived value of a product or service. This leads to an analysis of costs from the customer’s viewpoint. The customer may not want a costly feature. Alternatively, the customer may be willing to pay more for an additional feature that will reduce subsequent operating costs.

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

**Planning, Organizing, and Controlling**

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

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

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

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

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

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

The previous discussion has focused on understanding the difference between financial and managerial accounting and the broader context of managerial accounting within a company.
**Required:**
Identify the statements and phrases from the following list that are primarily relevant to managerial accounting, as opposed to financial accounting:
1. Preparing periodic financial statements
2. A company’s strategic position
3. Calculates earnings per share for stockholders
4. Summarizes information about past events
5. Is not based on generally accepted accounting principles
6. Must conform to external standards
7. Helping managers make decisions is its primary purpose
8. Encourages use of selective data, if relevant
9. Is tailored to the needs of the company and its managers
10. Cost driver analysis

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

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**Competition and Its Key Dimensions**

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

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

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

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

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

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

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**COST DRIVERS**

An activity is a unit of work. To serve a customer at a restaurant such as Outback Restaurants, a server might perform the following units of work:
- Seat customer and offer menu
- Take customer order
- Send order to kitchen
Bring food to customer
Serve and replenish beverages
Determine and bring bill to customer
Accept and process payment
Clear and reset table

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

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

**EXHIBIT 1.5  Structural, Organizational, and Activity Cost Drivers**

**Structural Cost Drivers**
- Fundamental choices about the size and scope of operations and technologies employed in delivering products or services to customers. For example, Apple Computer’s decision to enter the online music distribution business.

**Organizational Cost Drivers**
- Choices concerning the organization of activities and the involvement of persons inside and outside the organization in decision making. Authorizing lower-level employees to make decisions to solve problems is an example of an organizational cost driver.

**Activity Cost Drivers**
- Specific units of work (activities) performed to serve customer needs that consume costly resources. Assembling a product is an example of an activity cost driver.

**BUSINESS INSIGHT FedEx and UPS Stage Battle—Customer Is Sure to Win**

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

Both companies invest heavily in equipment and infrastructure to continue to meet increasingly tight delivery deadlines. This includes sorting hubs for air shipments and investments in new aircraft. FedEx even entered into an arrangement with the U.S. Postal Service to ship some USPS packages while the USPS placed FedEx boxes in selected Post Office buildings. A recent article in Business Week reports that UPS gained at least a temporary advantage by utilizing information technology to integrate its traditional strengths in ground transportation with its overnight air transportation system. According to the article, “UPS, like FedEx, still uses planes to make most (overnight) deliveries. But in the past two years, its logisticians have also figured out how to make quick mid-distance deliveries—as far as 500 miles in one night—by truck, which is much less expensive than by air.” While both companies battle to improve or at least maintain profitability, customers benefit from continuously improving quality and service at lower and lower costs.12

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Structural Cost Drivers

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

- **Determining the size of stores.** This affects the variety of merchandise that can be carried and operating costs.
- **Determining the type of construction.** While a lean warehouse type of construction is less expensive, it is not an appropriate setting for selling high-fashion clothing.
- **Determining the location of stores.** Locating in a shopping mall can cost more and subject the store to mall regulations but provides for more customer traffic and shared advertising.
- **Determining types of technology to employ in stores.** A computerized system for maintaining all inventory and sales data requires a large initial investment and fixed annual operating costs while providing more current information. However, the computerized inventory and sales systems can be less expensive at high sales volumes than a less costly system relying more on clerks taking physical inventory.

One of the most important structural cost drivers for many companies is the decision to reach out to a global marketplace. The following Business Insight illustrates how some companies have successfully weathered the current economic downturn as a result of their globalization strategy.

**BUSINESS INSIGHT Globalization as a Structural Cost Driver**

The Coca-Cola Company has operated internationally since the 1920s. It operates in more than 100 countries with about 75% of its sales coming from abroad. The Wall Street Journal recently reported that within the last year, Coca-Cola has announced plans to invest $27 billion in developing countries over the next decade.

In today’s recessionary economic environment, it is companies with a global focus that are experiencing the greatest revenue growth. The Journal reported that among the 30 companies in the Dow Jones Industrial Average, the 10 companies that get the largest share of their revenues from abroad saw revenue growth of 8.3%; whereas, the 10 companies with the least global revenues saw only a 1.6% growth. In tough economic times, with a weaker American economy, companies that have made structural cost decisions to go global are realizing significant payoff from those decisions.\(^\text{13}\)

Organizational Cost Drivers

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

- **Working closely with a limited number of suppliers.** This can help achieve proper materials in the proper quantities at the optimal time. Developing linkages with suppliers can also result in suppliers’ initiatives that improve the profitability of both organizations.
- **Providing employees with cost information and authorizing them to make decisions.** This helps improve decision speed and reduce costs while making employees more customer oriented. Pro-

duction employees may, for example, offer product design suggestions that reduce manufacturing costs or reduce defects.

