

## CHAPTER 1

### THE MANAGER AND MANAGEMENT ACCOUNTING

**1-1** Financial accounting is constrained by generally accepted accounting principles. Management accounting is not restricted to these principles. The result is that

- management accounting allows managers to charge interest on owners' capital to help judge a division's performance, even though such a charge is not allowed under GAAP,
- management accounting can include assets or liabilities (such as "brand names" developed internally) not recognized under GAAP, and
- management accounting can use asset or liability measurement rules (such as present values or resale prices) not permitted under GAAP.

**1-2** Management accountants can help formulate strategy by providing information about the sources of competitive advantage—for example, the cost, productivity, or efficiency advantages of their company relative to competitors or the premium prices a company can charge relative to the costs of adding features that make its products or services distinctive.

**1-3** The business functions in the value chain are

- **Research and development**—generating and experimenting with ideas related to new products, services, or processes.
- **Design of products and processes**—the detailed planning, engineering, and testing of products and processes.
- **Production**—procuring, transporting, storing, coordinating, and assembling resources to produce a product or deliver a service.
- **Marketing**—promoting and selling products or services to customers or prospective customers.
- **Distribution**—processing orders and shipping products or services to customers.
- **Customer service**—providing after-sales service to customers.

**1-4** "Management accounting deals only with costs." This statement is misleading at best, and wrong at worst. Management accounting measures, analyzes, and reports financial *and non-financial* information that helps managers define the organization's goals, and make decisions to fulfill them. Management accounting also analyzes revenues from products and customers in order to assess product and customer profitability. Therefore, while management accounting does use cost information, it is only a part of the organization's information recorded and analyzed by management accountants.

**1-5** The five-step decision-making process is (1) identify the problem and uncertainties, (2) obtain information, (3) make predictions about the future, (4) make decisions by choosing among alternatives, and (5) implement the decision, evaluate performance, and learn.

**1-6** *Planning decisions* focus on selecting organization goals and strategies, predicting results under various alternative ways of achieving those goals, deciding how to attain the desired goals, and communicating the goals and how to attain them to the entire organization.

*Control decisions* focus on taking actions that implement the planning decisions, deciding how to evaluate performance, and providing feedback and learning to help future decision making.

**1-7** The new controller could reply in one or more of the following ways:

- (a) Demonstrate to the plant manager how he or she could make better decisions if the plant controller was viewed as a resource rather than a deadweight. In a related way, the plant controller could show how the plant manager's time and resources could be saved by viewing the new plant controller as a team member.
- (b) Demonstrate to the plant manager a good knowledge of the technical aspects of the plant. This approach may involve doing background reading. It certainly will involve spending much time on the plant floor speaking to plant personnel.
- (c) Show the plant manager examples of the new plant controller's past successes in working with line managers in other plants. Examples could include
  - assistance in preparing the budget,
  - assistance in analyzing problem situations and evaluating financial and nonfinancial aspects of different alternatives, and
  - assistance in submitting capital budget requests.
- (d) Seek assistance from the corporate controller to highlight to the plant manager the importance of many tasks undertaken by the new plant controller. This approach is a last resort but may be necessary in some cases.

**1-8** The controller is the chief management accounting executive. The corporate controller reports to the chief financial officer, a staff function. Companies also have business unit controllers who support business unit managers or regional controllers who support regional managers in major geographic regions.

**1-9** The Institute of Management Accountants (IMA) sets standards of ethical conduct for management accountants in the following four areas:

- Competence
- Confidentiality
- Integrity
- Credibility

**1-10** Steps to take when established written policies provide insufficient guidance are

- (a) Discuss the problem with the immediate superior (except when it appears that the superior is involved).
- (b) Clarify relevant ethical issues by confidential discussion with an IMA Ethics Counselor or other impartial advisor.
- (c) Consult your own attorney as to legal obligations and rights concerning the ethical conflicts.

