Chapter 15--Managing Costs and Uncertainty

LEARNING OBJECTIVES

LO 1	What are the functions of an effective cost control system?
LO 2	What are the generic approaches to cost control?
LO 3	What factors cause costs to change from period to period or to deviate from expectations?
LO 4	What are the two primary types of fixed costs, and what are the characteristics of each?
LO 5	What are the typical approaches to controlling discretionary fixed costs?
LO 6	What are the objectives managers strive to achieve in managing cash?
LO 7	How is technology reducing costs of supply chain transactions?
LO 8	Why is uncertainty greater in dealing with future events than past events?
LO 9	What are the four generic approaches to managing uncertainty?

QUESTION GRID

True/False

	Difficulty Level			Learning Objectives								
	Easy	Moderate	Difficult	LO 1	LO 2	LO 3	LO 4	LO 5	LO 6	LO 7	LO 8	LO 9
1	x			x								
2		x			x							
3	x					x						
4		x				x						
5	x					x						
6	x						x					
7		x					x					
8		x						x				
9		x						x				
10		x						x				
11	x							x				
12	x							x				
13	x								x			
14		x							x			
15		x							x			
16		x							x			
17		x							x			
18	x									x		
19		x										x
20		x										x

Completion

	Difficulty Level			Learning Objectives								
	Easy	Moderate	Difficult	LO 1	LO 2	LO 3	LO 4	LO 5	LO 6	LO 7	LO 8	LO 9
1		x				x						
2		x				x						
3		x				x						
4	x						x					
5		x						x				
6		x						x				
7	x								x			
8	x								x			
9		x										x
10		x										x

Multiple Choice

	Difficulty Level			Learning Objectives								
	Easy	Moderate	Difficult	LO 1	LO 2	LO 3	LO 4	LO 5	LO 6	LO 7	LO 8	LO 9
1	x			x								
2	x					x						
3	x			x								
4	x				x							
5	x					x						
6	x					x						
7	x					x						
8	x					x						
9	x					x						
10		x				x						
11	x						x					
12	x						x					
13	x						x					
14	x						x					
15	x						x					
16	x						x					
17		x						x				
18		x						x				
19	x							x				
20	x							x				
21		x						x				
22	x							x				
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43	x							x				
44	x							x				
45	x							x				
46	x							x				
47	x							x				
48		x						x				
49		x						x				
50		x						x				
51		x						x				
52	x											x
53	x											x
54	x											x
55		x										x

Short-Answer

	Difficulty Level			Learning Objectives								
	Easy	Moderate	Difficult	LO 1	LO 2	LO 3	LO 4	LO 5	LO 6	LO 7	LO 8	LO 9
1		x						x				
2		x					x					
3		x						x				
4		x						x				
5		x						x				
6		x			x							
7		x				x						
8	x								x			
9		x										x
10		x									x	

Problem

	Difficulty Level			Learning Objectives								
	Easy	Moderate	Difficult	LO 1	LO 2	LO 3	LO 4	LO 5	LO 6	LO 7	LO 8	LO 9
1		x						x				
2		x						x				
3		x						x				
4		x						x				
5		x						x				
6		x						x				

TRUE/FALSE

1. Effective cost control begins in the planning stage of the management cycle.

   ANS: T DIF: Easy OBJ: 15-1

2. For cost control purposes, actual costs should be compared to prior period costs.

   ANS: F DIF: Moderate OBJ: 15-2

3. A flexible budget compares actual costs to budgeted costs at several activity levels

   ANS: T DIF: Easy OBJ: 15-3

4. When a CPA firm uses taped lectures rather than live presentations for continuing education, it is engaging in a cost reduction strategy.

