



Chapter 1

MANAGEMENT ACCOUNTING IN CONTEXT

1-1 *Management accounting* measures, analyses and reports financial and nonfinancial information that helps managers make decisions to achieve an organisation's goals. It focuses on internal reporting and is not restricted by Australian generally accepted accounting practice (GAAP).

Financial accounting focuses on reporting to external parties such as investors, government agencies and banks. It measures and records business transactions and provides financial statements that are GAAP based.

Other differences include (1) management accounting emphasises the future (not the past) and (2) management accounting influences the behaviour of managers and other employees (rather than primarily reporting economic events).

1-2 While financial accounting is constrained by GAAP, management accounting is not. 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) that are not recognised under GAAP, and
- management accounting can use asset or liability measurement rules (such as present values or resale prices) that are not permitted under GAAP

1-3 Management accountants can help to formulate strategy by providing information about the sources of competitive advantage—for example, the cost, productivity or efficiency advantage of their company relative to competitors or the premium that a company can charge when it adds features that differentiate its products or services.

1-4 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, services and processes**—the detailed planning and engineering of products, services or processes.
- **Production**—acquiring, coordinating and assembling resources to produce a product or deliver a service.
- **Marketing (including sales)**—promoting and selling products or services to customers or prospective customers.
- **Distribution**—delivering products or services to customers.
- **Customer service**—providing after-sales support to customers.

1-5 *Supply chain* describes the flow of goods, services and information from the initial sources of materials and services to the delivery of products to consumers, regardless of whether those activities occur in the same organisation or in other organisations.

Cost management focuses on the most effective and efficient use of resources. It's most effective when it integrates and coordinates activities across (1) all companies in the supply chain and (2) all business functions in an individual company's value chain.

1-6 'Management accounting deals only with costs.' This statement is misleading at best and wrong at worst. Management accounting measures, analyses and reports financial *and non-financial* information that helps managers define the organisation's goals and make decisions to fulfil them. Management accounting also analyses 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 organisation's information recorded and analysed by management accountants.

1-7 Management accountants can help improve quality and achieve timely product deliveries by recording and reporting an organisation's current quality and timeliness and by analysing and evaluating the costs and benefits—both financial and non-financial—of new quality initiatives such as TQM, relieving bottleneck constraints or providing faster customer service.

1-8 The five-step decision-making process is (1) identify the problem; (2) collect relevant information; (3) determine possible causes of action and consider consequences of each; (4) evaluate each possible course of action and select the best one; (5) implement the decision, evaluate performance and learn.

1-9 *Planning decisions* focus on (a) selecting organisation goals, predicting results under various alternative ways of achieving those goals, deciding how to attain the goals, and (b) communicating the goals and how to attain them to the entire organisation.

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

1-10 The three guidelines for management accountants are

1. Employ a cost-benefit approach.
2. Incorporate behavioural and technical considerations.
3. Apply different costs for different purposes.

1-11 Agree. A successful management accountant requires general business skills (such as understanding the strategy of an organisation) and people skills (such as motivating other team members) as well as technical skills (such as computer knowledge, calculating costs of products, and supporting planning and control decisions).

1-12 The new management accountant 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 management accountant were viewed as a resource rather than deadweight. In a related way, the plant manager could show how his/her time and resources could be saved by viewing the new management accountant 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 management accountant's past successes in working with line managers in other plants. Examples could include
 - assistance in preparing the budget,
 - assistance in analysing problem situations and evaluating financial and nonfinancial aspects of different courses of action, and
 - assistance in submitting capital budget requests
- (d) Seek assistance from the chief financial officer to highlight to the plant manager the importance of many tasks undertaken by the new management accountant. This approach is a last resort but may be necessary in some cases.

1-13 CPA Australia (Certified Practising Accountant Australia) and ICAA (Institute of Chartered Accountants Australia) are the two largest professional accounting organisations in Australia, the third being IPA (Institute of Public Accountants). CPA and ICAA members are finance, accounting and business professionals who have undergone training to obtain a recognised qualification, and whose membership requires continued professional development and adherence to an ethical code. Chartered Institute of Management Accountants (CIMA) has its headquarters in London and is an international body of management accountants.