**1-11 (15 min.) Value chain and classification of costs, computer company.**

<u>Cost Item</u>	<u>Value Chain Business Function</u>
a.	Production
b.	Distribution
c.	Design of products and processes
d.	Research and Development
e.	Customer Service or Marketing
f.	Design of products and processes (or Research and Development)
g.	Marketing
h.	Production

**1-12 (15 min.) Value chain and classification of costs, pharmaceutical company.**

<u>Cost Item</u>	<u>Value Chain Business Function</u>
a.	Design of products and processes
b.	Marketing
c.	Customer Service
d.	Research and Development
e.	Marketing
f.	Production
g.	Marketing
h.	Distribution

**1-13 (15 min.) Value chain and classification of costs, fast food restaurant.**

<u>Cost Item</u>	<u>Value Chain Business Function</u>
a.	Production
b.	Distribution or Customer Service
c.	Marketing
d.	Marketing
e.	Marketing
f.	Production
g.	Design of products and processes (or Research and Development)
h.	Customer service

**1-14 (15 min.) Key success factors.**

<u>Change in Operations/ Management Accounting</u>	<u>Key Success Factor</u>
a.	Innovation
b.	Cost and Quality
c.	Time and Quality
d.	Time and Cost
e.	Cost and Efficiency

**1-15** (10–15 min.) **Key success factors.**

<u>Change in Operations/ Management Accounting</u>	<u>Key Success Factors</u>
a.	Innovation and cost
b.	Time
c.	Quality and cost
d.	Quality
e.	Cost and efficiency

**1-16** (10–15 min.) **Planning and control decisions.**

<u>Action</u>	<u>Decision</u>
a.	Planning
b.	Control
c.	Control
d.	Planning
e.	Planning

**1-17** (15 min.) **Five-step decision-making process, manufacturing.**

<u>Action</u>	<u>Step in Decision-Making Process</u>
a.	Obtain information if done before chicken pie is introduced; implement the decision, evaluate performance, and learn if done after chicken pie is introduced
b.	Make predictions about the future
c.	Identify the problem and uncertainties
d.	Implement the decision, evaluate performance, and learn
e.	Make predictions about the future
f.	Make decisions by choosing among alternatives
g.	Obtain information

**1-18** (15 min.) **Five-step decision-making process, service firm.**

<u>Action</u>	<u>Step in Decision-Making Process</u>
a.	Obtain information
b.	Identify the problem and uncertainties
c.	Implement the decision, evaluate performance, and learn
d.	Make predictions about the future
e.	Obtain information
f.	Make decisions by choosing among alternatives

**1-19 (10–15 min.) Professional ethics and reporting division performance.**

1. Mendez’s ethical responsibilities are well summarized in the IMA’s “Standards of Ethical Conduct for Management Accountants” (Exhibit 1-7 of text). Areas of ethical responsibility include the following:
  - competence
  - confidentiality
  - integrity
  - credibility

The ethical standards related to Mendez’s current dilemma are integrity, competence and credibility. Using the integrity standard, Mendez should carry out duties ethically and communicate unfavorable as well as favorable information and professional judgments or opinions. Competence demands that Mendez perform her professional duties in accordance with relevant laws, regulations, and technical standards and provide decision support information that is accurate. Credibility requires that Mendez report information fairly and objectively and disclose deficiencies in internal controls in conformance with organizational policy and/or applicable law. Mendez should refuse to book the \$200,000 of sales until the goods are shipped. Both financial accounting and management accounting principles maintain that sales are not complete until the title is transferred to the buyer.

2. Mendez should refuse to follow Dalton’s orders. If Dalton persists, the incident should be reported to the corporate controller. Support for line management should be wholehearted, but it should not require unethical conduct.

**1-20 (15 min.) Planning and control decisions, Internet company.**

**1. Planning decisions**

- a. Decision to raise monthly subscription fee
- c. Decision to offer e-mail service and upgrade other online services (later decision to inform subscribers and upgrade online services is an implementation part of control)
- e. Decision to decrease monthly subscription fee starting in November.

**Control decisions**

- b. Decision to inform existing subscribers about the increase in subscription fees—an implementation part of control decisions
  - d. Dismissal of VP of Marketing—performance evaluation and feedback aspect of control decisions
2. Other planning decisions that may be made at PostNews.com: decision to raise or lower advertising fees; decision to charge a fee from on-line retailers when customers click-through from PostNews.com to the retailers’ websites.

Other control decisions that may be made at PostNews.com: evaluating how customers like the new format for the weather information, working with an outside vendor to redesign the website, and evaluating whether the waiting time for customers to access the website has been reduced.