   ANS: T DIF: Moderate OBJ: 15-3

5. Cost control should be viewed as a short-term process.

   ANS: F DIF: Easy OBJ: 15-3

6. Property taxes on an organization's plant building are considered as committed costs.

   ANS: T DIF: Easy OBJ: 15-4

7. Depreciation of fixed assets is considered to be a discretionary cost.

   ANS: F DIF: Moderate OBJ: 15-4

8. The benefits of discretionary costs are usually measurable in monetary terms.

   ANS: F DIF: Moderate OBJ: 15-5

9. Research and development expenses are normally considered to be discretionary costs.

   ANS: T DIF: Moderate OBJ: 15-5

10. When budgeting for discretionary costs, less is always better.

    ANS: T DIF: Moderate OBJ: 15-5

11. The value of discretionary costs is often measured using non-monetary measures.

    ANS: T DIF: Easy OBJ: 15-5

12. Engineered costs may be either variable or fixed.

    ANS: T DIF: Easy OBJ: 15-5

13. Maintaining excessive cash may reduce firm profitability because of low returns on cash investments.

ANS: T DIF: Easy OBJ: 15-6

14. An organization's bond rating may cause the organization to hold larger levels of cash than are necessary for operations.

ANS: T DIF: Moderate OBJ: 15-6

15. Increasing the discount period on accounts receivable will increase an organization's cash levels.

ANS: F DIF: Moderate OBJ: 15-6

16. Accelerating inventory turnover will increase an organization's levels of cash.

ANS: T DIF: Moderate OBJ: 15-6

17. The higher an organization's capital costs, the greater the opportunity cost of holding idle cash.

ANS: T DIF: Moderate OBJ: 15-6

18. Supply chain management can reduce the processing time for an organization to obtain raw materials.

ANS: T DIF: Easy OBJ: 15-7

19. A coefficient of determination has a value between -1 and +1.

ANS: F DIF: Moderate OBJ: 15-9

20. A coefficient of determination has a value between 0 and +1.

ANS: T DIF: Moderate OBJ: 15-9

COMPLETION

1. Increases in per unit variable costs and total fixed costs should be minimized through the process of ________________________________.

ANS: cost containment

DIF: Moderate OBJ: 15-3

2. Finding acceptable alternatives to higher cost items or not spending money for goods and services is referred to as ________________________________.

ANS: cost avoidance

DIF: Moderate OBJ: 15-3

3. Lowering existing costs of producing a good or service is referred to as ____________________.

   ANS: cost reduction

   DIF: Moderate OBJ: 15-3

4. Costs that are necessary to sustain an organization's operations are referred to as
   ______________________________.

   ANS: committed costs

   DIF: Easy OBJ: 15-4

5. A cost that must be reviewed periodically to determine if it is still appropriate and necessary is referred to as a ____.

   ANS: discretionary cost

   DIF: Moderate OBJ: 15-5

6. Costs that have been found to bear observable and known relationships to a quantifiable activity base are referred to as ____________________________________.

   ANS: engineered costs

   DIF: Moderate OBJ: 15-5

7. Having sufficient cash to pay liabilities as they become due is referred to as an organization's
   _________________________.

   ANS: liquidity

   DIF: Easy OBJ: 15-6

8. Current assets minus current liabilities equals ____________________________.

   ANS: working capital

   DIF: Easy OBJ: 15-6

9. The portion of variance in a dependent variable explained by an independent variable is referred to as the ____.

   ANS: coefficient of determination

   DIF: Moderate OBJ: 15-9

10. The use of options and forward contracts to manage price risk is referred to as ____________________.

    ANS: hedging

    DIF: Moderate OBJ: 15-9

MULTIPLE CHOICE

1. A logical structure of activities designed to analyze and evaluate management of expenditures is a cost
   a. consciousness system.
   b. understanding system.
   c. avoidance system.
   d. control system.

   ANS: D DIF: Easy OBJ: 15-1

2. For cost control purposes, actual costs should be compared to
   a. the original budget.
   b. actual costs for the prior period.
   c. a flexible budget.
   d. a static budget.

   ANS: C DIF: Easy OBJ: 15-3

3. When the organizational output is difficult to define, management may rely on ____________ for cost control.
   a. qualitative measures
   b. program budgeting
   c. surrogate measures of output
   d. all of the above

   ANS: D DIF: Easy OBJ: 15-1

4. Setting organizational goals and objectives and preparing a budget are aspects of control
   a. during an event.
   b. before an event.
   c. after an event.
   d. before, during, and after an event.

