Chapter 1
Managerial Accounting and the Business Environment

Solutions to Questions

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

1-2 A business plan is typically prepared by new businesses and contains information about the company's basic product or service and about the plans for getting it to market (i.e., the customers). Details will included in the plan will include the production method, the marketing plan and the financial resources needed. Key users are the potential providers of financial resources for the business – lenders and investors.

1-3 Customer value propositions fall into three broad categories—customer intimacy, operational excellence, and product leadership. A company with a customer intimacy strategy attempts to better understand and respond to its customers' individual needs than its competitors. A company that adopts an operational excellence strategy attempts to deliver products faster, more conveniently, and at a lower price than its competitors. A company that has a product leadership strategy attempts to offer higher quality products than its competitors.

1-4 Managers carry out three major activities in an organization: planning, directing and motivating, and controlling. Planning involves establishing a basic strategy, selecting a course of action, and specifying how the action will be implemented. Directing and motivating involves mobilizing people to carry out plans and run routine operations. Controlling involves ensuring that the plan is actually carried out and is appropriately modified as circumstances change.

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

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

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

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

1-9 The three main categories of inventories in a manufacturing company are raw materials, work in process, and finished goods.

1-10 The five steps in the lean thinking model are: (1) identify value in specific products and services; (2) identify the business process that delivers value; (3) organize work arrangements around the flow of the business process; (4) create a pull system that responds to customer orders; and (5) continuously pursue perfection in the business process.

1-11 Successful implementation of the lean thinking model should result in lower inventories, fewer defects, less wasted effort, and quicker customer response times.

1-12 In a pull production system, production is not initiated until a customer order is received. Inventories are reduced to a minimum by purchasing raw materials and producing products only as needed to meet customer demand.

1-13 Six Sigma is a process improvement method that relies on customer feedback and fact-based data gathering and analysis techniques to drive process improvement. The goal is to reduce defect rates below 3.4 defects per million. The most common framework used to guide the Six Sigma process is DMAIC: define, measure, analyze, improve and control.

1-14 Corporate social responsibility (CSR) is becoming increasingly important to organizations for four reasons: (1) many investors now care about an organization's social performance; (2) many employees only want to work for socially responsible companies; (3) many customers will only buy products or services from socially responsible companies; and (4) activist groups seek to publicly damage the reputation of organizations identified as not acting in a socially responsible way.

1-15 An enterprise system is supposed to overcome the problems that result from having separate, unintegrated software applications that support specific business functions. It does this by integrating data across an organization in a single software system that enables all employees to have simultaneous access to a common database.

1-16 Companies prepare a code of ethics to demonstrate their morals and values system, often in part to demonstrate corporate social responsibility. The code of ethics indicates what is expected of all employees and directors in their dealings with various stakeholders.

1- 17 Four key aspects of the Sarbanes Oxley Act of 2002 are: (1) requires CFO and CEO to certify the financial statements; (2) gives audit committee the power to hire, compensate and terminate the auditor; (3) restricts the nature and extent of non-auditing services that can be provided by public accounting firms; and (4) requires the company's annual report to contain in internal control report that is certified by management.

1-18 Enterprise risk management is a process used by organizations to actively identify and manage foreseeable risks. Theses risks can to employee theft, financial reporting or even strategic decision making.

Exercise 1-1 (10 minutes)

1. Managerial accounting, financial accounting
2. Planning
3. directing and motivating
4. feedback
5. decentralization
6. line
7. staff
8. controller
9. budgets
10. performance report
11. Chief Financial Officer
12. precision; nonmonetary data

Exercise 1-2 (20 minutes)

1. work in process
2. Six Sigma
3. business process
4. corporate governance
5. enterprise risk management
6. just-in-time
7. business risks
8. Non-value added activity
9. value chain
10. enterprise system
11. code of professional ethics
12. lean thinking model
13. customer value proposition
14. Sarbanes Oxley Act
15. corporate social responsibility

Exercise 1-3 (15 minutes)

If cashiers routinely short-changed customers whenever the opportunity presented itself, most of us would be careful to count our change before leaving the counter. Imagine what effect this would have on the line at your favourite fast-food restaurant. How would you like to wait in line while each and every customer laboriously counts out his or her change? Additionally, if you can't trust the cashiers to give honest change, can you trust the cooks to take the time to follow health precautions such as washing their hands? If you can't trust anyone at the restaurant would you even want to eat out?