- **Reorganizing the existing equipment in the plant so that sequential operations are closer.** This more efficient layout reduces the cost of moving inventory between workstations.
- **Designing components of a product so they can fit together only in the correct manner.** This can reduce defects as well as assembly time and cost.
- **Manufacturing a low-volume product on low-speed, general-purpose equipment rather than high-speed, special-purpose equipment.** Assuming the special-purpose equipment is more difficult and costly to set up for a new job, this decision can increase operating time and operating cost while reducing setup time and setup cost.

The following business insight illustrates how an innovative hospital in the suburbs of Seattle managed a key organizational cost driver to bring down costs and achieve profitability.

**BUSINESS INSIGHT Managing an Organizational Cost Driver at Providence Hospital**

A key costing challenge for any hospital is how to manage the traffic flow of patients as they go from one level of care to another, from the patient room to laboratory, radiology, or testing location and back to the patient room, or to and from physical therapy or other treatment locations. Just as in any production environment, how the processes are organized is a key cost driver. Providence Hospital in Everett, Washington radically changed its patient movement practices resulting not only in significant cost savings, but also greatly improved patient satisfaction. In their “single stay” section of the hospital, the patient remains in the same room at all times as the level of care changes, or as testing or therapy takes place. Instead of moving the patient around, equipment is moved in and out of the patient room depending on the required level of care, the testing, or treatment to be performed.  

**Activity Cost Drivers**

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

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

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

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

**MANAGERIAL DECISION** You are the CEO

How can you use information about structural, organizational, and activity cost drivers to help you in implementing the organization’s strategy? [Answer, p. 21]

**ETHICS IN MANAGERIAL ACCOUNTING**

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

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

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

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

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

When forced to think about the situation, most employees want to act in an ethical manner. The problem faced by personnel involved in measurement and reporting is that while they may question the propriety of a proposed action, and the arguments may be plausible, they want to be team players, and their careers can be affected by “whistle-blowing.” Of course, careers are also affected when individuals are identified as being involved in unethical behavior. The careers of people who fail to point out unethical behavior are also affected, especially if they have a responsibility for measurement and reporting.
Major ethical dilemmas often evolve from a series of small compromises, none of which appears serious enough to warrant taking a stand on ethical grounds. WorldCom is such a case, in which managers deferred expenses inappropriately over several periods to meet profit forecasts, expecting to recognize them at later time when sales improved. Unfortunately, these small compromises establish a pattern of behavior that is increasingly difficult to reverse. The key to avoiding these situations is recognizing the early warning signs of situations that involve questionable ethical behavior and taking whatever action is appropriate.

**Codes of Ethics**

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

Many corporations have established codes of ethics. A summary of General Motors Corporation’s 20-page code of ethics, “Winning with Integrity” is presented in the following Business Insight box. One of the important goals of corporate codes of ethics is to provide employees with a common foundation for addressing ethical issues. These codes provide a summary of a company’s policies that define ethical standards of employee conduct and they often include broad philosophical statements about behavior. A basic rule of thumb used by General Motors is that employees should never do anything they would be ashamed to explain to their families or to see in the front page of the local newspaper.

**BUSINESS INSIGHT GM Code of Ethics: “Winning with Integrity”**

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

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**Corporate Governance**

Corporate governance refers to the system of policies, processes, laws, and regulations that affect the way a company is directed and controlled. At the highest level, the system of corporate governance for a company is the responsibility of the board of directors, but it affects all stakeholders, including employees, creditors, customers, vendors, and the community at large. The large number of corporate failures of the last decade brought the topic of corporate governance to the forefront.
The collapse of Enron, along with its independent auditor, Arthur Andersen, prompted the U.S. Congress to pass the Sarbanes-Oxley Act of 2002 (or SOX), which was intended to address weaknesses affecting U.S. capital markets. Although SOX deals primarily with issues pertaining to the relationship between publicly traded companies and the capital markets, some of its requirements have become a standard for corporate responsibility and governance affecting both public and private companies, as well as not-for-profit organizations.