   ANS: B DIF: Easy OBJ: 15-2

5. Which of the following does **not** create a specific price level change?
   a. change in production technology
   b. change in the rate of inflation
   c. changes due to supply and demand
   d. changes in the number of competing suppliers

   ANS: B DIF: Easy OBJ: 15-3

6. As the economy becomes more and more depressed, a company's management decides to slash spending on research and development. What is the likely effect of this action on net income? Net income will be
   a. higher this period and lower in future periods.
   b. higher this period and higher in future periods.
   c. lower this period and higher in future periods.
   d. lower this period and lower in future periods.

   ANS: A DIF: Easy OBJ: 15-3

7. Spending levels in prior years are often the basis of
   a. traditional budgets.
   b. Zero-base budgets.
   c. variance targets.
   d. engineered cost analyses.

   ANS: A DIF: Easy OBJ: 15-3

8. Minimizing period-by-period increases in unit variable costs and total fixed costs defines efforts of cost
   a. control.
   b. avoidance.
   c. containment.
   d. reduction.

   ANS: C DIF: Easy OBJ: 15-3

9. Cost containment practices by a firm would **not** be effective for cost increases caused by
   a. inflation.
   b. a reduction in the quantity of an input purchased.
   c. normal seasonality.
   d. a reduction in the number of suppliers.

   ANS: A DIF: Easy OBJ: 15-3

10. All of the following are explanations of cost changes. Which of these influences can be substantially affected by cost containment measures?
    a. inflation/deflation
    b. changes in quantities purchased
    c. technological change
    d. changes in supply chain costs

    ANS: B DIF: Moderate OBJ: 15-3

11. The greatest degree of control for committed fixed costs is exerted
    a. in the post-investment audit.
    b. during the life of the investment.
    c. prior to acquisition.
    d. by equipment operators.

    ANS: C DIF: Easy OBJ: 15-4

12. Careful analysis of the capital budget is an important control activity for
    a. variable costs.
    b. discretionary costs.
    c. committed costs.
    d. period costs.

    ANS: C DIF: Easy OBJ: 15-4

13. An effective control system functions before, during, and after an event. However, little control is possible during the event for most
    a. variable manufacturing costs.
    b. variable period costs.
    c. discretionary fixed costs.
    d. committed fixed costs.

    ANS: D DIF: Easy OBJ: 15-4

14. The term "committed costs" refers to costs that
    a. management decides to incur in the current period to enable the company to achieve objectives other than the filling of orders placed by customers.
    b. are likely to respond to the amount of attention devoted to them by a specified manager.
    c. are governed mainly by past decisions that established the present levels of operating and organizational capacity and that only change slowly in response to small changes in capacity.
    d. fluctuate in total in response to small changes in the rate of utilization of capacity.

    ANS: C DIF: Easy OBJ: 15-4

15. A committed fixed cost can
    a. never be eliminated.
    b. be eliminated in the short term and in the long term.
    c. be eliminated in the long term but not in the short term.
    d. be eliminated in the short term but not in the long term.

    ANS: C DIF: Easy OBJ: 15-4

16. Which of the following is an example of a committed fixed cost?
    a. investment in production facilities
    b. advertising
    c. preventive maintenance
    d. employee training programs

    ANS: A DIF: Easy OBJ: 15-4

17. A company would be reducing its discretionary costs if it
    a. fired a production supervisor.
    b. closed its research and development department.
    c. successfully negotiated a reduction in its factory rent.
    d. reduced its direct labor costs by hiring temporary workers.

    ANS: B DIF: Moderate OBJ: 15-5

18. If a discretionary cost can be treated like an engineered cost, cost control may be achieved through the use of
    a. program budgeting.
    b. zero-base budgeting.
    c. capital budgeting.
    d. flexible budgeting.

    ANS: D DIF: Moderate OBJ: 15-5

19. Most discretionary costs relate to
    a. plant and equipment acquisitions.
    b. long-term investments.
    c. basic personnel costs.
    d. service activities.