Generally, when we buy goods and services in the free market, we assume we are buying from people who have a certain level of ethical standards. If we could not trust people to maintain those standards, we would be reluctant to buy. The net result of widespread dishonesty would be a shrunken economy with a lower growth rate and fewer goods and services for sale at a lower overall level of quality.

Problem 1-4 (30 minutes)

1. Several aspects of the code of professional ethics shown in Exhibit 1-5 potentially come into play here such as:

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

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

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

Problem 1-5 (30 minutes)

1. See the organization chart on the following page.

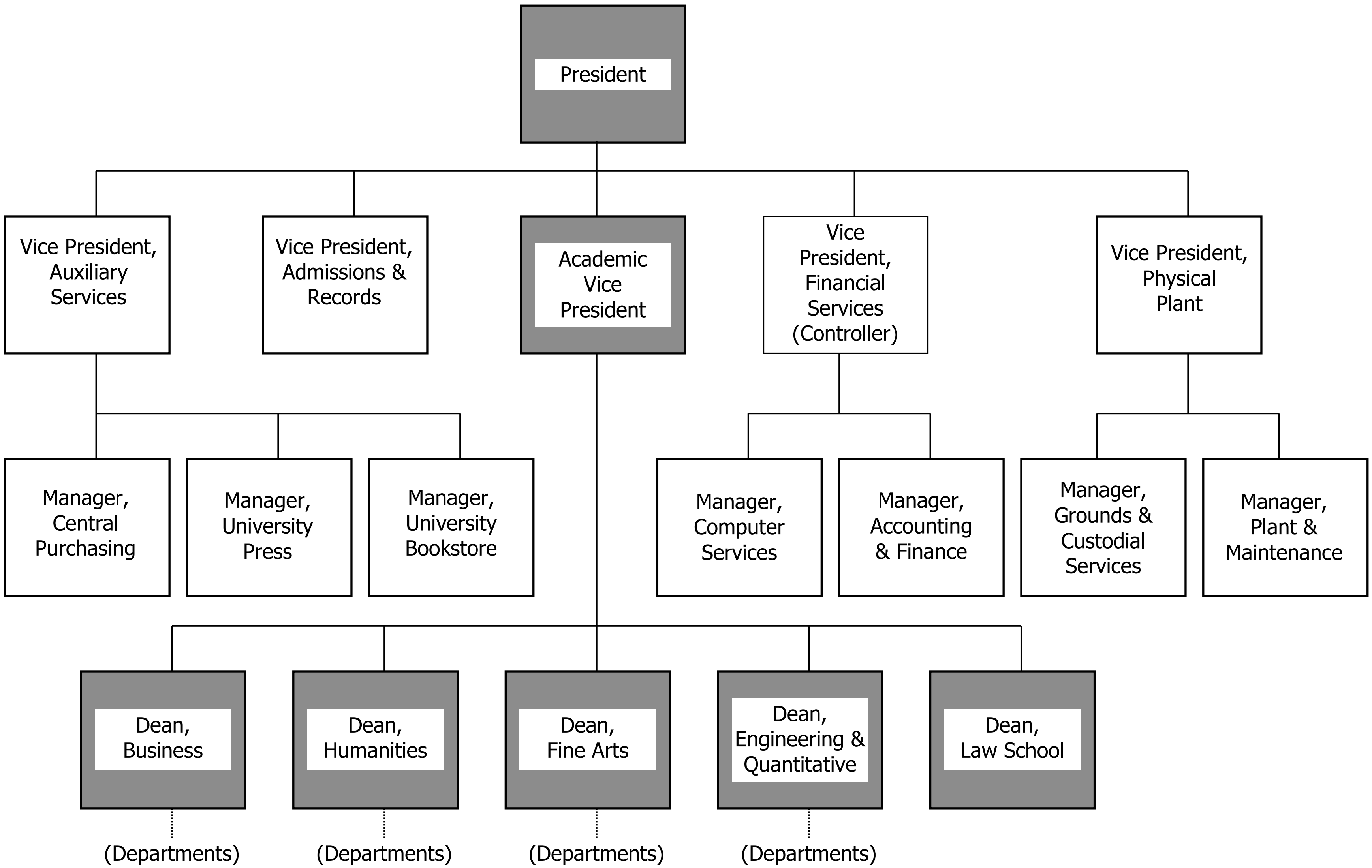
2. Line positions would include the university president, academic vice-president, and the deans of the five faculties. In addition, the department heads (as well as the faculty) would be in line positions. The reason is that their positions are directly related to the basic purpose of the university, which is education. (Line positions are shaded on the organization chart.)