**1-21 (20 min.) Strategic decisions and management accounting.**

1. The strategies the companies are following in each case are:
  - a. Cost leadership or low price strategy
  - b. Differentiated product strategy
  - c. Cost leadership or low price strategy
  - d. Differentiated product strategy
  
2. Examples of information the management accountant can provide for each strategic decision follow.
  - a. Cost to manufacture and sell the cell phone  
Productivity, efficiency and cost advantages relative to competition  
Prices of competitive cell phones  
Sensitivity of target customers to price and quality  
The production capacity of Pedro Phones and its competitors  
How the market for cell phones with standard features is growing
  
  - b. Cost to develop, produce and sell new software  
Premium price that customers would be willing to pay due to product uniqueness  
Price of basic software  
Price of closest competitive software  
Cash needed to develop, produce and sell new software
  
  - c. Cost of producing the “store-brand” lip gloss  
Productivity, efficiency and cost advantages relative to competition  
Prices of competitive products  
Sensitivity of target customers to price and quality  
The production capacity of Celine Cosmetics and its competitors  
How the market for lip gloss is growing
  
  - d. Cost to produce and sell new line of gourmet bologna  
Premium price that customers would be willing to pay due to product uniqueness  
Price of basic meat product  
Price of closest competitive product  
Cash available to develop, produce, and sell special line of gourmet bologna

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

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

2. Examples of information the management accountant can provide for each strategic decision follow.

- a. Cost related to training the new employees  
Productivity and efficiency advantages relative to competition  
Sensitivity of target customers to price and quality
- b. Cost of delivery service  
Premium price that customers would be willing to pay for the service  
Price of closest competitive product
- c. Cost to develop new software to check in customers  
Efficiency and cost advantages relative to competition  
Sensitivity of target customers to change in service
- d. Cost to hire horticultural specialist  
Premium price that customers would be willing to pay for expert advice  
Price of closest competitive product

**1-23 (15 min.) Management accounting guidelines.**

1. Cost-benefit approach
2. Behavioral and technical considerations
3. Different costs for different purposes
4. Cost-benefit approach
5. Behavioral and technical considerations
6. Cost-benefit approach
7. Behavioral and technical considerations
8. Different costs for different purposes
9. Behavioral and technical considerations

**1-24 (15 min.) Management accounting guidelines.**

1. Cost-benefit approach
2. Behavioral and technical considerations
3. Different costs for different purposes
4. Cost-benefit approach or Behavioral and technical considerations, for example, how employees will react to the new technology
5. Behavioral and technical considerations
6. Cost-benefit approach
7. Behavioral and technical considerations or different costs for different purposes. The goal of determining the loss in future business because of poor quality beyond the cost of scrap and waste reported in financial statements is to influence behavior toward improving quality by recognizing its high cost.

**1-25 (15 min.) Role of controller, role of chief financial officer.**

1.

<b>Activity</b>	<b>Controller</b>	<b>CFO</b>
Managing accounts payable	X	
Communicating with investors		X
Strategic review of different lines of businesses		X
Budgeting funds for a plant upgrade	X	
Managing the company's short-term investments		X
Negotiating fees with auditors		X
Assessing profitability of various products	X	
Evaluating the costs and benefits of a new product design	X	

2. As CFO, Jimenez will be interacting much more with the senior management of the company, the board of directors, auditors, and the external financial community. Any experience he can get with these aspects will help him in his new role as CFO. George Jimenez can be better positioned for his new role as CFO by participating in strategy discussions with senior management, by preparing the external investor communications and press releases under the guidance of the current CFO, by attending courses that focus on the interaction and negotiations between the various business functions and outside parties such as auditors and, either formally or on the job, getting training in issues related to investments and corporate finance.

**1-26 (30 min.) Pharmaceutical company, budgeting, ethics.**

1. The overarching principles of the IMA Statement of Ethical Professional Practice are Honesty, Fairness, Objectivity and Responsibility. The statement's corresponding "Standards for Ethical Conduct ..." require management accountants to

- Perform professional duties in accordance with relevant laws, regulations, and technical standards.
- Refrain from engaging in any conduct that would prejudice carrying out duties ethically.
- Communicate information fairly and objectively.
- Disclose all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, analyses, or recommendations.