ANS: D DIF: Easy OBJ: 15-5

20. If a cost can be reduced to zero in the short run without significantly harming the organization, the cost is a
    a. variable cost.
    b. committed cost.
    c. discretionary cost.
    d. product cost.

ANS: C DIF: Easy OBJ: 15-5

21. Discretionary costs are often difficult to control because
    a. it is difficult to measure the cost.
    b. they cannot be changed in the short run.
    c. they cannot be changed from period to period.
    d. it is difficult to measure the benefits of discretionary activities.

ANS: D DIF: Moderate OBJ: 15-5

22. Which of the following is likely to be a discretionary cost in most organizations?
    a. managerial training programs
    b. managerial labor costs
    c. factory utilities
    d. factory rent

ANS: A DIF: Easy OBJ: 15-5

23. The level of discretionary costs
    a. are set by management for one period at a time.
    b. cannot be changed in the short run.
    c. are determined when capital investment is undertaken.
    d. always varies with sales.

ANS: A DIF: Easy OBJ: 15-5

24. Which of the following is **not** a factor that directly affects the budget for a discretionary cost?
    a. the importance of the activity to the achievement of the organization's goals
    b. last period's budget
    c. the expected level of operations
    d. managerial negotiations in the budgeting process

ANS: B DIF: Easy OBJ: 15-5

25. If an actual discretionary cost is exactly equal to the budgeted level of that cost, which of the following statements is **true**?
   a. Funds were appropriately spent.
   b. The discretionary activity was efficient.
   c. The discretionary activity was effective.
   d. None of the above.

   ANS: D DIF: Moderate OBJ: 15-5

26. Discretionary activities in an organization are determined based on
   a. organizational policies and managerial preferences.
   b. the budgeted amount from the prior period.
   c. the level of long-term investment.
   d. an organization's internal control.

   ANS: A DIF: Moderate OBJ: 15-5

27. The term "discretionary costs" refers to
   a. costs that management decides to incur in the current period to enable the company to achieve objectives other than the filling of orders placed by customers.
   b. costs that are likely to respond to the amount of attention devoted to them by a specified manager.
   c. costs that are governed mainly by past decisions that established the present levels of operating and organizational capacity and that only change slowly in response to small changes in capacity.
   d. amortization of costs that were capitalized in previous periods.

   ANS: A DIF: Easy OBJ: 15-5

28. Avoidable costs are usually
   a. committed.
   b. common.
   c. discretionary.
   d. joint.

   ANS: C DIF: Easy OBJ: 15-5

29. Which of the following is **least** likely to be a discretionary cost?
   a. salaries of salespeople
   b. advertising
   c. maintenance
   d. insurance

   ANS: A DIF: Easy OBJ: 15-5

30. For cost control purposes, fixed costs are classified as
   a. product or period costs.
   b. discretionary or committed.
   c. direct or common.
   d. sunk or avoidable.

   ANS: B DIF: Easy OBJ: 15-5

31. If economic activity slows down, total costs could easily decline in which of the following categories?
    a. variable costs and committed fixed costs
    b. variable costs and discretionary fixed costs
    c. variable costs only
    d. committed fixed costs only

    ANS: B DIF: Easy OBJ: 15-5

32. Usually, with respect to a variable cost, optimal control is exerted when the cost
    a. can be controlled prior to incurrence.
    b. is compared to its budget amount.
    c. increases steadily over time.
    d. is closely monitored.

    ANS: D DIF: Easy OBJ: 15-5

33. Which kind of costs could be eliminated by closing a sales office?

	Direct	Discretionary	Committed
a.	yes	yes	no
b.	yes	no	yes
c.	yes	no	no
d.	no	no	yes

    ANS: A DIF: Moderate OBJ: 15-5

34. A major difference between committed and discretionary fixed costs is that
    a. incurring committed fixed costs is less risky than using discretionary costs.
    b. managers are usually responsible for committed fixed costs but not for discretionary fixed costs.
    c. incurring discretionary fixed costs rather than committed fixed costs gives a company more flexibility in controlling costs.
    d. companies are using more discretionary fixed costs because labor is easier to "remove" than technology.