SOX consists of 66 sections, including such topics as external auditing standards, auditor conflicts of interest, codes of ethics for financial officers, review of internal controls, and criminal penalties for fraud. Probably the most important provisions of SOX, from a managerial accounting standpoint, are those related to internal control systems. **Internal control systems** generally are made up of the policies and procedures that exist to ensure that company objectives are achieved with regard to (a) effectiveness and efficiency of operations, (b) reliability of financial reporting, and (c) compliance with laws and regulations.

SOX imposes the requirement that CEOs and CFOs annually review and assess the effectiveness of their company’s internal controls over financial reporting, and issue a report of their assessment. Although many CEOs and CFOs have argued that the cost of SOX compliance is unjustified by the benefits to investors, the following Research Insight provides evidence that SOX is improving the quality of financial reporting. Even though SOX limits the internal control review to aspects of the system related to financial reporting, in practice there is very little that takes place in any organization that does not impact the financial statements. Therefore, if SOX is resulting in improvements in data that goes into financial reports, it is likely that data supporting managerial accounting is also enhanced by a more reliable internal control system.

Many of the models and processes that we discuss in this text have either a direct or indirect impact on a company’s financial statements; hence, they are likely subject to the SOX internal control review. An overlap often exists between the systems that produce the data for the external financial statements and those that produce data for internal decision making. For example, cost data produced by the product costing system is often used for both financial reporting and managerial decision making purposes. A more detailed discussion of SOX and internal control systems can typically be found in financial accounting and auditing textbooks.

### RESEARCH INSIGHT SOX Improves Financial Reporting

A recent study of about 1,000 firms reported that companies subject to Sarbanes-Oxley internal control system reviews were significantly less likely to issue materially misstated financial statements, thereby suggesting that the SOX legislation is probably meeting its objective of improving the quality of financial reports. The study based its conclusions on the fact that smaller companies exempt from the SOX internal control reviews were 40% more likely to have material misstatements in their financial statements than companies required to conduct internal control reviews. The study did not attempt to answer the question of whether the reduction in misstatements was sufficient to justify the expense incurred as a result of SOX requirements.\(^{15}\)

### Corporate Social Responsibility

Closely related to the concepts of ethics and corporate governance is the topic of **corporate social responsibility**, which can simply be defined as being a good corporate citizen. It entails balancing the objective of profitability with the objective of giving proper attention to issues such as environmental sustainability and energy conservation, and avoiding actions that would lower the quality of life in the communities in which a company operates and sells its products or services. In earlier generations it would have meant giving a day’s wage for a day’s labor, not hiring underage children, or not dumping untreated waste into the local river.

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Managerial accounting includes a variety of models that help managers determine the cost of a particular activity or product, or the benefits and costs of various decision alternatives. Although such models in their current state of development may not take into account all external social costs, accountants are more aware today than in the past of the need to consider such costs. For example, when calculating the cost of building a new capital asset that is going to last for 25 years, it is necessary to include in that calculation the present value of the cost of the ultimate disposal of the asset, including any environmental cleanup.

Being a socially responsible company does not mean abandoning the profit motive or the goal of providing an attractive return to investors. It means that while pursuing these essential objectives, a for-profit company attempts to measure the total benefits and costs of its actions and accepts the responsibility for those actions. Also, being a good competitor should not be confused with social responsibility. For example, many companies offer certain fringe benefits, such as on-site childcare, because it attracts better employees, not because they feel they have a social responsibility to provide such services. Obviously, the line between being a good competitor and being socially responsible is sometimes blurred.

**CHAPTER- END REVIEW**

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

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

**Solution**

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

**GUIDANCE ANSWER**

**MANAGERIAL DECISION** You are the CEO

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

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

MINI EXERCISES

M1-13. Management Accounting Terminology (LO1-5)
Match the following terms with the best descriptions. Each description is used only once.

Terms
1. Ethics
2. Mission
3. Controlling
4. Goal
5. Cost drivers
6. Quality
7. Balance sheet
8. Income statement
9. Organizational cost driver
10. Financial accounting
11. Activity cost driver
12. Structural cost driver
13. Managerial accounting
14. Resources
15. Product differentiation

Description
a. Designing components so they are easily assembled
b. Factors that influence costs
c. Prepared as of a point in time
d. Accounting for external users
e. Increase year 2011 sales by 10 percent over year 2010 sales
f. Shows the results of operations for a period of time
g. Packing an order for shipment
h. Deciding to limit market focus to a region rather than the entire nation
i. The degree to which a new e-book reader meets a buyer’s expectations
j. Used internally to make decisions
k. Consumed by activities
l. The propriety of taking some action
m. Reduces customer price sensitivity
n. Basic purpose toward which activities are directed
o. Comparing the budget with the actual results