The idea of capitalizing some of the company's R&D expenditures is a direct violation of the IMA's ethical standards above. This transaction would not be "in accordance with relevant laws, regulations, and technical standards." Generally Accepted Accounting Principles require research and development costs to be expensed as incurred. Even if Jackson believes his transaction is justifiable, it violates the profession's technical standards and would be unethical.

The other "year-end" actions occur in many organizations and fall into the "gray" to "acceptable" area. Much depends on the circumstances surrounding each one, however, such as the following:

- Stop all research and development efforts on the drug Vyacon until after year-end. This change would delay the drug going to market by at least six months. It is also*



*possible that in the meantime a BrisCor competitor could make it to market with a similar drug.* While this solution may solve the budget short-fall in this year, it could result in a significant loss of future profits for BrisCor in the long-run, especially if a competitor is able to obtain a patent on a similar drug before BrisCor.

- b. Sell off rights to the drug, Martek. The company had not planned on doing this because, under current market conditions, it would get less than fair value. It would, however, result in a onetime gain that could offset the budget short-fall. Of course, all future profits from Marktek would be lost.* Again, this solution may solve the company's short-term budget crisis; but could result in the loss of future profits for BrisCor in the long-run.

2. While it is not uncommon for companies to sacrifice long-term profits for short-term gains, it may not be in the best interest of the company's shareholders. In the case of BrisCor, the CFO is primarily concerned with "maximizing shareholder wealth" in the immediate future (third quarter only), but not in the long-term. Because this executive's incentive pay and even employment may be based on his ability to meet short-term targets, he may not be acting in the best interest of the shareholders in the long-run.

Jackson definitely faces an ethical dilemma. It is not unethical on Jackson's part to want to please his new boss, nor is it unethical that Jackson wants to make a good impression on his first days at his new job; however, Jackson must still act within the ethical standards required by his profession. Taking illegal and/or unethical action by capitalizing R&D to satisfy the demands of his new supervisor, Ronald Meece, is unacceptable. Although not strictly unethical, I would recommend that Jackson not agree to slow down the R&D efforts on Vyacon or sell off the rights to Martek. Each of these actions appears to sacrifice the overall economic interests of BrisCor for short-run gain. Jackson should prepare an analysis to show how much each of these actions will cost the company in the long run and argue against doing this but not resign if Meece insists that these actions be taken. If, however, Meece asks Jackson to capitalize R&D, he should raise this issue with the chair of the Audit Committee after informing Meece that he is doing so. If the CFO still insists on Jackson capitalizing R&D, he should consult his attorney and resign rather than engage in unethical behavior.

### **1-27 (30–40 min.) Professional ethics and end-of-year actions.**

1. The possible motivations for the snack foods division wanting to take end-of-year actions include:

- (a) Management incentives. Daniel Foods may have a division bonus scheme based on one-year reported division earnings. Efforts to front-end revenue into the current year or transfer costs into the next year can increase this bonus.
- (b) Promotion opportunities and job security. Top management of Daniel Foods likely will view those division managers that deliver high reported earnings growth rates as being the best prospects for promotion. Division managers who deliver "unwelcome surprises" may be viewed as less capable.
- (c) Retain division autonomy. If top management of Daniel Foods adopts a "management by exception" approach, divisions that report sharp reductions in their earnings growth rates may attract a sizable increase in top management supervision.

2. The "Standards of Ethical Conduct . . ." require management accountants to

- Perform professional duties in accordance with relevant laws, regulations, and technical standards.
- Refrain from engaging in any conduct that would prejudice carrying out duties ethically.
- Communicate information fairly and objectively.

Several of the “end-of-year actions” clearly are in conflict with these requirements and should be viewed as unacceptable by Butler.

- (b) The fiscal year-end should be closed on midnight of December 31. “Extending” the close falsely reports next year’s sales as this year’s sales.
- (c) Altering shipping dates is falsification of the accounting reports.
- (f) Advertisements run in December should be charged to the current year. The advertising agency is facilitating falsification of the accounting records.