1-14 The Chartered Institute of Management Accountants (CIMA) sets standards of ethical conduct for management accountants in the following areas: competence, confidentiality, integrity and credibility. As per CIMA's code of ethics, a CIMA member must act in the public interest AND comply with FIVE fundamental principles:

- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality
- Professional behaviour.

(Note that this code, as with many professional accounting bodies, is based on the IFAC Code of Ethics.)

1-15 If a member cannot resolve an ethical issue by following The Chartered Institute of Management Accountants (CIMA) code of ethics the CIMA's code of ethics for professional management accountants which can be found at: www.cimaglobal.com/Documents/code%20FINAL.pdf, or by consulting the ethics information on CIMA's website, he or she should seek legal advice as to both his or her legal rights and any obligations he or she may have. The CIMA Charter, By-laws and Regulations give definitive rules on many matters.

1-16 (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, services or processes
d.	Research and Development
e.	Customer Service (or Marketing)
f.	Design of products, services or processes (or Research and Development)
g.	Marketing
h.	Production

1-17 (15 min.) Value chain and classification of costs, pharmaceutical company

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

1-18 (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
c.	Distribution
d.	Marketing
e.	Production
f.	Design of products, services or processes (or Research and Development)

1-19 (15 min.) Value chain, supply chain and key success factors

Change in Management Accounting	Key Theme
a.	Value-chain analysis
b.	Key success factors (cost and efficiency)
c.	Key success factors (cost and efficiency)
d.	Supply-chain analysis
e.	Key success factors (time)

1-20 (10–15 min.) Planning and control decisions

Action	Decision
a.	Control
b.	Control
c.	Planning
d.	Planning
e.	Control

1-21 (15 min.) Five-step decision-making process, manufacturing

Action	Step in Decision-Making Process
a.	Collect relevant information
b.	Determine possible courses of action and consider the consequences of each
c.	Identify the problem
d.	Implement the decision, evaluate performance and learn
e.	Determine possible courses of action and consider the consequences of each
f.	Evaluate each possible course of action and select the best one
g.	Collect relevant information

1-22 (15 min.) Five-step decision-making process, service firm

Action	Step in Decision-Making Process
a.	Collect relevant information
b.	Identify the problem
c.	Determine possible courses of action and consider possible consequences of each
d.	Implement the decision, evaluate performance and learn
e.	Determine possible courses of action and consider possible consequences of each
f.	Collect relevant information
g.	Evaluate each possible course of action and select the best one

1-23 (10–15 min.) Professional ethics and reporting division performance:

1. Scott's ethical responsibilities are well summarised in the CIMA's code of ethics for professional management accountants which can be found at:

www.cimaglobal.com/Documents/code%20FINAL.pdf. Areas of ethical responsibility include the following:

- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality
- Professional behaviour

The ethical standards related to Scott's current dilemma are Integrity, Objectivity, Professional competence and due care, Confidentiality and Professional behaviour. Using the integrity standard, Scott should carry out duties ethically and communicate unfavourable as well as favourable information and professional judgments or opinions. Competence and due care, and professional behaviour, demand that Scott perform her professional duties in accordance with relevant laws, regulations and technical standards. Objectivity requires that Scott report information fairly and objectively. Scott should refuse to book the A\$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. Scott should refuse to follow Andrews' orders. If Andrews persists, the incident should be reported to the Company Management Accountant. Support for line management should be wholehearted, but it should not require unethical conduct.