    ANS: C DIF: Easy OBJ: 15-5

35. The distinction between avoidable and unavoidable costs is similar to the distinction between
    a. variable costs and fixed costs.
    b. variable costs and mixed costs.
    c. step-variable costs and fixed costs.
    d. discretionary costs and committed costs.

    ANS: D DIF: Moderate OBJ: 15-5

36. The maximum allowable expenditure is the
    a. appropriation.
    b. allowance.
    c. allocation.
    d. committed fixed cost.

    ANS: A DIF: Easy OBJ: 15-5

37. If a firm is successful in meeting its output goal for a period, the firm has been
    a. efficient.
    b. effective.
    c. profitable.
    d. exercising cost containment measures.

    ANS: B   DIF: Easy   OBJ: 15-5

38. A reasonable measure of efficiency relies on
    a. qualitative measures of inputs and outputs.
    b. a match of inputs in one period with outputs in subsequent periods.
    c. a causal relationship between inputs and outputs.
    d. a ratio of planned output to actual output.

    ANS: C   DIF: Easy   OBJ: 15-5

39. A ratio of outputs to inputs is a(n)
    a. effectiveness measure.
    b. efficiency measure.
    c. qualitative measure.
    d. cost reduction measure.

    ANS: B   DIF: Easy   OBJ: 15-5

40. A small manufacturing company recently stated its sales goal for a period was $100,000. At this level of activity, its budgeted expenses were $80,000. Its actual sales were $100,000, but its actual expenses were $85,000. This company operated
    a. effectively and efficiently.
    b. neither effectively nor efficiently.
    c. effectively but not efficiently.
    d. efficiently but not effectively.

    ANS: C   DIF: Easy   OBJ: 15-5

41. Proficient Corporation has a sales goal of $500,000 for the coming year. Based on this level of activity, Proficient budgets its total expenses at $450,000. Actual sales are $480,000 and actual costs are $460,000. Proficient Corporation’s operations were
    a. both efficient and effective.
    b. neither efficient nor effective.
    c. efficient but not effective.
    d. effective but not efficient.

    ANS: B   DIF: Easy   OBJ: 15-5

42. The difference between actual sales and budgeted sales is
    a. a flexible budget variance.
    b. an efficiency measure.
    c. required in program budgeting.
    d. an effectiveness measure.

    ANS: D   DIF: Easy   OBJ: 15-5

43. A cost that is found to bear an observable and known relationship to a quantifiable activity base is a(n)
   a. discretionary cost.
   b. product cost.
   c. period cost.
   d. engineered cost.

   ANS: D DIF: Easy OBJ: 15-5

44. Control of engineered costs is frequently achieved through the use of
   a. zero-base budgeting.
   b. program budgeting.
   c. standards.
   d. cash budgeting.

   ANS: C DIF: Easy OBJ: 15-5

45. A variance represents the difference between a budgeted and an actual cost. Thus, the variance measures
   a. only controllable cost differences.
   b. only uncontrollable cost differences.
   c. both uncontrollable and controllable cost differences.
   d. the effectiveness of management.

   ANS: C DIF: Easy OBJ: 15-5

46. Assume actual output exceeds the level of output in the original budget. You would expect costs in which of the following categories to exceed the original budget?
   a. total variable costs
   b. committed fixed costs
   c. discretionary fixed costs
   d. all of the above

   ANS: A DIF: Easy OBJ: 15-5

47. An organization plans to produce and sell 50,000 units. It actually produces and sells 45,000 units. Total costs would be expected to be below the planned level due to cost
   a. consciousness.
   b. control.
   c. reductions.
   d. behavior.