The other “end-of-year actions” occur in many organizations and fall into the “gray” to “acceptable” area. However, much depends on the circumstances surrounding each one, such as the following:

- (a) If the independent contractor does not do maintenance work in December, there is no transaction regarding maintenance to record. The responsibility for ensuring that packaging equipment is well maintained is that of the plant manager. The division controller probably can do little more than observe the absence of a December maintenance charge.
- (d) In many organizations, sales are heavily concentrated in the final weeks of the fiscal year-end. If the double bonus is approved by the division marketing manager, the division controller can do little more than observe the extra bonus paid in December.
- (e) If TV spots are reduced in December, the advertising cost in December will be reduced. There is no record falsification here.
- (g) Much depends on the means of “persuading” carriers to accept the merchandise. For example, if an under-the-table payment is involved, or if carriers are pressured to accept merchandise, it is clearly unethical. If, however, the carrier receives no extra consideration and willingly agrees to accept the assignment because it sees potential sales opportunities in December, the transaction appears ethical.

Each of the (a), (d), (e), and (g) “end-of-year actions” may well disadvantage Daniel Foods in the long run. For example, lack of routine maintenance may lead to subsequent equipment failure. The divisional controller is well advised to raise such issues in meetings with the division president. However, if Daniel Foods has a rigid set of line/staff distinctions, the division president is the one who bears primary responsibility for justifying division actions to senior corporate officers.

3. If Butler believes that Ray wants her to engage in unethical behavior, she should first directly raise her concerns with Ray. If Ray is unwilling to change his request, Butler should discuss her concerns with the Corporate Controller of Daniel Foods. She could also initiate a confidential discussion with an IMA Ethics Counselor, other impartial adviser, or her own attorney. Butler also may well ask for a transfer from the snack foods division if she perceives Ray is unwilling to listen to pressure brought by the Corporate Controller, CFO, or even President of Daniel Foods. In the extreme, she may want to resign if the corporate culture of Daniel Foods is to reward division managers who take “end-of-year actions” that Butler views as

unethical and possibly illegal. It was precisely actions along the lines of (b), (c), and (f) that caused Betty Vinson, an accountant at WorldCom to be indicted for falsifying WorldCom's books and misleading investors.

**1-28 (30 min.) Professional ethics and end-of-year actions.**

1. The possible motivations for Controller, Rhett Gable to modify the division's year-end earnings are:

- (i) Job security and promotion. The company's CFO will likely reward him for meeting the company's performance expectations. Alternately, Gable may be penalized, perhaps even by losing his job if the performance expectations are not met.
- (ii) Management incentives. Gable's bonus may be based on the division's ability to meet certain profit targets. If the Consumer Products division has not already met its profit target for the year, the Controller may personally benefit if new printing equipment is sold off and replaced with the discarded equipment that no longer meets current safety standards, or if operating income is manipulated by questionable revenue and/or expense recognition.
- (iii) Retain division autonomy. If top management of Macon Publishing adopts a "management by exception" approach, divisions that report sharp reductions in their operating income may attract a sizable increase in top management supervision.

2. The overarching principles of the IMA Statement of Ethical Professional Practice are Honesty, Fairness, Objectivity and Responsibility. The statement's corresponding "Standards for Ethical Conduct . . ." require management accountants to

- Perform professional duties in accordance with relevant laws, regulations, and technical standards.
- Refrain from engaging in any conduct that would prejudice carrying out duties ethically.
- Communicate information fairly and objectively.
- Disclose all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, analyses, or recommendations.

Several of the "year-end" actions are clearly in conflict with the statement's principles and required standards and should be viewed as unacceptable.

- (c) Subscription revenue received in December in advance for magazines that will be sent out in January is a liability. Showing it as revenue falsely reports next year's revenue as this year's revenue.
- (d) Reversing the division's Allowance for Bad Debt Expense would violate Generally Accepted Accounting Principles unless the bad debt allowance is currently overstated. Recording this transaction would result in an overstatement of income and could potentially mislead investors.
- (e) Booking advertising revenues that relate to January in December falsely reports next year's revenue as this year's revenue.