M1-14. Financial and Managerial Accounting (LO1)
Indicate whether each phrase is more descriptive of financial accounting or managerial accounting.

a. May be subjective
b. Often used to state corporate goals
c. Typically prepared quarterly or annually
d. May measure time or customer satisfaction

e. Future oriented

g. Keeps records of assets and liabilities

h. Highly aggregated statements

i. Must conform to external standards

j. Special-purpose reports

k. Decision-making tool

l. Income statement, balance sheet, and statement of cash flows

M1-15. Missions, Goals, and Strategies (LO2)
Identify each of the following as a mission, goal, or strategy.

a. Budget time for study, sleep, and relaxation

b. Provide shelter for the homeless

c. Provide an above-average return to investors

d. Protect the public

e. Locate fire stations so that the average response time is less than five minutes

f. Overlap police patrols so that there are always police cars on major thoroughfares

g. Achieve a 12 percent market share

h. Lower prices and costs

i. Select the most scenic route to drive between Las Vegas and Denver

j. Graduate from college

M1-16. Line and Staff Organization (LO2)
Presented are the names of several departments often found in a merchandising organization such as Macy’s Department Store.

a. Maintenance

b. Home Furnishings
c. Store Manager
d. Payroll
e. Human Resources

f. Advertising

Required
Identify each as a line or a staff department.

M1-17. Line and Staff Organization (LO2)
Presented are the names of several departments often found in a manufacturing organization such as Kimberly-Clark.

a. Manager, Plant 2
d. Controller

b. Design Engineering
e. Property Accounting
c. President

f. Sales Manager, District 1

Required
Identify each as a line or a staff department.

M1-18. Classifying Cost Drivers (LO4)
Classify each of the following as structural, organizational, or activity cost drivers.

a. Oneida Silversmiths reorganizes production facilities from a layout in which all similar types of machines are grouped together to a layout in which a set of machines is designated for the production of a particular product and that set of machines is grouped together.

b. A cable television company decides to start offering telephone service.

c. IBM decides to stop making personal computers.

d. Canon decides to start making high-volume photocopy equipment to compete head-to-head with Xerox.

e. The number of meals a cafeteria serves.

f. The number of miles a taxi is driven.

g. A company eliminates the position of supervisor and has each work group elect a team leader.

h. Toyota empowers employees to halt production if a quality problem is identified.

i. The number of tons of grain a ship loads.

j. Crossgate Mall decides to build space for 80 additional stores.
M1-19. **Classifying Cost Drivers (LO4)**

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

**Required**

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

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

**EXERCISES**

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

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

**Required**

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

E1-21. **Developing an Organization Chart (LO2)**

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

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

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

- a. **Cornell University** wishes to evaluate the success of last year’s graduating class.
- b. **Cook County Hospital** wishes to evaluate the performance of its emergency room.
- c. **L.L. Bean** wishes to evaluate the performance of its telephone order-filling operations.
- d. **Hilton Hotels** wishes to evaluate the performance of registration activities at one of its hotels.
- e. **United Parcel Service** wishes to evaluate the success of its operations in Knoxville.

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

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

- a. **Verizon**’s evaluation of the performance of its Internet service in Boston.
- b. **Time Warner Cable**’s evaluation of the performance of new customer cable installations in Rochester.
- c. **Dell Computer**’s evaluation of the performance of its logistical arrangements for delivering computers to residential customers.
- d. **Amazon.com**’s evaluation of the performance of its Web site.
- e. **Emory University**’s evaluation of the success of its freshman admissions activities.
**E1-24. Identifying Information Needs of Different Managers**  \( \text{(LO2)} \)

Manfred Pak operates a number of auto dealerships for **Hundai** and **Nissan**. Identify possible monetary and nonmonetary performance measures for each of the following situations. One nonmonetary measure should relate to quality, and one should relate to time.

