

## **c1**

*Student:* \_\_\_\_\_

1. A cost-management system is the set of cost-management techniques that function together to support the organization's goals and activities.

True False

2. Cost management is a philosophy, an attitude, and a set of techniques aimed at generating the most revenues possible in a corporation.

ACIPA BB: Industry

True False

3. Cost accounting and cost management are the same functions and operations.

True False

4. Companies in the United States are required by law to follow the code of ethics developed by the Institute of Management Accountants (IMA).

True False

5. Strategy is an organization's overall plan or policy to achieve its goals.

True False

6. Two major questions asked in strategic decision making are "where" and "who."

True False

7. Strategic decision making is not applicable in non-profit organizations because financial rewards do not exist for shareholders.

True False

8. The Value Chain is a set of linked operations or processes that begins in the manufacturing process of a company.

True False

9. Quantitative information is expressed in dollars or other quantities relating to size or frequency.

True False

10. The use of Internet-based information and Web sites for solicitations is an example of the customer service part of the value chain.

True False

11. The extended value chain encompasses the ways companies obtain their resources and distribute their products and services, possibly using the services of other organizations.

True False

12. Email response to customers' questions and complaints is an example of the customer service aspect of the value chain.

True False

13. The value chain is a set of activities within an organization beginning with the purchase of materials and ending with the completion of a finished product.

True False

14. Companies that outsource support services do not understand the concepts underlying the value chain.

True False

15. The ethical standard of confidentiality would prohibit Management Accountants from testifying in Court against their employers. (Appendix)

True False

16. Refraining from disclosing confidential information acquired in the course of their work is an example of the ethical standard of competence for Management Accountants. (Appendix)

True False

17. The first level of evaluating plans and outcomes is strategic performance analysis.

True False

18. Removing obstacles to change is an important feature of successful organizational change.

True False

19. The only primary processes in the value chain are research and development and design.

True False

20. Benefit-cost analysis is a technique for identifying opportunities for improvement and measuring the effects of proposed improvements by comparing both the costs and benefits of a proposal.

True False

21. Quantitative information is expressed only in dollars.

True False

22. Benefit-cost analysis takes into account only quantitative benefits and costs of proposed plans.

True False

23. Qualitative information is descriptive and based on characteristics or perceptions, such as relative desirability, rather than quantities.

True False

24. Cost managers almost always have training as accountants.

True False

25. Teams are replacing individual decision makers in many organizations.

True False

26. Management should emphasize long term success over short term achievements in creating a successful culture for organizational change.

True False

27. Cost Management teams often find that employees are sources of valuable information and suggestions in cost management review.

True False

28. Variances are the differences between a plan's actual and expected quantities.

True False

29. The ethical standard of competence states that Management Accountants have a responsibility to perform their professional duties in accordance with relevant laws, regulations and professional standards. (Appendix)

True False

30. Management accountants have a responsibility to communicate only unfavorable professional judgments or opinions. (Appendix)

True False

31. Quantitative information is always more important than qualitative information in benefit-cost analysis.

True False

32. Variance analysis will be primarily used in the quantitative aspect of performance evaluation.

True False

33. Which one of the following is not a characteristic of cost management?

- A. Philosophy
- B. Techniques
- C. Strategy
- D. Attitude

34. Cross Functional Decision Making:

- A. Brings together individuals from diverse functions and backgrounds in order to generate innovative solutions to problems
- B. Brings together individuals from different industries to benchmark solutions to similar problems
- C. Brings together individuals with different jobs in the same function to generate innovative solutions to problems
- D. Focuses on finding new opportunities, informed but not restricted to what has worked in the past

35. Promoting the idea of continually finding ways to help organizations make the right decisions to create more customer value at lower cost is an example of the characteristic of the:

- A. Attitude of effective cost management
- B. Variance analysis of effective cost management
- C. Technique of effective cost management
- D. Philosophy of effective cost management

36. Which of the following is not an ethical standard of competence in the Standards of Ethical Conduct for Management Accountants?

- A. Development of professional knowledge and skills
- B. Preparation of complete and clear reports and recommendations of relevant and reliable information
- C. Refraining from engaging in activities that would discredit the profession
- D. Performing professional duties in accordance with relevant laws, regulations and technical standards

37. Which of the following is not a piece of qualitative information in a decision?

- A. The effect of the decision on employees' morale
- B. The effect of the decision on customer perception of service quality
- C. The effect of the decision on the quality of the product produced
- D. The total cost savings to be gained from the decision

38. Maria Kadison, Controller at Robbins Corporation, became aware that Robbins is in talks with Hallion Company for a friendly merger. Maria discloses this information to her immediate family. No member of Maria's family purchases either Robbins' or Hallion's stock before the merger. Which of the following is True?

- A. Maria has violated the ethical standard of integrity
- B. Maria has violated the ethical standard of confidentiality
- C. Maria has not violated any ethical standards because the disclosure was made only to her immediate family
- D. Maria has not violated any ethical standards because her immediate family did not profit from the information that she disclosed

39. Which of the following would be found in a high risk, high return strategic mission?

- A. Focus on capturing market share
- B. Focus on cutting costs
- C. Need to minimize losses
- D. Focus on finding buyer quickly

40. Which of the following would be found in a low risk, low reward strategic mission?

- A. Need to maintain growth
- B. The company must be a major player in the market
- C. Declining market
- D. Focus on capturing market share

41. Which of the following activities would be included in the value chain of a manufacturing company?

- A. Research and Development
- B. Customer Service
- C. Design
- D. All of the above are included in the value chain

42. A company with a "hold" strategy as its strategic mission would focus on:

- A. Minimizing losses
- B. The market potential of new products
- C. Maintaining its current rate of growth
- D. Capturing market share

43. Microsoft's replies to customers' questions via email would be an example of which element of the value chain?

- A. Customer Service
- B. Marketing
- C. Design
- D. Supply

44. The delivery of products or services to customers is an example of which element in the value chain?

- A. Supply
- B. Design
- C. Marketing
- D. Distribution

45. The extended value chain:

- A. Is a set of linked operations or processes that begins with obtaining resources and ends with providing products or services that customers value
- B. Is a related set of tasks, manual or automated, that transforms inputs into identifiable outputs
- C. Encompasses how companies obtain their resources and distribute their products and services, possibly using the services of other organizations
- D. Is a technique for identifying opportunities for improvement and measuring the effects of proposed improvements by comparing both the costs and benefits of a proposal

46. Which of the following would not be a member of a cross-functional team?

- A. The lead engineer
- B. The Chairman of the Board of Directors
- C. The cost accounting manager from the accounting department
- D. The supervisor of salespeople in marketing

47. Which of the following would not be part of an organization's eight-step process for implementing change?

- A. Identifying the need for change
- B. Reinforcing a culture of more improvement and more effective management
- C. Ensuring that long term achievements are emphasized over short term achievements
- D. Creating a team to lead and manage the change

48. The eight-step process for implementing change in a successful organization begins with:

- A. Creating a vision of the change and a strategy for achieving the vision
- B. Identifying the need for change
- C. Encouraging innovation and removing obstacles to change
- D. Reinforcing a culture of more improvement, better leadership and more effective management

Use the following to answer questions 49-52:

Perry's Sandwich Department had the following summarized results for the month ending April 30:

	Budget	Actual
Revenues	\$26,000	\$30,000
Total sandwich costs	<u>22,800</u>	<u>26,800</u>
Net departmental income	3,200	3,200

49. As the cost accountant, which single note to the above financial results is most appropriate in the report to management?
- A. The departmental manager is performing to expectations because budgeted income equals actual income
  - B. Revenues are above budget and a bonus based on this increase should be considered
  - C. Costs as a percentage of revenues are above budget and a further scrutiny of the results might be appropriate
  - D. Costs are 17.5% above budget and the department manager's position should be critically evaluated by senior management
50. If the budget were based on the sale of 13,000 sandwiches at \$2.00 each and the actual results reflect the sale of 13,000 sandwiches, identify the most appropriate conclusion in the report to management
- A. If costs as a percentage of revenues had remained at the budgeted level, net income would have declined
  - B. If costs as a percentage of revenues remain at the actual level any increase in revenues would probably be matched by a decrease in departmental net income
  - C. If costs as a percentage of revenues had remained at the budgeted level, net income would be \$492 above budget
  - D. If costs as a percentage of revenues had remained at the budgeted levels, net income would be \$4,000 above budget
51. If an additional 2,000 sandwiches were sold at the regular price, during additional store opening hours, identify the most appropriate conclusion in the report to management.
- A. The budget should be updated to take into account the change
  - B. The additional hours should be canceled, as net income did not increase
  - C. An analysis of the differential costs of the additional store hours should be undertaken prior to drawing a conclusion as to the success of the change
  - D. Both A and C above
52. An example of a qualitative factor that should be considered in the benefit-cost analysis of opening the store for additional hours is:
- A. The impact of employees' morale because of additional working hours on weekends required
  - B. The additional payroll taxes to be paid
  - C. Additional hours of the owner's time to be spent in the store
  - D. All of the above are considered qualitative factors



Use the following to answer questions 53-55:

In the Management's Discussion and Analysis section of its 2005 annual report, the CEO of McDonald's Corporation discussed the strategic direction and financial performance of the company by referring to the comprehensive revitalization plan initiated by the company in 2003:

"in 2003, the Company initiated a comprehensive revitalization plan focused on maximizing customer satisfaction and strengthening our financial position. We redefined our strategy to emphasize growth through adding more customers to existing restaurants and aligned the System around our customer- focused Plan to Win. We streamlined processes such as new product development and restaurant operations, improved our training programs, and implemented performance measures, including a restaurant review and measurement process, to enable and motivate franchisees and restaurant employees to serve customers better."