The other "year-end" actions occur in many organizations and fall into the "gray" to "acceptable" area. Much depends on the circumstances surrounding each one, however, such as the following:

- (a) *Cancelling two of the division's least profitable magazines, resulting in the layoff of twenty-five employees.* While employee layoffs may be necessary for the business to survive, the layoff decision could result in economic hardship for those employees who lose their jobs, as well as result in employee morale problems for the rest of the division. Most companies would prefer to avoid causing hardship for their existing employees due to layoffs unless absolutely necessary for the survival of the business as a whole.
- (b) *Selling the new printing equipment that was purchased in January and replacing it with discarded equipment from one of the company's other divisions. The previously discarded equipment no longer meets current safety standards.* Again, while this method may result in a short-term solution for the Controller and the Production Manager personally, this decision may actually harm the corporation financially as a whole, not to mention the potential resulting injuries to production workers from hazardous equipment. This method would also be ethically questionable and would likely violate the IMA's ethical standards of integrity and credibility.
- (f) *Switching from declining balance to straight line depreciation to reduce depreciation expense in the current year.* Many companies switch their depreciation policy from one method to another. Macon Publishing could argue that straight-line depreciation better represents the decrease in the economic value of the asset compared to the declining balance method. Straight-line depreciation may also be more in line with what its competitors do. If, however, the company changes to straight-line depreciation with the sole purpose of reducing expenses to meet its profit goals, such behavior would be unacceptable. The Standards of Ethical Behavior require management accountants to communicate information fairly and objectively and to carry out duties ethically.

3. Gable should directly raise his concerns first with the CFO, especially if the pressure from the CFO is so great that the only course of action on the part of the controller is to otherwise behave unethically. If the CFO refuses to change his direction, then the controller should raise these issues with the CEO, and next to the Audit Committee and the Board of Directors, after informing the CFO that he is doing so. The Controller could also initiate a confidential discussion with an IMA Ethics Counselor, other impartial adviser, or his/her own attorney. In the extreme, the Controller may want to resign if the corporate culture of Macon Publishing is to reward executives who take year-end actions that the Controller views as unethical and possibly illegal. It was precisely actions along the lines of (c), (d) and (e) that caused Betty Vinson, an accountant at WorldCom, to be indicted for falsifying WorldCom's books and misleading investors.

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

1. The overarching principles of the IMA Statement of Ethical Professional Practice are Honesty, Fairness, Objectivity and Responsibility. The statement's corresponding "Standards for Ethical Conduct ..." require management accountants to

- Perform professional duties in accordance with relevant laws, regulations, and technical standards.
- Refrain from engaging in any conduct that would prejudice carrying out duties ethically.
- Communicate information fairly and objectively.
- Disclose all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, analyses, or recommendations.

Several of the suggestions made by Chang's staff are clearly in conflict with the statement's principles and required standards and should be viewed as unacceptable.

- (c) *Pressure current customers to take early delivery of goods before the end of the year so that more revenue can be reported on this year's financial statements.* This tactic, commonly known as channel stuffing, merely results in shifting future period revenues into the current period. The overstatement of revenue in the current period may mislead investor's to believe that the company's financial well being is better than the actual results achieved. This practice would violate the IMA's standards of credibility and integrity. Channel stuffing is frequently considered a fraudulent practice.
- (e) *Record the executive year-end bonus compensation for the current year in the next year when it is paid until after the December fiscal year-end.* Generally Accepted Accounting Principles requires expenses to be recorded (accrued) when incurred, not when paid (cash basis accounting). Therefore, failure to record the executives' year-end bonus would violate the IMA's standards of credibility and integrity.
- (f) *Recognize sales revenues on orders received, but not shipped as of the end of the year.* Generally Accepted Accounting Principles requires income to be recorded (accrued) when the four criteria of revenue recognition have been met:
  1. The company has completed a significant portion of the production and sales effort.
  2. The amount of revenue can be objectively measured.
  3. The major portion of the costs has been incurred, and the remaining costs can be reasonably estimated.
  4. The eventual collection of the cash is reasonably assured.

Because criteria 1 and 3 have not been met at the time the order is placed the revenue should not be recognized until after year-end. Therefore, recording next year's revenue in the current year would be a violation of Generally Accepted Accounting Principles and would be falsifying revenue. This would be a violation of the IMA's standards of credibility and integrity and would be considered fraudulent.