   All other positions on the organization chart are staff positions. The reason is that these positions are indirectly related to the educational process, and exist only to provide service or support to the line positions.

3. All positions would have need for accounting information of some type. For example, the manager of central purchasing would need to know the level of current inventories and budgeted allowances in various areas before doing any purchasing; the vice president for admissions and records would need to know the status of scholarship funds as students are admitted to the university; the dean of the business faculty would need to know his/her budget allowances in various areas, as well as information on cost per student credit hour; and so forth.

Problem 1-5 (continued)

1. Organization chart:



Problem 1-6 (30 minutes)

1. Adam Williams has an ethical responsibility to take some action in the matter of GroChem Inc. and the dumping of toxic wastes. Elements of the code of professional ethics that apply are as follows:
   - The code of professional ethics (1a in Exhibit 1-5) states that members should act with "responsibility for and fidelity to the public needs." GroChem's dumping of toxic waste is clearly not in the best interests of the public.
   - Also, item 1c in Exhibit 1-5 states that members are expected to act with "high ideals of personal honour and professional integrity." Knowing that GroChem is engaging in an illegal activity and doing nothing would not be inconsistent with this element of the code.

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

2. As noted in the code of professional ethics in Exhibit 1-5 (3a), members are not to disclose confidential information about their employer's affairs to outside parties unless "acting in the course of his or her duties" or unless involved in legal proceedings of some sort.

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

   Communication of confidential information to anyone outside the company is inappropriate unless there is a legal obligation to do so (Exhibit 1-5, 3a). If it turns out that there is a legal obligation to report the activity, Williams should contact the proper law enforcement authorities, not the local newspaper.

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

(CMA Unofficial Solution, adapted)

Problem 1-7 (20 minutes)

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

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

   Note to instructors: At the time this solution was written, there had been little evidence in the press indicating that Toyota did not have effective governance practices in place. However, the series of events that transpired in early 2010 suggests there was room for improvement.

Problem 1-8 (30 minutes)

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

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

2. Reasons for conflict between line and staff positions include the following.
   - Line managers perceive staff managers as threats to their authority, especially when staff persons have functional authority.
   - Line managers may become uncomfortable when they grow dependent on staff expertise and knowledge.
   - Line managers may perceive staff managers as overstepping their authority, having a narrow perspective, or stealing credit. Staff managers, on the other hand, may perceive line managers as not utilizing their expertise, not giving staff enough authority, or resisting staff's ideas.
   - Line managers may perceive staff managers as interfering when the line managers are being held responsible for results.
   - Staff mangers may see line managers as unappreciati~~t~~ve and uncooperative in supplying information and using results of analyses.

Problem 1-8 (continued)

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

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

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

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

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

(CMA Unofficial Solution, adapted)

Research 1-9, 1-10, 1-11

Solutions for these research questions depend on the specifics of the investigations assigned and the time horizon of the investigation. Thus no solution can be provided.