Among the improvements cited were:

- (1) Improving the taste of many of the core offerings
- (2) Streamlining processes such as new product development and restaurant operations
- (3) Implemented performance measures to enable and motivate franchises to service customers better
- (4) Achieved high levels of customer awareness worldwide

During 2005, McDonald's comparable sales increased 3.9%, earnings per share increased from \$1.79 to \$2.04, cash from operations increased \$433 million to \$4.3 billion and the company repurchased \$1.2billion in common stock. (McDonald's 2005 Annual Report)

53. McDonald's strategic mission could best be described as:

- A. Build
- B. Hold
- C. Harvest
- D. Divest

54. Which of the improvements cited by McDonald's is an example of the extended value chain?

- A. Number 1
- B. Number 2
- C. Number 3
- D. Number 4

55. Improvement number 3 is an example of which link in the value chain?

- A. Supply
- B. Research and Development
- C. Customer Service
- D. Production

56. Match the following operations with appropriate elements of an organization's value chain.

Value Chain Element

(A) Research and Development

(B) Design

(C) Supply

(D) Production

(E) Marketing

(F) Distribution

(G) Customer Service

\_\_\_\_ (1) Crate and Barrel's replies to customers' questions on merchandise.

\_\_\_\_ (2) Updating Pottery Barn's electronic Internet catalogue of sporting goods and spring merchandise.

\_\_\_\_ (3) Development of new software applications at Oracle.

\_\_\_\_ (4) Inspection of incoming chip parts at IBM.

\_\_\_\_ (5) Contracting with Federal Express to ship computers to customers at Gateway.

\_\_\_\_ (6) Writing of software programs at IBM's Lotus Division.

\_\_\_\_ (7) Creation of new movie ideas at Paramount Pictures

57. C & P Frosties is a local ice cream shop. The company currently is showing an operating loss, as evidenced by the income statement below:

Sales	\$75,000
Costs:	
Food supplies	20,000
Labor	16,000
Utilities	4,000
Rent	12,000
Other	4,000
Manager's salary	25,000
Total costs	81,000
Profit(loss)	(\$6,000 )

The President of the company is considering adding sandwiches to the menu. Sales will be expected to increase by \$60,000. The cost of sandwich supplies would be \$30,000. Labor costs would increase 40% and other costs 10%. The current manager will continue to manage the operation.

Required:

(a) Prepare a quantitative analysis of the decision to add sandwiches to the menu.

(b) What qualitative considerations should the company consider in this decision?

58. The Callahan family currently lives in a suburb of a major city. They have a lovely home close to major routes of transportation. Both Mr. and Mrs. Callahan have convenient commutes of 30 minutes or less. Because the school system in their town does not have a quality reputation, they currently send their daughter to private school, conveniently located less than one mile from their home. The family's current monthly living expenses are listed below:

	Monthly Budget
Mortgage, including taxes and insurance	\$ 5,000
Other utilities, including water, heat and telephone	500
Costs of running automobiles	800
Cost of private school	2,000
<b>Total monthly budget</b>	<b>\$8,300</b>

The Callahans are considering moving to a town approximately 20 minutes away. Because of the desirability of the local schools and strict zoning, housing is very expensive in this town. Their daughter would attend public schools. The Facts estimate that their monthly mortgage, taxes and insurance would increase to \$7,000 per month, while the cost of running automobiles would increase 20% and other utilities 10%. Mortgage interest costs are tax deductible and the Facts are in the 25% tax bracket. Assume that \$700 of the increase in their monthly budget is for mortgage interest. What are the costs and benefits of moving? Which can be quantified and which cannot?

59. The Linden chain of ladies' fashion wear wishes to appraise its security system in an effort to reduce pilferage for the coming period. The following details are estimated for the current period:

Sales revenues	\$ 20,000,000	
Cost of goods sold	13,000,000	
Pilferage at retail value	400,000	(estimated and not included in Cost of goods sold)

Ignoring income taxes and assuming that cost of goods sold is a constant percentage of sales, calculate the maximum amount that would be economically optimal to spend on a security system if pilferage could be completely eliminated.

60. Home Retail, Inc. wishes to appraise its security system in an effort to reduce pilferage for the coming period. The following details are estimated for the current period:

Sales revenues	15,000,000
Cost of goods sold	9,000,000
Pilferage at retail value	500,000
	(estimated and not included in Cost of goods sold)

Ignoring income taxes and assuming that cost of goods sold is a constant percentage of sales, calculate the maximum amount that would be economically optimal to spend on a security system if pilferage could be completely eliminated.

61. The Cut Stop is a small but prosperous hair cutting salon. Kathy Harvey, the manager of the salon, has been asked by several clients if she will ever offer other "hair related" services (e.g., perm, dye, etc). After careful thought, Harvey is considering expanding her offerings. However, in order to do so, she will have to hire one additional stylist at a salary of \$26,000 per year. Other expenses will increase as follows: rent by 20%, supplies and utilities by 25%, and miscellaneous expenses by 10%. Her revenues from additional services are likely to be \$55,000 for the next year (i.e., 2007). The Cut Stop's income statement for the most recent year is presented below.

The Cut Stop Income Statement for the Year Ended December 2006		
Sales Revenues		\$220,000
Costs:		
Labor	52,000	
Utilities	12,000	
Supplies	45,000	
Rent	18,000	
Miscellaneous	5,000	
Manager's salary	30,000	162,000
Operating profit (loss)		\$58,000

Required:

- Based on your financial analysis, should Kathy Harvey go ahead with the expansion?
- What other factors must Harvey consider before making a final decision?

62. Anika Linden, the Vice-President for Human Resources in Educational Toys, Inc. was concerned about a recent memo she had recently received from the CEO's office regarding the possibility of outsourcing the payroll function to Salary Experts, a growing provider of a variety of human resource services. She was shocked that the CEO's office had discussed this matter with the Board of Directors, but failed to consult her. Linden was preparing for a meeting with the CEO. In reading the memo and its attachments, Linden observed the following comparison of costs in a report prepared by the controller's office:

*Payroll department expenses:*

Salaries of employees	\$210,000
Share of utilities	75,000
Share of building rent	39,350
Manager's salary	69,000
Computers and supplies	26,000
Other department expenses	20,000
Total annual expenses	\$439,350

Linden also noted that Salary Experts quoted a fixed fee of \$125,000 and variable processing costs of \$7.50 per employee transaction. She did not believe that the company will actually save money by outsourcing the payroll function. For one, she did not think that the company will actually save all of the above mentioned amounts. She knew that the payroll department manager could not be removed from the company because he had to oversee the payroll function and serve as a liaison with the outside company. However, all other employees in the department would likely not be required.

Required:

- (a) Assume Educational Toys has 14,000 employees on its payroll. Can the company save money by outsourcing the payroll function?
- (b) What are the pros and cons of outsourcing the payroll function?

63. Julie King, the production manager of Mussell Corporation is frustrated by the company's policy of not scrapping defective units but reworking them. She has pointed out several times to senior management that some units are beyond rework and should be scrapped. According to her, in most cases, it would be cheaper to scrap and build a new unit from scratch rather than trying to rework a defective unit. However, Paul Oasis, the CEO, is not convinced. She wants her controller, Mandie Castagna, to gather some information. After researching the problem, Castagna provides the following information:

Selling price:	\$132	per unit
Manufacturing costs:		
Direct materials	27	
Direct labor	32	
Variable overhead	24	
Variable marketing costs	10	
Fixed overhead	32	
Reworking costs:		
Materials:	\$ 25	
Labor:	48	
Direct machining costs:	35	

Castagna also observes that reworking a defective product consumes more labor time than making a unit from scratch. As a result, for every three units reworked, Mussell forgoes the production and sale of two units.

Required:

- Do you agree with Julie King that it is cheaper to scrap than rework a defective unit? Show your computations.
- How can the cost information generated by Castagna be useful in reducing the number of defectives?

64. Laurie Riley is a purchasing agent for a motorcycle manufacturer. Laurie is evaluating two potential suppliers of seats for the company's motorcycles. One supplier (A) quotes a price of \$165 per seat and assures 100% quality and delivery standards. The second supplier (B) quotes a price of \$135 per seat but does not give any written assurances on quality or delivery. Riley is not sure which supplier should be awarded the contract. Assume you are the management accountant for the motorcycle manufacturer. Riley asks you to prepare an estimate of the related costs of buying the seats from supplier B. She tells you that the estimate is needed because unless dollar estimates are attached to nonfinancial factors, such as lost production costs, her supervisor will not give it full attention. Riley provides you with the following information:

- Production output is 2,000 motorcycles per year based on 250 production days a year.
- Production time per day is 8 hours at a cost of \$4,000 per hour to run the production line.
- Lost production time due to poor quality is 1%.
- Satisfied customers purchase, on average, three motorcycles during a lifetime.
- Satisfied customers recommend the product, on average, to 5 other people.
- Marketing estimates that using the seat from supplier B will result in 5 lost customers per year from repeat business and referrals.
- Average contribution margin per motorcycle is \$5,000.

Required:

Estimate the costs of buying motorcycle seats from supplier B. (*Note:* This problem requires you to think creatively and make reasonable estimates; therefore, there is more than one correct answer.)

65. Thompson Metal Corporation (TMC) supplies various types of machine tools to manufacturing companies. TMC has always paid a lot of attention to the quality of its products. Recently, an outside supplier has approached TMC to supply an important and intricate component of one of its more advanced tools that TMC has been manufacturing in-house. Sam Weiss, a junior accountant at TMC, has collected the following information regarding this proposal.

The cost of manufacturing one unit of this component internally are as follows:

Direct materials:	\$29.60	
Direct labor:	13.00	
Variable overhead:	19.50	(@150% of direct labor cost)
Fixed overhead:	26.00	(@200% of direct labor cost)
Total cost:	\$88.10	

The outside supplier has quoted a price of \$90 per unit for supplying this component. The following is a conversation that took place among the manufacturing manager (Dana Rice), buyer (Emily Scanlon) and Sam Weiss.

Weiss: I think that we should continue to manufacture internally because we can save \$1.90 per unit on this component.