The other “year-end” actions occur in many organizations and fall into the “gray” to “acceptable” area. Much depends on the circumstances surrounding each one, however, such as the following:

- (a) *Stop all transatlantic shipping efforts. The start-up costs for the new operations are hurting current profit margins.* While this method may result in better short-term financial results for Andahl, it may do harm to the long-term financial condition of the corporation as a whole.
- (b) *Make deep cuts in pricing through the end of the year to generate additional revenue.* Again, this is only a short-term tactic to improve this year’s financial results. Investors may be content in the short-run, but in the long run the new shipping company will see reduced margins from these actions.
- (d) *Sell-off distribution equipment prior to year-end. The sale would result in one-time gains that could offset the company’s lagging profits. The owned equipment could be replaced with leased equipment at a lower cost in the current year.* While this course of action does not necessarily violate the IMA’s code of ethical standards, it may be only a short-term tactic to improve this year’s financial results. Chang will need to weigh his options long-term to make the most cost effective decision for his company.
- (g) *Establish corporate headquarters in Ireland before the end of the year, lowering the company’s corporate tax rate from 28% to 12.5%.* Chang may have other legitimate reasons for relocating his company to Ireland, but doing so only to reduce his tax liability would likely be considered an evasion of taxes in the company’s home country. Chang should seek the advice of skilled consultants in the area of international tax before making any such move. The company could face large fines and even criminal charges for evading corporate income taxes of the home country.

2. It is possible that any of the “year-end” actions that fall into the “gray” area may be good for investors, depending on the credible evidence which supports the management decision. For example, replacing owned equipment with leased equipment may result in both short-term gains for the company and long-term cost reduction. If so, this decision would be in the best interest of the investors. If the decision only results in short-term gains, but higher costs in the long-run, then the decision may not be in the best long-term interest of the company’s investors and should not be implemented solely to prop up short-term earnings.

Those decisions that clearly violate the IMA code of ethical standards (c, e, and f) would never be in the best interest of the investor. These options would result in misleading financial statements and could result in the demise of the company or even in criminal charges, as was the case with companies such as Enron and WorldCom. If Chang asks the management accountant to take any of the actions that are clearly unethical, the management accountant should raise this issue with the chair of the Audit Committee after informing Chang that he is doing so. If Chang still insists on the management accountant taking these actions, he should resign rather than engage in unethical behavior.

## CHAPTER 1 TEACHING NOTE

### British Motor Company

This case gives students perspective on and highlights the following:

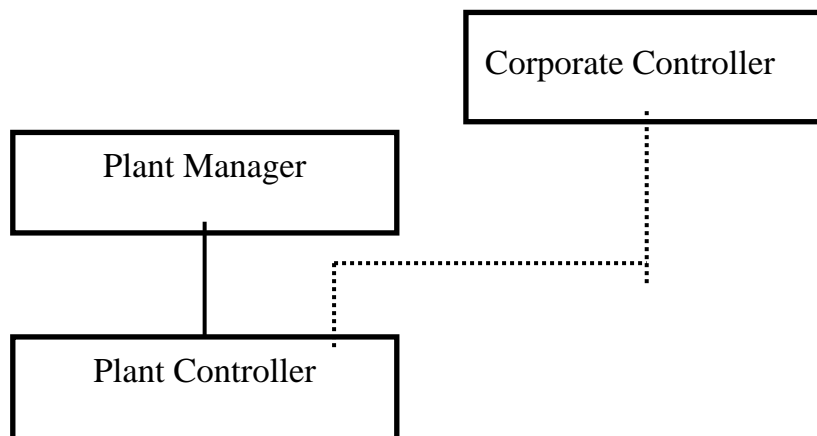
- (a) Accounting is a human activity, often entailing some delicate interpersonal communication.
- (b) Management accounting involves far more than scorekeeping. Controllers must simultaneously be watchdogs and helpers. The challenge is often difficult but stimulating.

1. The statement refers to the fact that markets are now worldwide, changing at a very fast rate, products are changing, and technology is changing. The fast rate of change in the market place requires the same rate of change in firms and their management accounting functions to be successful.

2. Accounting functions (for example, cost records, cost analysis, and interpretation) are best done in each region, division, or plant, because the accounting can then be tailored to the needs of each individual division. Local cost information often leads to quicker decision making by division, region, or plant managers and gives the business a competitive advantage.