1-24 (15 min.) Planning and control decisions, internet company

1. Planning decisions

- a. Decision to raise monthly subscription fee
- c. Decision to upgrade content of online services (later decision to inform subscribers and upgrade online services is an implementation part of control)
- e. Decision to decrease monthly subscription fee

Control decisions

- b. Decision to inform existing subscribers about the rate of increase—an implementation part of control decisions
- d. Dismissal of Director of Marketing—performance evaluation and feedback aspect of control decisions

2. Other planning decisions that may be made at Intheknow.com.au: to raise or lower advertising fees; or to charge a fee from on-line retailers when customers click-through from WebNews.com.au to the retailers' websites.

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

1-25 (20 min.) Strategic decisions and management accounting

1. The strategies that the companies are following in each case are:
 - a. Low price strategy
 - b. Differentiated product strategy
 - c. Low price strategy
 - d. Differentiated product strategy
2. The following are examples of information the management accountant can provide for each strategic decision.
 - 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 Eeriephones and its competitors.
 - 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' roll-on sunblock.
Productivity, efficiency and cost advantages relative to competition.
Prices of competitive products.
Sensitivity of target customers to price and quality.
How the market for roll-on sunblock is growing.
 - d. Cost to produce and sell new line of gourmet pasta sauce.
Premium price that customers would be willing to pay due to product uniqueness.
Price of basic ingredients.
Price of closest competitive product.

1-26 (15 min.) Management accounting guidelines

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

1-27 (15 min.) Role of management accountant, role of chief financial officer (CFO)

1.

Activity	Management accountant	CFO
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, Saunders will be interacting much more with the senior management of the company, the board of directors and the external financial community. Any experience he can get with these aspects will help him in his new role as CFO. Martin Saunders 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, either formally or on the job, getting training in issues related to investments and corporate finance.

1-28 (30 min.) Software procurement decisions, ethics

1. Marks face an ethical problem. The trip appears to be a gift which could influence her purchase decision. The ethical standard of integrity requires Marks to refuse the gift. Companies with 'codes of conduct' frequently have a 'supplier clause' that prohibits their employees from accepting 'material' (in some cases, any) gifts from suppliers. The motivations include:

- (a) Integrity/conflict of interest. Suppose Marks recommends that a Pinnacle product should subsequently be purchased by Prakash & Sons. She could make this recommendation because she felt obligated to them as her trip to the Hong Kong conference was fully paid by Pinnacle.
- (b) The appearance of a conflict of interest. Even if the Pinnacle product is the superior one at that time, other suppliers likely will have a different opinion. They may believe that the way to sell products to Prakash & Sons is via 'all-expenses-paid package to Hong Kong.' Those not wanting to do business this way may downplay future business activities with Prakash & Sons even though they could gain much from such activities.

Some executives view the meeting as 'suspect' from the start given the Hong Kong location and its 'rest and recreation' tone.

2. Prakash & Sons should not allow executives to attend user meetings while negotiating with other vendors about a purchase decision. The payment of expenses for the trip constitutes a gift that could appear to influence their purchase decision.

Pros of attending user meeting

- (a) Opportunity to learn more about Pinnacle's software products.
- (b) Opportunity to interact with other possible purchasers and get their opinions.
- (c) Opportunity to influence the future product development plans of Pinnacle in a way that will benefit Prakash & Sons. An example is Pinnacle subsequently developing software modules tailored to food product companies.
- (d) Saves Prakash & Sons' money. Visiting suppliers and their customers typically cost money, whereas Pinnacle is paying for the Hong Kong conference.

Cons of attending

- (a) The ethical issues raised in requirement 1.
- (b) Negative morale effects on other Prakash & Sons employees who do not get to attend the Hong Kong conference. These employees may reduce their trust and respect for Marks' judgment, arguing she has been on a 'supplier-paid vacation.'

Conditions on attending that Prakash & Sons might impose

- (a) Sizable part of that time in Hong Kong has to be devoted to business rather than recreation.
- (b) Decision on which Prakash & Sons executive attends is not made by the person who attends (this reduces the appearance of a conflict of interest).
- (c) Person attending (Marks) does not have final say on purchase decision (this reduces the appearance of a conflict of interest).
- (d) Prakash & Sons executives go only when a new major purchase is being contemplated (to avoid the conference becoming a regular 'vacation').