Rice: According to your report, we would save \$1.90 per unit, but I do not agree with those numbers.

Weiss: What do you mean? I have followed the same costing guidelines this company has used for years. I have even cross-checked my numbers with historical data and know for sure that the overhead rates which I have used are correct.

Rice: I am sure you have done your job thoroughly, but I think that our costing system is archaic. This component is complex and difficult to manufacture. I believe that our overhead allocation method does not accurately capture the production difficulties and the additional resources that are devoted to the manufacture of this component. For example, a significant portion of our quality problems are due to this component. We spend close to a third of our quality inspection time on just this component alone, but that is not reflected. These quality problems cause delays in getting this component to the assembly department, and that causes a delay in getting the final product to the customers. Many of our customers are expecting just-in-time deliveries, and they get upset when we're late.

Scanlon: I know that the supplier that has approached us has a strong reputation for quality. Therefore, we can rest assured that we will have negligible quality problems.

Rice: Sam, your report does not consider this additional benefit from buying outside. I would appreciate if you can rework your numbers to better reflect the true costs associated with manufacturing this component internally.

Required:

- Assume the role of Sam Weiss. What are the different elements of costs that are likely to be associated with the manufacture of the component? Does the current costing system capture these costs?
- Recommend improvements in the costing system.
- How can Weiss quantify "qualitative" benefits such as quality and on-time delivery?



66. Streamline Shoe Company, a manufacturer of women's shoes, recently implemented a quality improvement program aimed at streamlining the manufacturing process. Carl Silverman, an industrial engineer and a resident expert on process improvement, was assigned the task of implementing the program.

Silverman's first task was to educate all the employees involved with the production process. He sent a memo to representatives in product design and development, materials management (including purchasing), marketing, distribution, customer service and accounting, in addition to those in the production department, inviting them to attend an information session on the improvement program.

He began the meeting by thanking all those who were present (over 35 in number) and spent the first hour explaining the need for such a program. Soon after, the attendees were engaged in a discussion. Several questions were raised during the discussion. Among these, three questions stood out. What is the need for including members from design, marketing, and other functional areas when the improvement program's focus is on streamlining the manufacturing process? What is the role of the cost management expert in this program? Finally, why should the machine operators be involved, as they are not engineers?

Required:

Consider the three questions that stood out in the discussion. Assume the role of Carl Silverman and prepare a response addressing the questions.

67. Consider the following management activities:

- Choose the organization's long-term strategy
- Plan and organize the use of resources into efficient operations
- Implement plans and organizational change
- Measure and report results
- Define the organization's scale and scope of operations

Required: (a) Identify the sequence in which the decisions must be carried out. Why is it important to carry out these activities sequentially?

(b) How can an effective cost management system support the above activities?

68. Greg Piff, a new assistant sales manager was faced with a dilemma. His supervisor, Kathleen Holbrook, instructed him to prepare an invoice for \$300,000 in the name of General Builders, a regular customer. Upon refusing to comply with the request because no order was received, Holbrook explained to Piff that this was normal practice during the end of the year in order to meet or exceed the annual sales target. Holbrook also clarified that the goods will not be physically delivered to the customer and a reverse entry will be made in the accounting records during the next year.

Piff is unsure about what is to be done because the amount is significant. He recollected that Holbrook had promised to give him a favorable review if he complied with the instruction. Piff has come to seek your advice as a professional, regarding the proper way to handle the situation in order to minimize the effects of any repercussions his actions may have.

Required:

- (a) Does Greg have an ethical responsibility to take a course of action?
- (b) What course of action would you take? What course of action should Piff take?
- (c) Why is it important that such actions are curbed?

69. Cleary Yard Equipment Corporation manufactures lawn mowers and snow blowers. It also manufactures engines that are used by the Lawn Mower Assembly Division (LMAD). The Engine Division (ED) also sells about 40% of its output to the outside market (these are multipurpose engines). Its annual capacity is 150,000 units and annual output 135,000 units. All engines sold internally to the LMAD are priced at cost plus 20% markup.

In January 2007, the Snow Blower Assembly Division (SBAD) approached the ED to 'buy' 20,000 engines. Diane Holinger, the controller of ED, computed the costs of manufacturing these engines as follows:

	<u>Total</u>	<u>Per unit</u>
Materials	\$300,000	<u>\$ 15.00</u>
Labor	400,000	20.00
Special equipment	36,000	1.80
Quality inspection	24,000	1.20
Other manufacturing costs	<u>350,000</u>	<u>17.50</u>
Total costs	<u>\$ 1,110,000</u>	<u>\$ 55.50</u>

Holinger quoted a price of \$66.60 for each engine transferred to the SBAD. John Hargreaves, the manager of SBAD, was furious to note that the ED was "trying to make money off a sister division." He argued that the price must include only the cost of materials, as all other costs will be incurred irrespective of whether or not SBAD places the order for 20,000 engines. Matt Hall, the production manager of ED, pointed out that the special equipment will be purchased only for fulfilling this internal order. Moreover, he argued that inspection must also be done just like on all other engines; therefore, the inspection costs must also be included. Labor is paid a flat monthly salary. Other manufacturing costs include both variable and fixed components (in roughly equal proportion).

Required:

- Given that excess capacity exists, what is the minimum price that the ED must charge to the SBAD?
- What are the pros and cons of internal sourcing?

70. In September, 2006, Paul Otellini, CEO of Intel Inc., a computer chipmaker, announced the company's plan to eliminate 10,000 jobs, approximately 10% of the company's worldwide workforce of 100,000 employees. Many of the job cuts would be in the marketing area, as company studies concluded that the company's ratio of marketing personnel to salespeople was higher than that of competitors. This move follows the layoff of 1,000 managers in July, 2006. The strategic moves were in response to Intel's lost market share to rival Advanced Micro Devices in recent years and 57% drop in net income and 13% drop in revenues from the previous fiscal year. (News.Com. September 5, 2006)

Required:

- (a) Describe the quantitative aspects of Intel's decision.
- (b) Describe the qualitative aspects of Intel's decision.
- (c) What step in Intel's value chain is impacted by this decision?

71. In a presentation to the investment community, Sam Palmisano, CEO of IBM Corporation, stated: "We intend to continue to take share, as we have in the past two or three years, in our core businesses." Palmisano contended that the category of business-process transformation services, such as customer support, human resources, and other administrative overhead, represents an untapped market of \$500 billion dollars if businesses outsourced these functions to companies like IBM. IBM's expressed goal is to capture 10% of this new market. Palmisano also cited new business opportunities in information technology. The company's new chief financial officer, John Loughridge, stated that IBM's goal was to achieve high-single digit annual percentage gains in sales and greater than 10% yearly increases in earnings per share. (Source: Barron's: May 24, 2004)

Required:

- (a) Does the strategy described by IBM's management fall into the build, hold, harvest or divest category of strategic missions? Explain your answer with specific examples related to the general characteristics of that category of strategic mission.
- (b) Identify the types of risks and rewards normally encountered by a company with the strategic mission described by IBM's management.

72. Briefly explain this statement: Cost Management is important to organizations because it is more than measuring and reporting product and service costs. It is a philosophy, an attitude and a set of techniques to create more value at lower costs.

## c1 Key

1. A cost-management system is the set of cost-management techniques that function together to support the organization's goals and activities.

**TRUE**

*AACSB: Reflective Thinking*

*AICPA BB: Industry*

*Difficulty: Easy*

*Hilton - Chapter 01 #1*

*Learning Objective: 1*

2. Cost management is a philosophy, an attitude, and a set of techniques aimed at generating the most revenues possible in a corporation.

ACIPA BB: Industry

**FALSE**

*AACSB: Analytic*

*Difficulty: Easy*

*Hilton - Chapter 01 #2*

*Learning Objective: 1*

3. Cost accounting and cost management are the same functions and operations.

**FALSE**

*AACSB: Analytic*

*AICPA BB: Industry*

*Difficulty: Easy*

*Hilton - Chapter 01 #3*

*Learning Objective: 1*

4. Companies in the United States are required by law to follow the code of ethics developed by the Institute of Management Accountants (IMA).

**FALSE**

*AACSB: Ethics*

*AICPA BB: Global*

*AICPA BB: Legal*

*Difficulty: Medium*

*Hilton - Chapter 01 #4*

*Learning Objective: 2*

5. Strategy is an organization's overall plan or policy to achieve its goals.

**TRUE**

*AACSB: Reflective Thinking*  
*AICPA BB: Industry*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #5*  
*Learning Objective: 3*

6. Two major questions asked in strategic decision making are "where" and "who."

**FALSE**

*AACSB: Reflective Thinking*  
*AICPA FN: Decision Making*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #6*  
*Learning Objective: 3*

7. Strategic decision making is not applicable in non-profit organizations because financial rewards do not exist for shareholders.

**FALSE**

*AACSB: Reflective Thinking*  
*AICPA FN: Decision Making*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #7*  
*Learning Objective: 3*

8. The Value Chain is a set of linked operations or processes that begins in the manufacturing process of a company.

**FALSE**

*AACSB: Reflective Thinking*  
*AICPA BB: Industry*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #8*  
*Learning Objective: 3*

9. Quantitative information is expressed in dollars or other quantities relating to size or frequency.

**TRUE**

*AACSB: Reflective Thinking*  
*AICPA BB: Industry*  
*AICPA FN: Measurement*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #9*  
*Learning Objective: 4*

10. The use of Internet-based information and Web sites for solicitations is an example of the customer service part of the value chain.

**FALSE**

*AACSB: Communications*

*AICPA BB: Marketing*

*Difficulty: Medium*

*Hilton - Chapter 01 #10*

*Learning Objective: 3*

11. The extended value chain encompasses the ways companies obtain their resources and distribute their products and services, possibly using the services of other organizations.

**TRUE**

*AACSB: Reflective Thinking*

*AICPA BB: Resource Management*

*Difficulty: Easy*

*Hilton - Chapter 01 #11*

*Learning Objective: 3*

12. Email response to customers' questions and complaints is an example of the customer service aspect of the value chain.