Some accounting functions are best done at headquarters (for example, treasury, investor relations, internal auditing, income taxes,) because decisions within these functions require an aggregation of information from different divisions. Doing these functions at headquarters also avoids duplication of activities.

3. The division accounting offices are to be “placed under the direct jurisdiction of the managers of the operations they serve.” The following diagram represents the organization arrangements described in the quote for the managerial accounting functions transferred to the divisions.



The essence of putting division accounting offices under the direct jurisdiction of division managers is the relative freedom to make decisions. For example, the relative freedom of the factory controller to furnish services to factory management as desired. Some evidence of the division accounting office serving the division manager includes the following points, which are not mutually exclusive:

- (a) Structure of accounts---keeping detailed records and the flow of reports to division management.
- (b) Geography---physically locating the accountants' offices near the regional management.
- (c) Formal organization structure is important, but informal relationships also need examination.
- (d) Loyalties---does the factory controller feel primarily responsible to the plant manager?
- (e) Channels of communication---Is there a lot of face to face contact between accounting personnel and the division management?

Students are likely to suggest the following advantages of having the division accountant report to the division manager. Some of these points may have been made in passing in the discussion around the second question of the case. (1) It allows the general managers of organization subunits and the accountants to work as a team. This allows the manager to get the necessary inputs to make good decisions (2) Another advantage of the proposed arrangement is that the accountant becomes a business partner and a member of the organization---region, division, or plant; whereas if he were under the direct authority of the corporate controller he might be looked upon as an outsider, and therefore be given little opportunity to assist divisional management in planning and coordinating operations. (3) It helps in faster decision-making because if there are differences of opinion between a division accountant and his division manager, the manager would have the authority to make a decision as a basis for operating until the question can be reviewed by senior executives at headquarters. Otherwise, conflicting instructions might be issued to division employees by the division manager and the corporate function manager.

The controller should have very positive functional authority over division accountants. Instructions in regard to accounting policies and procedures would be issued by the controller's office and division accountants would be expected to interpret the instructions to the division managers and employees and to make sure they were carried out. The controller should have a voice in the selection and the promotion of division accountants as he would have to depend on them to a larger extent for obtaining reliable information regarding division operations.

The instructor may want to point out that management accounting tasks for diversified and widespread operations usually entails having local regional or plant controllers at various geographic locations. The organizational question to be answered in such cases is: Who is the plant controller's boss? Some large companies have the plant controller directly responsible to the company controller but most companies have the plant controller directly responsible (line) to the plant manager but functionally responsible (staff) to the company controller as in the British Motors case. The key feature of effective managerial accounting is the relative freedom on the part of the plant controller to furnish services to plant management as desired.

Hiring, firing, transferring, and other personnel policies are usually negotiated between the plant manager and the company controller.



4. The word “spy” in question 3 has been deliberately used to provoke the students. The instructor may want to first ask the students what might be this spying role. Some students may say that the word “spy” is too strong but the intent is to communicate that the division controller has a responsibility to the corporate controller to ensure that the accounting is being done correctly and that all policies are being followed. For example, the division controller should not misreport numbers that may make the division manager’s performance look better than it actually is. That is the planning, attention-directing, and problem-solving, and business partner roles should be completely separated from scorekeeping. The former tend to be helper roles; the latter are often regarded as spy roles.

This separation can be achieved by carefully defining the relationship of the plant controller to the corporate controller and the plant manager. As described earlier, even if the plant controller is directly under the jurisdiction of the plant manager, he /she often reports functionally to the corporate controller.

One way to simultaneously fulfill the “helper” and “spy” roles is to use the two-count system that is followed by, among other companies, Ford and General Motors. Two essential components of this system are:

- (a) The corporate controller has the right to fire the plant controller, even if the plant manager wants to retain him/her.
- (b) The plant controller works for the plant manager (first count). However, he or she is responsible for the integrity of the financial statements (second count). If there is any trouble, the plant controller should deal initially with the plant manager. If the matter is not resolved satisfactorily, the plant controller should report to the corporate controller. (Per IMA Statement of Ethical Professional Practice Resolution of Ethical Conflict.)

Arjay Miller, former controller, president, and vice chairman of Ford, believes that the two count system is a key explanation for Ford and General Motors having almost no “accounting” problems.

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