3. The company does not need its own code of ethics. They can use the code of ethics developed by the CIMA the CIMA's code of ethics for professional management accountants which can be found at: www.cimaglobal.com/Documents/code%20FINAL.pdf.

Pros of having a written code

The Conference Board outlines the following reasons why companies adopt codes of ethics:

- (a) Signals commitment of senior management to ethics.
- (b) Promotes public trust in the credibility of the company and its employees.
- (c) Signals the managerial professionalism of its employees.
- (d) Provides guidance to employees as to how difficult problems are to be handled. If adhered to, employees will avoid many actions that are unethical or appear to be unethical.
- (e) Drafting of the policy (and its redrafting in the light of ambiguities) can assist management in anticipating and preparing for ethical issues not yet encountered.

Cons of having a written code

- (a) Can give appearance that all issues have been covered. Issues not covered may appear to be 'acceptable' even when they are not
- (b) Can constrain the entrepreneurial activities of employees. It forces people to always 'behave by the book.'
- (c) Cost of developing code can be 'high' if it consumes a lot of employee time.

1-29 (30–40 min.) Professional ethics and end-of-financial-year actions

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

- (a) Management incentives. Superior 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 Superior 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 Superior 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 'CIMA Code of Ethics for Professional Accountants' requires 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-financial-year actions' clearly are in conflict with these requirements and should be viewed as unacceptable by Sommers.

- (b) The financial year-end should be closed on midnight of 30 June. '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 June should be charged to the current year. The advertising agency is facilitating falsification of the accounting records.

The other 'end-of-financial-year actions' occur in many organisations and fall into the 'grey' 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 June, 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 June maintenance charge.
- (d) In many organisations, 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 June.

- (e) If TV spots are reduced in June, the advertising cost in June 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 June, the transaction appears ethical.

Each of the (a), (d), (e) and (g) 'end-of-financial-year actions' may well disadvantage Superior 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 Superior 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 Sommers believes that Haast wants her to engage in unethical behaviour, she should first directly raise her concerns with Haast. If Haast is unwilling to change his request, Sommers should discuss her concerns with the Corporate Controller of Superior Foods. She could also initiate a confidential discussion with a CPA Australia (ICAA or CIMA) Counsellor, other impartial adviser or her own attorney. Sommers may also ask for a transfer from the snack foods division if she perceives that Haast is unwilling to listen to pressure brought by the CFO or President of Superior Foods. In the extreme, she may want to resign if the corporate culture of Superior Foods is to reward division managers who take 'end-of-financial-year actions' that Sommers views as unethical and possibly illegal.

1-30 (30 min.) Professional ethics and earnings management

1. The possible motivations for Trade Issue Pty Ltd's CEO to 'manage' earnings include

- (a) Manage the stock price. The CEO of Trade Issue wants to meet the forecast earnings number of A\$1.34 per share because the CEO believes that the share price will drop if actual earnings fall short of the forecast.
- (b) Job security. The CEO may be concerned that the Board of Directors may have a poor view of him if he delivers 'unwelcome surprises'. Depending on how much the share price falls, they may even consider dismissing him.
- (c) Management incentives. The bonuses of top management and the CEO may be based on earnings. If earnings decrease, either smaller or no bonuses may be paid. If top management and the CEO have share options, the value of these options will be adversely affected if the share price falls.

2. The 'CIMA Code of Ethics for Professional Accountants' requires 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-financial-year actions' are clearly in conflict with these requirements and should be viewed as unacceptable.

- (a) Subscriptions cancelled in June should be recorded in June itself and not delayed until July.
- (c) Subscription revenue received in June in advance for magazines that will be sent out in July is a liability. Showing it as revenue falsely reports next year's revenue as this year's revenue.
- (d) Office supplies purchased in June should be recorded as an expense of the current year and not as an expense of the next year.
- (e) Recording advertising revenues that relate to July in June falsely reports next year's revenue as this year's revenue.