**TRUE**

*AACSB: Communication Abilities*

*AICPA BB: Marketing*

*Difficulty: Easy*

*Hilton - Chapter 01 #12*

*Learning Objective: 3*

13. The value chain is a set of activities within an organization beginning with the purchase of materials and ending with the completion of a finished product.

**FALSE**

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*Difficulty: Medium*

*Hilton - Chapter 01 #13*

*Learning Objective: 3*

14. Companies that outsource support services do not understand the concepts underlying the value chain.

**FALSE**

*AACSB: Reflective Thinking*

*AICPA FN: Decision Making*

*Difficulty: Easy*

*Hilton - Chapter 01 #14*

*Learning Objective: 3*



15. The ethical standard of confidentiality would prohibit Management Accountants from testifying in Court against their employers. (Appendix)

**FALSE**

*AACSB: Ethics*  
*AICPA BB: Legal*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #15*  
*Learning Objective: 2*

16. Refraining from disclosing confidential information acquired in the course of their work is an example of the ethical standard of competence for Management Accountants. (Appendix)

**FALSE**

*AACSB: Ethics*  
*AICPA BB: Legal*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #16*  
*Learning Objective: 2*

17. The first level of evaluating plans and outcomes is strategic performance analysis.

**FALSE**

*AACSB: Analytic*  
*AICPA BB: Critical Thinking*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #17*  
*Learning Objective: 4*

18. Removing obstacles to change is an important feature of successful organizational change.

**TRUE**

*AACSB: Reflective Thinking*  
*AICPA BB: Resource Management*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #18*  
*Learning Objective: 3*

19. The only primary processes in the value chain are research and development and design.

**FALSE**

*AACSB: Reflective Thinking*  
*AICPA BB: Critical Thinking*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #19*  
*Learning Objective: 3*

20. Benefit-cost analysis is a technique for identifying opportunities for improvement and measuring the effects of proposed improvements by comparing both the costs and benefits of a proposal.

**TRUE**

*AACSB: Reflective Thinking  
AICPA FN: Decision Making  
Difficulty: Easy  
Hilton - Chapter 01 #20  
Learning Objective: 4*

21. Quantitative information is expressed only in dollars.

**FALSE**

*AACSB: Reflective Thinking  
AICPA BB: Critical Thinking  
Difficulty: Medium  
Hilton - Chapter 01 #21  
Learning Objective: 4*

22. Benefit-cost analysis takes into account only quantitative benefits and costs of proposed plans.

**FALSE**

*AACSB: Reflective Thinking  
AICPA FN: Decision Making  
Difficulty: Easy  
Hilton - Chapter 01 #22  
Learning Objective: 4*

23. Qualitative information is descriptive and based on characteristics or perceptions, such as relative desirability, rather than quantities.

**TRUE**

*AACSB: Reflective Thinking  
AICPA FN: Decision Making  
Difficulty: Medium  
Hilton - Chapter 01 #23  
Learning Objective: 4*

24. Cost managers almost always have training as accountants.

**FALSE**

*AACSB: Diversity  
AICPA BB: Resource Management  
Difficulty: Medium  
Hilton - Chapter 01 #24  
Learning Objective: 1*

25. Teams are replacing individual decision makers in many organizations.

**TRUE**

*AACSB: Diversity  
AICPA BB: Resource Management  
Difficulty: Easy  
Hilton - Chapter 01 #25  
Learning Objective: 3*

26. Management should emphasize long term success over short term achievements in creating a successful culture for organizational change.

**FALSE**

*AACSB: Communication  
AICPA BB: Industry  
AICPA BB: Resource Management  
Difficulty: Medium  
Hilton - Chapter 01 #26  
Learning Objective: 3*

27. Cost Management teams often find that employees are sources of valuable information and suggestions in cost management review.

**TRUE**

*AACSB: Communication  
AICPA BB: Resource Management  
Difficulty: Easy  
Hilton - Chapter 01 #27  
Learning Objective: 3*

28. Variances are the differences between a plan's actual and expected quantities.

**TRUE**

*AACSB: Reflective Thinking  
AICPA FN: Measurement  
Difficulty: Easy  
Hilton - Chapter 01 #28  
Learning Objective: 4*

29. The ethical standard of competence states that Management Accountants have a responsibility to perform their professional duties in accordance with relevant laws, regulations and professional standards. (Appendix)

**TRUE**

*AACSB: Ethics  
AICPA BB: Legal  
Difficulty: Easy  
Hilton - Chapter 01 #29  
Learning Objective: 2*

30. Management accountants have a responsibility to communicate only unfavorable professional judgments or opinions. (Appendix)

**FALSE**

*AACSB: Communication  
AICPA FN: Reporting  
Difficulty: Medium  
Hilton - Chapter 01 #30  
Learning Objective: 2*

31. Quantitative information is always more important than qualitative information in benefit-cost analysis.

**FALSE**

*AACSB: Reflective Thinking  
AICPA FN: Measurement  
Difficulty: Easy  
Hilton - Chapter 01 #31  
Learning Objective: 4*

32. Variance analysis will be primarily used in the quantitative aspect of performance evaluation.

**TRUE**

*AACSB: Reflective Thinking  
AICPA FN: Measurement  
Difficulty: Medium  
Hilton - Chapter 01 #32  
Learning Objective: 4*

33. Which one of the following is not a characteristic of cost management?

- A. Philosophy
- B. Techniques
- C. Strategy**
- D. Attitude

*AACSB: Reflective Thinking  
AICPA BB: Resource Management  
Difficulty: Easy  
Hilton - Chapter 01 #33  
Learning Objective: 1*

34. Cross Functional Decision Making:

- A. Brings together individuals from diverse functions and backgrounds in order to generate innovative solutions to problems
- B. Brings together individuals from different industries to benchmark solutions to similar problems
- C. Brings together individuals with different jobs in the same function to generate innovative solutions to problems
- D. Focuses on finding new opportunities, informed but not restricted to what has worked in the past

*AACSB: Diversity*

*AICPA FN: Decision Making*

*Difficulty: Medium*

*Hilton - Chapter 01 #34*

*Learning Objective: 3*

35. Promoting the idea of continually finding ways to help organizations make the right decisions to create more customer value at lower cost is an example of the characteristic of the:

- A. Attitude of effective cost management
- B. Variance analysis of effective cost management
- C. Technique of effective cost management
- D. Philosophy of effective cost management

*AACSB: Reflective Thinking*

*AICPA BB: Marketing*

*Difficulty: Medium*

*Hilton - Chapter 01 #35*

*Learning Objective: 1*

36. Which of the following is not an ethical standard of competence in the Standards of Ethical Conduct for Management Accountants?

- A. Development of professional knowledge and skills
- B. Preparation of complete and clear reports and recommendations of relevant and reliable information
- C. Refraining from engaging in activities that would discredit the profession
- D. Performing professional duties in accordance with relevant laws, regulations and technical standards

*AACSB: Ethics*

*AICPA BB: Legal*

*Difficulty: Medium*

*Hilton - Chapter 01 #36*

*Learning Objective: 2*

37. Which of the following is not a piece of qualitative information in a decision?

- A. The effect of the decision on employees' morale
- B. The effect of the decision on customer perception of service quality
- C. The effect of the decision on the quality of the product produced
- D.** The total cost savings to be gained from the decision

*AACSB: Reflective Thinking*  
*AICPA FN: Decision Making*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #37*  
*Learning Objective: 4*

38. Maria Kadison, Controller at Robbins Corporation, became aware that Robbins is in talks with Hallion Company for a friendly merger. Maria discloses this information to her immediate family. No member of Maria's family purchases either Robbins' or Hallion's stock before the merger. Which of the following is True?

- A. Maria has violated the ethical standard of integrity
- B.** Maria has violated the ethical standard of confidentiality
- C. Maria has not violated any ethical standards because the disclosure was made only to her immediate family
- D. Maria has not violated any ethical standards because her immediate family did not profit from the information that she disclosed

*AACSB: Ethics*  
*AICPA BB: Legal*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #38*  
*Learning Objective: 2*

39. Which of the following would be found in a high risk, high return strategic mission?

- A.** Focus on capturing market share
- B. Focus on cutting costs
- C. Need to minimize losses
- D. Focus on finding buyer quickly

*AACSB: Reflective Thinking*  
*AICPA BB: Critical Thinking*  
*AICPA BB: Industry*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #39*  
*Learning Objective: 3*

40. Which of the following would be found in a low risk, low reward strategic mission?

- A. Need to maintain growth
- B. The company must be a major player in the market
- C. Declining market**
- D. Focus on capturing market share

*AACSB: Reflective Thinking*  
*AICPA BB: Critical Thinking*  
*AICPA BB: Industry*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #40*  
*Learning Objective: 3*

41. Which of the following activities would be included in the value chain of a manufacturing company?

- A. Research and Development
- B. Customer Service
- C. Design
- D. All of the above are included in the value chain**

*AACSB: Reflective Thinking*  
*AICPA BB: Critical Thinking*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #41*  
*Learning Objective: 3*

42. A company with a "hold" strategy as its strategic mission would focus on:

- A. Minimizing losses
- B. The market potential of new products
- C. Maintaining its current rate of growth**
- D. Capturing market share

*AACSB: Reflective Thinking*  
*AICPA BB: Critical Thinking*  
*AICPA BB: Industry*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #42*  
*Learning Objective: 3*

43. Microsoft's replies to customers' questions via email would be an example of which element of the value chain?

- A.** Customer Service
- B. Marketing
- C. Design
- D. Supply

*AACSB: Reflective Thinking*  
*AICPA BB: Marketing*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #43*  
*Learning Objective: 3*

44. The delivery of products or services to customers is an example of which element in the value chain?

- A. Supply
- B. Design
- C. Marketing
- D.** Distribution

*AACSB: Reflective Thinking*  
*AICPA BB: Marketing*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #44*  
*Learning Objective: 3*