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

**E1-25. Activities and Cost Drivers**  \( \text{(LO4)} \)

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

<table>
<thead>
<tr>
<th>Activity</th>
<th>Cost Driver</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Pay vendors</td>
<td>a. Number of different raw material items</td>
</tr>
<tr>
<td>2. Receive material deliveries</td>
<td>b. Number of classes offered</td>
</tr>
<tr>
<td>3. Inspect raw materials</td>
<td>c. Number of machine hours</td>
</tr>
<tr>
<td>4. Plan for purchases of raw materials</td>
<td>d. Number of employees</td>
</tr>
<tr>
<td>5. Packaging</td>
<td>e. Number of maintenance hours</td>
</tr>
<tr>
<td>6. Supervision</td>
<td>f. Number of units of raw materials received</td>
</tr>
<tr>
<td>7. Employee training</td>
<td>g. Number of new customers</td>
</tr>
<tr>
<td>8. Operating machines</td>
<td>h. Number of deliveries</td>
</tr>
<tr>
<td>9. Machine maintenance</td>
<td>i. Number of checks issued</td>
</tr>
<tr>
<td>10. Opening accounts at a bank</td>
<td>j. Number of customer orders</td>
</tr>
</tbody>
</table>

**MANAGEMENT APPLICATIONS**

**MA1-26. Goals and Strategies**  \( \text{(LO2)} \)

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

**MA1-27. Product Differentiation**  \( \text{(LO3)} \)

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

**Required**

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

**MA1-28. Ethics and Short-Term Borrowing**  \( \text{(LO5)} \)

Ashley, an administrative assistant, is in charge of petty cash for a local law firm. Normally, about $500 is kept in the petty cash box. When Ashley is short on cash and needs some for lunch or to pay her babysitter, she sometimes takes a few dollars from the box. Since she is in charge of the box, nobody knows that she takes the money, and she always replaces it within a few days.

**Required**

a. Is Ashley’s behavior ethical?
b. Assume that Ashley has recently had major problems meeting her bills. She also is in charge of purchasing supplies for the office from petty cash. Last week when she needed $25 for the babysitter, she falsified a voucher for the amount of $25. Is this behavior ethical?

**MA1-29. Ethics and Travel Reimbursement**  \( \text{(LO5)} \)

Scott takes many business trips throughout the year. All of his expenses are paid by his company. Last week he traveled to Rio De Janeiro, Brazil, and stayed there on business for five days. He is
allowed a maximum of $50 per day for food and $150 per day for lodging. To his surprise, the food and accommodations in Brazil were much less than he expected. Being upset about traveling last week and having to sacrifice tickets he’d purchased to a Red Sox baseball game, he decided to inflate his expenses a bit. He increased his lodging expense from $75 per day to $100 per day and his food purchased from $30 per day to $40 per day. Therefore, for the five-day trip, he overstated his expenses by $175 total. After all, the allowance was higher than the amount he spent.

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

**MA1-30. Ethical Issues with Supplier-Buyer Partnerships (LO5)**

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

1. Working with Household engineers to design electric switches that can be manufactured to meet Household’s cost and quality requirements.
2. Assisting Household in resolving any problems related to electric switches.
3. Monitoring the inventory levels of electric switches at Household and placing orders for additional switches when appropriate.

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

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

**Required**
If you were John, what would you do?

**MA1-31. Expected Values of Questionable Decisions (LO5)**

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

During the course of the trial, a memo by an in-house attorney of Exxon Mobil came to light. The memo noted that Royal Dutch/Shell, which had signed a similar lease, interpreted it “in the same manner as the state.” The memo then presented arguments the company might use to claim the deduction, estimated the probability of the arguments being successful (less than 50 percent), and proceeded to consider whether Exxon should obey the law using a cost-benefit analysis. According to the memo, “If we adopt anything beyond a ‘safe’ approach, we should anticipate a quick audit and subsequent litigation.”

The memo also observed that “our exposure is 12 percent interest on underpayments calculated from the due date, and the cost of litigation.” Deducing the questionable costs did, indeed, result in an audit and a lawsuit. Source: *Business Week*.17

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

**MA1-32. Management Decisions Affecting Cost Drivers (LO4)**

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

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

MA1-33. Success Factors and Performance Measurement (LO2)
Three years ago, Vincent Chow completed his college degree. The economy was in a depressed state at the time, and Vincent managed to get an offer of only $35,000 per year as a bookkeeper. In addition to its relatively low pay, this job had limited advancement potential. Since Vincent was an enterprising and ambitious young man, he instead started a business of his own. He was convinced that because of changing lifestyles, a drive-through coffee establishment would be profitable. He was able to obtain backing from his parents to open such an establishment close to the industrial park area in town. Vincent named his business The Cappuccino Express and decided to sell only two types of coffee: cappuccino and decaffeinated.
As Vincent had expected, The Cappuccino Express was very well received. Within three years, Vincent had added another outlet north of town. He left the day-to-day management of each site to a manager and turned his attention toward overseeing the entire enterprise. He also hired an assistant to do the record keeping and other selected chores.18

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