The other 'end-of-financial-year actions' occur in many organisations and fall into the 'grey' to 'acceptable' area. Much depends on the circumstances surrounding each one, however, such as the following:

- (b) If the software on office computers is not updated until the next financial year, there is no transaction or expense to record in June. The responsibility for ensuring that the software is updated is that of the chief information technology officer. The management accountant can do little more than observe the absence of June software update and question whether this will have an adverse long-term impact on Harvest Day.
- (f) If building repairs are not done in June, there is no transaction to record in June. There is no record falsification here. The decision regarding when to do building repairs is made by the operations manager.
- (g) Many companies switch their depreciation policy from one method to another. Trade Issue 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, Trade Issue changes to straight-line depreciation with the sole purpose of reducing expenses to meet its earnings goal, such behaviour would be unacceptable. The CIMA Code of Ethics for Professional Accountants requires management accountants to communicate information fairly and objectively and to carry out duties ethically.

3. Trade Issue's management accountant should raise his/her concerns directly with the CEO. If the CEO refuses to change his request, the Management accountant should raise these issues with the Audit Committee and the Board of Directors. The Management accountant could also initiate a confidential discussion with a CIMA Ethics Counsellor, other impartial adviser or his/her own attorney. In the extreme, the Management accountant may want to resign if the corporate culture of Trade Issue is to reward executives who take 'end-of-financial-year actions' that the Management accountant views as unethical and possibly illegal.

1-31 (40 min.) Global company, ethical challenges

1. It is clear that bribes are illegal according to Australian laws. It is not clear from the case whether bribes are illegal in Sandos. However, knowledgeable people in global business would attest to the fact that it is virtually impossible to find any country in the world that specifically sanctions bribery. The major point, however, that deserves discussion is: Should Pure Tone engage in any unethical activities even if they are not illegal?

It is difficult to make a generalisation about all shareholders of the company. It is, however, safe to assume that not all shareholders would want to keep their investment in a company that is engaged in unethical and/or illegal activities. There is historical evidence to substantiate this point: When apartheid laws were in effect in South Africa, many investors divested shares of companies doing business in South Africa.

2. Apparently Corder thinks that local culture and common practice are one and the same. This, in fact, is not the case. There are many common practices in developing countries, which are against the native culture.

Specifically, bribery often leads to decisions that are not made on the basis of the merits of the alternative selected. This results in misallocation of meagre resources of the developing country. Misallocation of resources has adverse effects on the economy of a country and the living standard of its population. The negative impact is intensified in developing countries because they can least afford the misallocation of resources.

As it applies to local common practice, multinational companies may make some small allowances but draw a hard line against paying the A\$1 million 'commission'.

3. Pure Tone might have an articulated corporate policy against such payments to get the message across that regardless of laws, the top management would not tolerate any bribery payments made by its employees. A strong and consistent message from the top often has a noticeable effect on the corporate culture and employee behaviour.

Australian laws specifically prohibit bribery payments. Such payments can result in heavy penalties to the company making the payments.

4. If this contract is of great importance to the global strategy of Pure Tone, it is likely that this kind of issue will come up again as Pure Tone expands into very diverse cultures and the company should tackle it head on and make a policy decision against offering bribes. Richard Burns should discuss the situation with the top management at Pure Tone and re-affirm his goal to get the Sandos contract by legal means. He could seek the help of the Australian representative in Sandos to continue a dialogue with Sandos' deputy minister of communications. He could propose other creative, legal changes to the Pure Tone's bid, even at the cost of reducing the profitability of the current project. Concessions such as training programs, schools and other public works projects may be legal. Get the attention of the Sandos government and raise Pure Tone's profile both at home and abroad. In the worst case, if the Sandos government does not agree to any of the creative, legal 'extras' that Pure Tone can provide in order to win the contract; Burns should report this to Pure Tone's management and be willing to walk away from the Sandos project.