45. The extended value chain:

- A. Is a set of linked operations or processes that begins with obtaining resources and ends with providing products or services that customers value
- B. Is a related set of tasks, manual or automated, that transforms inputs into identifiable outputs
- C.** Encompasses how companies obtain their resources and distribute their products and services, possibly using the services of other organizations
- D. Is a technique for identifying opportunities for improvement and measuring the effects of proposed improvements by comparing both the costs and benefits of a proposal

*AACSB: Reflective Thinking*  
*AICPA BB: Critical Thinking*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #45*  
*Learning Objective: 3*



46. Which of the following would not be a member of a cross-functional team?

- A. The lead engineer
- B. The Chairman of the Board of Directors**
- C. The cost accounting manager from the accounting department
- D. The supervisor of salespeople in marketing

AACSB: Diversity  
AICPA FN: Decision Making  
Difficulty: Easy  
Hilton - Chapter 01 #46  
Learning Objective: 3

47. Which of the following would not be part of an organization's eight-step process for implementing change?

- A. Identifying the need for change
- B. Reinforcing a culture of more improvement and more effective management
- C. Ensuring that long term achievements are emphasized over short term achievements**
- D. Creating a team to lead and manage the change

AACSB: Reflective Thinking  
AICPA BB: Industry  
Difficulty: Medium  
Hilton - Chapter 01 #47  
Learning Objective: 3

48. The eight-step process for implementing change in a successful organization begins with:

- A. Creating a vision of the change and a strategy for achieving the vision
- B. Identifying the need for change**
- C. Encouraging innovation and removing obstacles to change
- D. Reinforcing a culture of more improvement, better leadership and more effective management

AACSB: Reflective Thinking  
AICPA BB: Industry  
Difficulty: Easy  
Hilton - Chapter 01 #48  
Learning Objective: 3

Use the following to answer questions 49-52:

Perry's Sandwich Department had the following summarized results for the month ending April 30:

	Budget	Actual
Revenues	\$26,000	\$30,000
Total sandwich costs	22,800	26,800
Net departmental income	3,200	3,200

Hilton - Chapter 01

49. As the cost accountant, which single note to the above financial results is most appropriate in the report to management?
- A. The departmental manager is performing to expectations because budgeted income equals actual income
  - B. Revenues are above budget and a bonus based on this increase should be considered
  - C.** Costs as a percentage of revenues are above budget and a further scrutiny of the results might be appropriate
  - D. Costs are 17.5% above budget and the department manager's position should be critically evaluated by senior management

*AACSB: Analytic*  
*AICPA BB: Critical Thinking*  
*Difficulty: Hard*  
*Hilton - Chapter 01 #49*  
*Learning Objective: 4*

50. If the budget were based on the sale of 13,000 sandwiches at \$2.00 each and the actual results reflect the sale of 13,000 sandwiches, identify the most appropriate conclusion in the report to management
- A. If costs as a percentage of revenues had remained at the budgeted level, net income would have declined
  - B. If costs as a percentage of revenues remain at the actual level any increase in revenues would probably be matched by a decrease in departmental net income
  - C.** If costs as a percentage of revenues had remained at the budgeted level, net income would be \$492 above budget
  - D. If costs as a percentage of revenues had remained at the budgeted levels, net income would be \$4,000 above budget

*AACSB: Analytic*  
*AICPA BB: Critical Thinking*  
*Difficulty: Hard*  
*Hilton - Chapter 01 #50*  
*Learning Objective: 4*

51. If an additional 2,000 sandwiches were sold at the regular price, during additional store opening hours, identify the most appropriate conclusion in the report to management.
- A. The budget should be updated to take into account the change
  - B. The additional hours should be canceled, as net income did not increase
  - C. An analysis of the differential costs of the additional store hours should be undertaken prior to drawing a conclusion as to the success of the change
  - D.** Both A and C above

*AACSB: Analytic*  
*AICPA BB: Critical Thinking*  
*Difficulty: Hard*  
*Hilton - Chapter 01 #51*  
*Learning Objective: 4*

52. An example of a qualitative factor that should be considered in the benefit-cost analysis of opening the store for additional hours is:

- A.** The impact of employees' morale because of additional working hours on weekends required
- B. The additional payroll taxes to be paid
- C. Additional hours of the owner's time to be spent in the store
- D. All of the above are considered qualitative factors

*AACSB: Reflective Thinking*  
*AICPA BB: Critical Thinking*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #52*  
*Learning Objective: 4*

Use the following to answer questions 53-55:

In the Management's Discussion and Analysis section of its 2005 annual report, the CEO of McDonald's Corporation discussed the strategic direction and financial performance of the company by referring to the comprehensive revitalization plan initiated by the company in 2003:

"in 2003, the Company initiated a comprehensive revitalization plan focused on maximizing customer satisfaction and strengthening our financial position. We redefined our strategy to emphasize growth through adding more customers to existing restaurants and aligned the System around our customer- focused Plan to Win. We streamlined processes such as new product development and restaurant operations, improved our training programs, and implemented performance measures, including a restaurant review and measurement process, to enable and motivate franchisees and restaurant employees to serve customers better."

Among the improvements cited were:

- (1) Improving the taste of many of the core offerings
- (2) Streamlining processes such as new product development and restaurant operations
- (3) Implemented performance measures to enable and motivate franchises to service customers better
- (4) Achieved high levels of customer awareness worldwide

During 2005, McDonald's comparable sales increased 3.9%, earnings per share increased from \$1.79 to \$2.04, cash from operations increased \$433 million to \$4.3 billion and the company repurchased \$1.2billion in common stock. (McDonald's 2005 Annual Report)

*Hilton - Chapter 01*

53. McDonald's strategic mission could best be described as:

- A. Build
- B.** Hold
- C. Harvest
- D. Divest

*AACSB: Reflective Thinking*  
*AICPA BB: Critical Thinking*  
*AICPA BB: Industry*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #53*  
*Learning Objective: 3*

54. Which of the improvements cited by McDonald's is an example of the extended value chain?

- A. Number 1
- B. Number 2
- C. Number 3
- D.** Number 4

*AACSB: Reflective Thinking*  
*AICPA BB: Critical Thinking*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #54*  
*Learning Objective: 3*

55. Improvement number 3 is an example of which link in the value chain?

- A. Supply
- B. Research and Development
- C.** Customer Service
- D. Production

*AACSB: Reflective Thinking*  
*AICPA BB: Critical Thinking*  
*Difficulty: Easy*  
*Hilton - Chapter 01 #55*  
*Learning Objective: 3*

56. Match the following operations with appropriate elements of an organization's value chain.

Value Chain Element

- (A) Research and Development
- (B) Design
- (C) Supply
- (D) Production
- (E) Marketing
- (F) Distribution
- (G) Customer Service

- \_\_\_\_ (1) Crate and Barrel's replies to customers' questions on merchandise.
- \_\_\_\_ (2) Updating Pottery Barn's electronic Internet catalogue of sporting goods and spring merchandise.
- \_\_\_\_ (3) Development of new software applications at Oracle.
- \_\_\_\_ (4) Inspection of incoming chip parts at IBM.
- \_\_\_\_ (5) Contracting with Federal Express to ship computers to customers at Gateway.
- \_\_\_\_ (6) Writing of software programs at IBM's Lotus Division.
- \_\_\_\_ (7) Creation of new movie ideas at Paramount Pictures

(1) G, (2) E, (3) B, (4) C, (5) F, (6) D, (7) A

*AACSB: Reflective Thinking*  
*AICPA BB: Critical Thinking*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #56*  
*Learning Objective: 3*

57. C & P Frosties is a local ice cream shop. The company currently is showing an operating loss, as evidenced by the income statement below:

Sales	\$75,000
Costs:	
Food supplies	20,000
Labor	16,000
Utilities	4,000
Rent	12,000
Other	4,000
Manager's salary	25,000
Total costs	81,000
Profit(loss)	(\$6,000 )

The President of the company is considering adding sandwiches to the menu. Sales will be expected to increase by \$60,000. The cost of sandwich supplies would be \$30,000. Labor costs would increase 40% and other costs 10%. The current manager will continue to manage the operation.

Required:

- Prepare a quantitative analysis of the decision to add sandwiches to the menu.
- What qualitative considerations should the company consider in this decision?

(a)

	<u>Current</u>	<u>Differential</u>	<u>Total</u>
Sales	\$75,000	\$60,000	\$135,000
Costs:			
Food supplies	20,000	30,000	50,000
Labor	16,000	6,400	22,400
Utilities	4,000	-	4,000
Rent	12,000	-	12,000
Other	4,000	400	4,400
Manager's salary	25,000	-	25,000
Total costs	81,000	36,800	117,800
Profit(loss)	(\$6,000 )	\$23,200	\$17,200

(b) Qualitative considerations should include the impact on the current manager's morale with the large increase in responsibility, the ability of the company to successfully integrate the new menu and the response of customers to the addition of sandwiches in an ice cream shop.

58. The Callahan family currently lives in a suburb of a major city. They have a lovely home close to major routes of transportation. Both Mr. and Mrs. Callahan have convenient commutes of 30 minutes or less. Because the school system in their town does not have a quality reputation, they currently send their daughter to private school, conveniently located less than one mile from their home. The family's current monthly living expenses are listed below:

	Monthly Budget
Mortgage, including taxes and insurance	\$ 5,000
Other utilities, including water, heat and telephone	500
Costs of running automobiles	800
Cost of private school	2,000
<b>Total monthly budget</b>	<b>\$8,300</b>

The Callahans are considering moving to a town approximately 20 minutes away. Because of the desirability of the local schools and strict zoning, housing is very expensive in this town. Their daughter would attend public schools. The Facts estimate that their monthly mortgage, taxes and insurance would increase to \$7,000 per month, while the cost of running automobiles would increase 20% and other utilities 10%. Mortgage interest costs are tax deductible and the Facts are in the 25% tax bracket. Assume that \$700 of the increase in their monthly budget is for mortgage interest. What are the costs and benefits of moving? Which can be quantified and which cannot?

The Callahans should recognize that their total household expenses will not increase significantly. The increased mortgage will be offset by the savings on private school. In addition, since the mortgage is tax deductible and the school is not, the savings in taxes will just about offset the increased monthly costs:

Additional mortgage cost	\$2,000
Private school savings	(2,000)
Tax savings (700 * .25)	(175)
Increased auto cost \$800 *.2	160
Increased utilities \$500 *.1	50
Net increase (decrease)	35

Other costs and benefits are not measurable. The Callahans are assuming that their daughter will receive the same quality of education in the public school. Commuting time will increase by 40 minutes per day for both Mr. and Mrs. Callahan. The convenience of being located very close to a major route of transportation will no longer be theirs.

59. The Linden chain of ladies' fashion wear wishes to appraise its security system in an effort to reduce pilferage for the coming period. The following details are estimated for the current period:

Sales revenues	\$ 20,000,000	
Cost of goods sold	13,000,000	
Pilferage at retail value	400,000	(estimated and not
		included in Cost of goods sold)

Ignoring income taxes and assuming that cost of goods sold is a constant percentage of sales, calculate the maximum amount that would be economically optimal to spend on a security system if pilferage could be completely eliminated.

Cost of pilferage \$400,000 x .65 = \$260,000 (maximum amount to be spent)

AACSB: Analytical Skills  
AICPA BB: Critical Thinking  
Difficulty: Medium  
Hilton - Chapter 01 #59  
Learning Objective: 4

60. Home Retail, Inc. wishes to appraise its security system in an effort to reduce pilferage for the coming period. The following details are estimated for the current period:

Sales revenues	15,000,000
Cost of goods sold	9,000,000
Pilferage at retail value	500,000
	(estimated and not included
	in Cost of goods sold)

Ignoring income taxes and assuming that cost of goods sold is a constant percentage of sales, calculate the maximum amount that would be economically optimal to spend on a security system if pilferage could be completely eliminated.

$$\text{Cost percentage} = \frac{\$9,000,000}{15,000,000} = 60\%$$

Cost of pilferage \$500,000 x .60 = \$300,000 (maximum amount to be spent)

AACSB: Analytical Skills  
AICPA BB: Critical Thinking  
Difficulty: Medium  
Hilton - Chapter 01 #60  
Learning Objective: 4

61. The Cut Stop is a small but prosperous hair cutting salon. Kathy Harvey, the manager of the salon, has been asked by several clients if she will ever offer other "hair related" services (e.g., perm, dye, etc). After careful thought, Harvey is considering expanding her offerings. However, in order to do so, she will have to hire one additional stylist at a salary of \$26,000 per year. Other expenses will increase as follows: rent by 20%, supplies and utilities by 25%, and miscellaneous expenses by 10%. Her revenues from additional services are likely to be \$55,000 for the next year (i.e., 2007). The Cut Stop's income statement for the most recent year is presented below.

The Cut Stop Income Statement for the Year Ended December 2006		
Sales Revenues		\$220,000
Costs:		
Labor	52,000	
Utilities	12,000	
Supplies	45,000	
Rent	18,000	
Miscellaneous	5,000	
Manager's salary	<u>30,000</u>	<u>162,000</u>
Operating profit (loss)		\$58,000

Required:

- Based on your financial analysis, should Kathy Harvey go ahead with the expansion?
- What other factors must Harvey consider before making a final decision?

(a) The financial implications of expanding the services offered by The Cut Stop are as follows:

	Hair cutting only		Additional services	Combined
Sales revenues	\$220,000		\$55,000	\$275,000
Costs				
Labor	52,000		26,000	78,000
Utilities	12,000	@	3,000	15,000
Supplies	45,000	#	11,250	56,250
Rent	18,000	&	3,600	21,600
Miscellaneous	5,000	*	500	5,500
Manager's salary	<u>30,000</u>			<u>30,000</u>
Operating profit (loss)	\$58,000		\$10,650	\$68,650

@ 25% of \$12,000

# 25% of \$45,000

& 20% of \$18,000

\* 10% of \$ 5,000

Based on the financial analysis, Kathy Harvey should go ahead with the expansion because her profits will increase by \$10,650 or 15.4%. However, the assumption underlying her decision is that she considers the estimates to be reliable.

(b) Other factors that Harvey might consider are as follows:

Expansion of the business may bring in new customers who may ask for a haircut in addition to other services. This will increase revenues from hair cutting also.

Expansion may also take away some customers who liked the small size of the salon (provides a more relaxed feeling.)

Offering a variety of services will allow Harvey to quote package prices on different combinations of services. Kathy will have more responsibilities in overseeing the expansion, additional employees and more customers reducing the quality and quantity of personal time available.



*AACSB: Analytic*  
*AICPA BB: Critical Thinking*  
*AICPA FN: Decision Making*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #61*  
*Learning Objective: 1*  
*Learning Objective: 4*

62. Anika Linden, the Vice-President for Human Resources in Educational Toys, Inc. was concerned about a recent memo she had recently received from the CEO's office regarding the possibility of outsourcing the payroll function to Salary Experts, a growing provider of a variety of human resource services. She was shocked that the CEO's office had discussed this matter with the Board of Directors, but failed to consult her. Linden was preparing for a meeting with the CEO. In reading the memo and its attachments, Linden observed the following comparison of costs in a report prepared by the controller's office:

*Payroll department expenses:*

Salaries of employees	\$210,000
Share of utilities	75,000
Share of building rent	39,350
Manager's salary	69,000
Computers and supplies	26,000
Other department expenses	<u>20,000</u>
Total annual expenses	\$439,350

Linden also noted that Salary Experts quoted a fixed fee of \$125,000 and variable processing costs of \$7.50 per employee transaction. She did not believe that the company will actually save money by outsourcing the payroll function. For one, she did not think that the company will actually save all of the above mentioned amounts. She knew that the payroll department manager could not be removed from the company because he had to oversee the payroll function and serve as a liaison with the outside company. However, all other employees in the department would likely not be required.

Required:

(a) Assume Educational Toys has 14,000 employees on its payroll. Can the company save money by outsourcing the payroll function?

(b) What are the pros and cons of outsourcing the payroll function?

(a) Outsourcing the payroll function will involve an out of pocket expense of \$230,000( $\$125,000 + (\$7.50 \times 14,000)$ ). Moreover, some of the payroll department's costs will continue to be incurred by the company:

• Utilities	\$75,000	
• Rent	39,350	
• Manager's salary	<u>69,000</u>	\$183,350

The total cost associated with outsourcing the function will be \$413,350 compared to \$439,350 if the payroll function is not outsourced. Therefore, Educational Toys, Inc. can save exactly \$26,000 by outsourcing the payroll function. More money might be saved if there are savings in utilities. A portion of the unavoidable costs could also be recovered if this space is sublet or put to productive use in some other manner.

(b) Several considerations must be made before deciding to outsource the payroll function.

- Efficiency of the outside party vis-a-vis carrying out the function internally.
- In some cases, it may be worthwhile to outsource certain activities.
- Employee morale due to layoffs (with possible implications on the reputation of the company).
- Possibility of outsourcing other functions and their repercussions on employees.
- Sensitivity of the nature of the information being handled by individuals external to the organization.

*AACSB: Analytic*  
*AICPA BB: Critical Thinking*  
*AICPA FN: Decision Making*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #62*  
*Learning Objective: 4*

63. Julie King, the production manager of Mussell Corporation is frustrated by the company's policy of not scrapping defective units but reworking them. She has pointed out several times to senior management that some units are beyond rework and should be scrapped. According to her, in most cases, it would be cheaper to scrap and build a new unit from scratch rather than trying to rework a defective unit. However, Paul Oasis, the CEO, is not convinced. She wants her controller, Mandie Castagna, to gather some information. After researching the problem, Castagna provides the following information:

Selling price:	\$132	per unit
Manufacturing costs:		
Direct materials	27	
Direct labor	32	
Variable overhead	24	
Variable marketing costs	10	
Fixed overhead	32	
Reworking costs:		
Materials:	\$ 25	
Labor:	48	
Direct machining costs:	35	

Castagna also observes that reworking a defective product consumes more labor time than making a unit from scratch. As a result, for every three units reworked, Mussell forgoes the production and sale of two units.

Required:

- (a) Do you agree with Julie King that it is cheaper to scrap than rework a defective unit? Show your computations.
- (b) How can the cost information generated by Castagna be useful in reducing the number of defectives?

(a) The costs of scrapping versus reworking can be determined as follows:

	Scrap	Rework
Sales revenue	\$ 0	\$ 132
Relevant costs	0	(108) <sup>1</sup>
Contribution margin lost	0	(26) <sup>2</sup>
Net benefit (loss)	\$ 0	\$ (2)

1 Given in the problem (\$25 + \$48 + \$35)

2 Contribution margin per unit is \$39 (\$132 - \$27 - \$32 - \$24 - \$10). Opportunity cost is \$26 as follows:  $\$39 \times 2 = \$78 \div 3 = \$26$

From the computations, it is clear that scrapping is cheaper. Julie King is therefore correct.

(b) The cost information generated by Castagna can be useful in reducing the number of defectives in several ways. First, it gets the attention of management by quantifying the impact of poor quality on profits (senior managers like to see the financial implications of nonfinancial indicators). Next, it focuses the attention of managers, engineers and even operators to the sources of these costs. Once the magnitude of the problem is understood and the sources of costs identified, the next step is to find ways to identify the sources of the quality problem (i.e., why are these defectives being produced). Then the company can use total quality management principles to improve processes that cause defective products.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Decision Making

Difficulty: Medium

Hilton - Chapter 01 #63

Learning Objective: 1

Learning Objective: 4

64. Laurie Riley is a purchasing agent for a motorcycle manufacturer. Laurie is evaluating two potential suppliers of seats for the company's motorcycles. One supplier (A) quotes a price of \$165 per seat and assures 100% quality and delivery standards. The second supplier (B) quotes a price of \$135 per seat but does not give any written assurances on quality or delivery. Riley is not sure which supplier should be awarded the contract. Assume you are the management accountant for the motorcycle manufacturer. Riley asks you to prepare an estimate of the related costs of buying the seats from supplier B. She tells you that the estimate is needed because unless dollar estimates are attached to nonfinancial factors, such as lost production costs, her supervisor will not give it full attention. Riley provides you with the following information:

- Production output is 2,000 motorcycles per year based on 250 production days a year.
- Production time per day is 8 hours at a cost of \$4,000 per hour to run the production line.
- Lost production time due to poor quality is 1%.
- Satisfied customers purchase, on average, three motorcycles during a lifetime.
- Satisfied customers recommend the product, on average, to 5 other people.
- Marketing estimates that using the seat from supplier B will result in 5 lost customers per year from repeat business and referrals.
- Average contribution margin per motorcycle is \$5,000.

Required:

Estimate the costs of buying motorcycle seats from supplier B. (*Note:* This problem requires you to think creatively and make reasonable estimates; therefore, there is more than one correct answer.)

There is more than one right answer to this problem. The response to this problem should show estimates for: 1) lost revenue from repeat business and referrals from satisfied customers and 2) cost associated with re-work and lost production. Students may experience a level of frustration in completing this problem. However, this is part of the process in learning how difficult it may be to make financial estimates regarding opportunity costs. Also, it should show that purchasing a higher quality product at a greater cost saves money in the long run.

Annual costs of the seat are as follows:

If purchased from supplier A,  $\$165 \times 2,000 \text{ seats} = \$330,000$

If purchased from supplier B,  $\$135 \times 2,000 \text{ seats} = \$270,000$

The difference in purchase costs is \$60,000 in favor of supplier B.

However, this analysis does not include opportunity costs of purchasing from supplier B. These costs are as follows:

Lost customers from repeat business and referrals ( $5 \text{ customers} \times \$5,000 \text{ contribution margin}$ ) = \$25,000.

Lost production time ( $1\% \times 250 \text{ days} \times 8 \text{ hours} \times \$4,000 \text{ per hour}$ ) = \$80,000.

The above analysis shows that the company could experience an increase in costs (due to lost opportunities) of \$45,000 ( $\$25,000 + \$80,000 - \$60,000$ ).

Note:

Some students may analyze the costs associated with lost production time as the contribution margin lost because of not producing motorcycles.

Lost time =  $1\% \times 250 \text{ days} \times 8 \text{ hours} = 20 \text{ hours}$

Assuming that it takes one hour to assemble a motorcycle, the company loses contribution margin of \$100,000 from the possible sale of 20 additional motorcycles ( $\$5,000 \times 20 \text{ motorcycles}$ ). In this situation, the total cost associated with purchasing from supplier B increases to \$65,000.

*AACSB: Analytic*  
*AICPA BB: Critical Thinking*  
*AICPA FN: Decision Making*  
*Difficulty: Hard*  
*Hilton - Chapter 01 #64*  
*Learning Objective: 1*  
*Learning Objective: 4*

65. Thompson Metal Corporation (TMC) supplies various types of machine tools to manufacturing companies. TMC has always paid a lot of attention to the quality of its products. Recently, an outside supplier has approached TMC to supply an important and intricate component of one of its more advanced tools that TMC has been manufacturing in-house. Sam Weiss, a junior accountant at TMC, has collected the following information regarding this proposal.

The cost of manufacturing one unit of this component internally are as follows:

Direct materials:	\$29.60	
Direct labor:	13.00	
Variable overhead:	19.50	(@150% of direct labor cost)
Fixed overhead:	26.00	(@200% of direct labor cost)
Total cost:	\$88.10	

The outside supplier has quoted a price of \$90 per unit for supplying this component. The following is a conversation that took place among the manufacturing manager (Dana Rice), buyer (Emily Scanlon) and Sam Weiss.

Weiss: I think that we should continue to manufacture internally because we can save \$1.90 per unit on this component.

Rice: According to your report, we would save \$1.90 per unit, but I do not agree with those numbers.

Weiss: What do you mean? I have followed the same costing guidelines this company has used for years. I have even cross-checked my numbers with historical data and know for sure that the overhead rates which I have used are correct.

Rice: I am sure you have done your job thoroughly, but I think that our costing system is archaic. This component is complex and difficult to manufacture. I believe that our overhead allocation method does not accurately capture the production difficulties and the additional resources that are devoted to the manufacture of this component. For example, a significant portion of our quality problems are due to this component. We spend close to a third of our quality inspection time on just this component alone, but that is not reflected. These quality problems cause delays in getting this component to the assembly department, and that causes a delay in getting the final product to the customers. Many of our customers are expecting just-in-time deliveries, and they get upset when we're late.

Scanlon: I know that the supplier that has approached us has a strong reputation for quality. Therefore, we can rest assured that we will have negligible quality problems.

Rice: Sam, your report does not consider this additional benefit from buying outside. I would appreciate if you can rework your numbers to better reflect the true costs associated with manufacturing this component internally.

Required:

- Assume the role of Sam Weiss. What are the different elements of costs that are likely to be associated with the manufacture of the component? Does the current costing system capture these costs?
- Recommend improvements in the costing system.
- How can Weiss quantify "qualitative" benefits such as quality and on-time delivery?

(a) Several costs are likely to be incurred to manufacture the component. Examples include:

- direct and indirect materials
- direct and indirect labor
- machining
- inspecting
- reworking
- packaging
- procurement of materials
- design and engineering

The current costing system appears to capture direct materials and direct labor costs separately, and lump all other costs into overhead. It is also not clear as to what items are included as part of overhead. Moreover, the current costing system seems to assume that all products consume overhead resources in a fixed ratio, thereby ignoring that the manufacture of complex components would likely consume more resources than the level of resources consumed by simple components. Moreover, the current costing system fails to identify the additional costs due to the quality problems associated with this component.

(b) The most important change to the costing system is better tracing of costs and identification of cost drivers. By separating the costs of machining, inspection, reworking, packaging, procurement, design and engineering costs, TMC will be able to attach costs to products (or components) based on their consumption of the different resources. Such a system will allow managers to more clearly identify all costs and benefits associated with buying the component from an outside supplier versus continuing to manufacture it internally.

(c) Factors such as quality and on-time delivery are becoming important sources of competitive advantage. Unfortunately, very few organizations are attempting to "quantify" these benefits. The costs associated with poor quality can be tracked by recording the costs of additional inspection, reworking, scrap and warranty. The notion of Cost of Quality (COQ) has been adopted by several companies and is providing valuable information for managers to make process improvements. Similarly, costs associated with late delivery because of poor processes can be tracked. These would include expediting costs in order to meet delivery schedules and potential lost sales due to poor on-time delivery performance.



66. Streamline Shoe Company, a manufacturer of women's shoes, recently implemented a quality improvement program aimed at streamlining the manufacturing process. Carl Silverman, an industrial engineer and a resident expert on process improvement, was assigned the task of implementing the program.

Silverman's first task was to educate all the employees involved with the production process. He sent a memo to representatives in product design and development, materials management (including purchasing), marketing, distribution, customer service and accounting, in addition to those in the production department, inviting them to attend an information session on the improvement program.

He began the meeting by thanking all those who were present (over 35 in number) and spent the first hour explaining the need for such a program. Soon after, the attendees were engaged in a discussion. Several questions were raised during the discussion. Among these, three questions stood out. What is the need for including members from design, marketing, and other functional areas when the improvement program's focus is on streamlining the manufacturing process? What is the role of the cost management expert in this program? Finally, why should the machine operators be involved, as they are not engineers?

Required:

Consider the three questions that stood out in the discussion. Assume the role of Carl Silverman and prepare a response addressing the questions.

A process improvement program typically cuts across departmental boundaries by extending through most of the components of the value chain of a company. It is important to recognize that decisions made in the upstream activities such as product design and development affect downstream activities (i.e., manufacturing, distribution and customer service). Individuals from these downstream functions can make design engineers aware of the implications of design decisions on their respective activities. For example, the production engineer can inform the design engineer that certain designs are more compatible with the existing assembly line than others (the latter will cost more to produce). Therefore, the inclusion of individuals from different functional areas is to educate and inform each other.

The cost management expert assumes a very significant role in a process improvement program by providing cost-benefit information pertaining to different improvement initiatives. Once again, this activity adds value to the process improvement program because the cost manager can identify the cost implications of upstream activities on the downstream activities. For example, a product designed with common parts simplifies the purchasing activity, production activity and customer service activity (if and when required---e.g., repairs are easy).

The involvement of machine operators in such an improvement initiative is critical because the operator is closest to the process and therefore is likely to be very knowledgeable about how the process works.

Consequently, the operator can visualize problems and point them out to other individuals in the team. Many operators might also be in a position to offer suggestions for improvements. The involvement of operators in improvement teams is becoming more common in the modern business environment.

67. Consider the following management activities:

- Choose the organization's long-term strategy
- Plan and organize the use of resources into efficient operations
- Implement plans and organizational change
- Measure and report results
- Define the organization's scale and scope of operations

Required: (a) Identify the sequence in which the decisions must be carried out. Why is it important to carry out these activities sequentially?

(b) How can an effective cost management system support the above activities?

(a) The sequence of activities is as follows:

- Choose the organization's long-term strategy
- Define the organization's scale and scope of operations
- Plan and organize the use of resources into efficient operations
- Implement plans and organizational change
- Measure and report results

It is important to carry out the above activities sequentially because managers must follow a logical step-by-step approach in successfully managing an organization. For example, selecting the long-term strategy provides direction to managers regarding how to achieve an organization's objectives. Without a clear definition of this direction, it would not make sense to try to define the scale and scope of operations. In the absence of a sequential approach, there is a significant chance of decisions being made in a haphazard manner resulting in chaos.

(b) An effective cost management system can provide useful support to managers in carrying out the above activities. First of all, a cost management system can provide information about an organization's objectives, which will help in determining strategy. The system can gather information about the cost implications of different levels of scale and scope of operations and the efficiencies associated with these levels. It can then help in planning and organizing the use of resources by reporting on the cost of alternative resources, products and services. Finally, it can report the actual results of the actions taken by management in terms of how well individual and organizational objectives are achieved. This feedback can be used by management to modify strategies and/or actions as necessary.

68. Greg Piff, a new assistant sales manager was faced with a dilemma. His supervisor, Kathleen Holbrook, instructed him to prepare an invoice for \$300,000 in the name of General Builders, a regular customer. Upon refusing to comply with the request because no order was received, Holbrook explained to Piff that this was normal practice during the end of the year in order to meet or exceed the annual sales target. Holbrook also clarified that the goods will not be physically delivered to the customer and a reverse entry will be made in the accounting records during the next year.

Piff is unsure about what is to be done because the amount is significant. He recollected that Holbrook had promised to give him a favorable review if he complied with the instruction. Piff has come to seek your advice as a professional, regarding the proper way to handle the situation in order to minimize the effects of any repercussions his actions may have.

Required:

- (a) Does Greg have an ethical responsibility to take a course of action?
- (b) What course of action would you take? What course of action should Piff take?
- (c) Why is it important that such actions are curbed?

(a) There are three issues that may constitute unethical behavior:

- Instructing a subordinate to prepare a "fake" invoice
- Manipulating the accounting records
- Offering an incentive to behave unethically

The first two issues might fall under the category of misrepresentation and misstatement of facts. The third issue deals with integrity.

As a professional, Greg has an ethical responsibility to take some action because the actions of his supervisor, Kathleen Holbrook, would violate any professional code of ethics (e.g., the code established by the Institute of Management Accountants).

(b) You could take several alternative courses of action:

- If you are at the same level as Piff's supervisor, you could approach her directly and point out that she is following a wrong practice.
- You could bring this matter to the attention of your supervisor or some other higher authority and let that individual take appropriate action.

How bold you can be might also depend on how any of your potential actions might affect your employment in the organization.

With respect to Piff, he may have limited options because he is directly under Holbrook's supervision and has been warned about his performance review if he fails to comply with the request. First of all, he should explore whether this practice is prevalent in other parts of the organization (e.g., other divisions or sales territories managed by other supervisors). If it is not, he could approach Holbrook and inform her that this practice is not the norm in the organization. However, if it is practiced in other areas, he might want to approach a higher authority (e.g., vice-president of sales and marketing for the entire organization) and hope that the higher authority recognizes the seriousness of the problem. His last resort is to resign from the company to maintain his integrity.

(c) Condoning such actions may lead employees to believe that management is not serious about instilling ethical behavior (management only provides lip service). Consequently, two problems can occur. First, this cancer can spread throughout the organization as more and more people start behaving unethically just to "fit" within the organization. Second, honest employees will be frustrated and might be forced to quit their jobs.

*AACSB: Ethics*

*AICPA BB: Legal*

*Difficulty: Medium*

*Hilton - Chapter 01 #68*

*Learning Objective: 2*

69. Cleary Yard Equipment Corporation manufactures lawn mowers and snow blowers. It also manufactures engines that are used by the Lawn Mower Assembly Division (LMAD). The Engine Division (ED) also sells about 40% of its output to the outside market (these are multipurpose engines). Its annual capacity is 150,000 units and annual output 135,000 units. All engines sold internally to the LMAD are priced at cost plus 20% markup.

In January 2007, the Snow Blower Assembly Division (SBAD) approached the ED to 'buy' 20,000 engines. Diane Holinger, the controller of ED, computed the costs of manufacturing these engines as follows:

	<u>Total</u>	<u>Per unit</u>
Materials	\$300,000	<u>\$ 15.00</u>
Labor	400,000	20.00
Special equipment	36,000	1.80
Quality inspection	24,000	1.20
Other manufacturing costs	<u>350,000</u>	<u>17.50</u>
Total costs	<u>\$ 1,110,000</u>	<u>\$ 55.50</u>

Holinger quoted a price of \$66.60 for each engine transferred to the SBAD. John Hargreaves, the manager of SBAD, was furious to note that the ED was "trying to make money off a sister division." He argued that the price must include only the cost of materials, as all other costs will be incurred irrespective of whether or not SBAD places the order for 20,000 engines. Matt Hall, the production manager of ED, pointed out that the special equipment will be purchased only for fulfilling this internal order. Moreover, he argued that inspection must also be done just like on all other engines; therefore, the inspection costs must also be included. Labor is paid a flat monthly salary. Other manufacturing costs include both variable and fixed components (in roughly equal proportion).

Required:

- Given that excess capacity exists, what is the minimum price that the ED must charge to the SBAD?
- What are the pros and cons of internal sourcing?

(a) The costs that are explicitly associated with the manufacture of engines required by the SBAD are as follows:

Materials:	\$300,000	
Special equipment:	36,000	
Inspection:	24,000	
Other manufacturing costs:	<u>175,000</u>	
Total	\$535,000	\$26.75 per unit

Therefore, the minimum price at which the ED can 'sell' to the SBAD would be \$32.10 ( $\$26.75 \times 1.20$ ). It is important to note that excess capacity exists; therefore, the ED does not have any opportunity costs associated with the SBAD's order.

(b) The pros of internal sourcing are as follows:

- Productive use of excess capacity.
- Potential cost savings
- Protection of proprietary knowledge.

The cons of internal sourcing are as follows:

- Setting internal pricing policies and refereeing disputes.
- Supporting inefficient operations with artificially high internal prices.

It is important to note that any policy stated as "cost plus 20 percent" is asking for trouble, because "cost" is undefined. If market prices are available, the company probably should use these for internal sales, with a policy of sourcing internally at the market price. Using cost-based internal prices may be necessary, but creates complications of creating the price that motivates managers to benefit themselves and the company as a whole.

70. In September, 2006, Paul Otellini, CEO of Intel Inc., a computer chipmaker, announced the company's plan to eliminate 10,000 jobs, approximately 10% of the company's worldwide workforce of 100,000 employees. Many of the job cuts would be in the marketing area, as company studies concluded that the company's ratio of marketing personnel to salespeople was higher than that of competitors. This move follows the layoff of 1,000 managers in July, 2006. The strategic moves were in response to Intel's lost market share to rival Advanced Micro Devices in recent years and 57% drop in net income and 13% drop in revenues from the previous fiscal year. (News.Com. September 5, 2006)

Required:

- (a) Describe the quantitative aspects of Intel's decision.
- (b) Describe the qualitative aspects of Intel's decision.
- (c) What step in Intel's value chain is impacted by this decision?

(a) The decision to lay off 10% of the highly-paid marketing staff and managers workers reflects the quantitative aspect of this decision. The company should experience significant cost savings as result of the layoffs. The company would expect significant savings in selling and administrative expenses in subsequent financial results.

(b) The qualitative aspects of this decision include employee morale, as employees find themselves with more responsibility. In addition, since a significant number of managerial positions are being cut, the company should be concerned that all responsibilities previously carried out by the former managers are covered by the remaining staff. The company should also be concerned that the quality of its marketing does not negatively impact sales.

(c) The decision to lay off employees affects the Marketing step in the value chain.

*AACSB: Reflective Thinking*  
*AICPA BB: Marketing*  
*AICPA FN: Decision Making*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #70*  
*Learning Objective: 3*  
*Learning Objective: 4*

71. In a presentation to the investment community, Sam Palmisano, CEO of IBM Corporation, stated: "We intend to continue to take share, as we have in the past two or three years, in our core businesses." Palmisano contended that the category of business-process transformation services, such as customer support, human resources, and other administrative overhead, represents an untapped market of \$500 billion dollars if businesses outsourced these functions to companies like IBM. IBM's expressed goal is to capture 10% of this new market. Palmisano also cited new business opportunities in information technology. The company's new chief financial officer, John Loughridge, stated that IBM's goal was to achieve high-single digit annual percentage gains in sales and greater than 10% yearly increases in earnings per share. (Source: Barron's: May 24, 2004)

Required:

(a) Does the strategy described by IBM's management fall into the build, hold, harvest or divest category of strategic missions? Explain your answer with specific examples related to the general characteristics of that category of strategic mission.

(b) Identify the types of risks and rewards normally encountered by a company with the strategic mission described by IBM's management.

(a) The goals and objectives described by IBM fall into the "build" strategy. This strategy requires the organization to identify new markets with high growth potential, to focus on capturing market share, to be an early entrant into new markets. IBM is hoping to be among the first to offer such support services, to attract new customers, capture a large share of a new, growing market, and earn high rewards.

(b) The "build" strategy is risky because the potentially high rewards will attract competitors who also want to gain from this potentially lucrative market. If IBM is wrong or late, the company could lose customers, reputation, and investment in new products and services.

*AICPA BB: Industry*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #71*  
*Learning Objective: 1*  
*Learning Objective: 3*

72. Briefly explain this statement: Cost Management is important to organizations because it is more than measuring and reporting product and service costs. It is a philosophy, an attitude and a set of techniques to create more value at lower costs.

Cost management is a philosophy of improvement because it promotes the idea of continually finding ways to help organizations make the right decisions to create customer value at lower cost.

It is an attitude that all of the costs of products or services result from management decisions; cost managers are active in improving products and reducing costs. It is a set of reliable techniques because cost managers must consider tradeoffs between the benefits of new ideas and suggestions and their costs.

*AACSB: Reflective Thinking*  
*Difficulty: Medium*  
*Hilton - Chapter 01 #72*  
*Learning Objective: 1*



## c1 Summary

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AICPA BB: Critical Thinking	29
AICPA BB: Global	1
AICPA BB: Industry	13
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