   ANS: D DIF: Easy OBJ: 15-5

Edwards Company

The following information is provided for Edwards Company for the month of June

Actual	Standard
1,800 units	5 DLHs per unit @ $10.00 per DLH
8,900 DLHs @ $10.50 per DLH	VOH rate per DLH $ .75
Variable OH $6,400	FOH rate per DLH $1.90
Fixed OH $17,500	Budgeted FOH $16,910

48. Refer to Edwards Company. What is the price variance?
    a. $4,450 F
    b. $4,450 U
    c. $1,000 F
    d. $1,000 U

    ANS: B

    AQ*(AP - SP) = Price Variance
    8,900 DLH * ($10.50/DLH - $10.00/DLH) = $4,450 U

    DIF: Moderate OBJ: 15-5

49. Refer to Edwards Company. What is the efficiency variance?
    a. $4,450 F
    b. $4,450 U
    c. $1,000 F
    d. $1,000 U

    ANS: C

    SP*(AQ - SQ) = Price Variance
    $10/DLH * (8,900 DLH - 9,000 DLH) = $1,000 F

    DIF: Moderate OBJ: 15-5

50. Refer to Edwards Company. What is the spending variance?
    a. $590 U
    b. $590 F
    c. $190 F
    d. $190 U

    ANS: A

    Spending Variance = Actual Cost - Budgeted Fixed Cost
    = $(17,500 - $16,910)
    = $590 U

    DIF: Moderate OBJ: 15-5

51. Refer to Edwards Company. What is the volume variance?
   a. $590 U
   b. $590 F
   c. $190 F
   d. $190 U

ANS: C

Volume Variance = Budgeted Fixed Cost - (Standard Fixed Rate * Standard Hours Allowed)
= $16,910 - ($1.90/DLH * 9,000 DLH)
= $(16,910 - 17,100)
= $190 F

DIF: Moderate OBJ: 15-5

52. Which of the following strategies is used to deal with uncertainty related to a specific event?
   a. Statistical analysis
   b. Cost restructuring
   c. Hedging
   d. Insurance

ANS: D DIF: Easy OBJ: 15-9

53. Which of the following strategies is used to deal with uncertainty related to price risk?
   a. Statistical analysis
   b. Cost restructuring
   c. Hedging
   d. Insurance

ANS: C DIF: Easy OBJ: 15-9

54. Which of the following strategies is used to deal with uncertainty related to estimating future costs?
   a. Statistical analysis
   b. Cost restructuring
   c. Hedging
   d. Insurance

ANS: A DIF: Easy OBJ: 15-9

55. In the least-squares equation, $y = a + b$X, a represents
   a. the coefficient of determination.
   b. the level of activity.
   c. the fixed component of a cost.
   d. the variable cost per unit.

ANS: C DIF: Moderate OBJ: 15-9

SHORT ANSWER

1. What factors make discretionary costs difficult to control?

   ANS:
   Discretionary costs are difficult to control because it is difficult to identify the exact benefits of discretionary activities and the relationship of these activities to the organization's output and goals. Thus, it is difficult to decide at what level a discretionary activity should be funded or if it should be funded at all based on the lack of a definite causal relationship between the discretionary activity and the firm's output and goals.

   DIF: Moderate OBJ: 15-5

2. What are the differences between committed fixed costs and discretionary fixed costs?

   ANS:
   Committed fixed costs are those costs that flow from the basic existence of the organization. These are the direct costs of the organization's long-term investments (such as plant and equipment) and the costs of essential personnel. These costs can only be changed in the long run without significantly affecting the organization. Discretionary fixed costs are all fixed costs that do not fit into the committed category. This includes the costs of auxiliary service activities including activities that could be discontinued in the short run without adversely affecting the long-run viability of the organization.

   DIF: Moderate OBJ: 15-4

3. When can a discretionary fixed cost be subjected to control methods that are used for engineered costs?

   ANS:
   When a discretionary cost is repetitive and can be related to some fundamental activity measure (such as machine hours or units of output), it may be treated like an engineered cost. With a repetitive cost that can be related to an activity base, performance standards can be developed and flexible budget variances can be computed and used as cost control tools.

   DIF: Moderate OBJ: 15-5

4. What factors influence the total level of discretionary costs in an organization?

   ANS:
   Organizations tend to fund discretionary activities at different levels depending on the state of the economy and the original profit level. When management anticipates unfavorable economic conditions or downturns in profitability, discretionary costs may be reduced. Likewise, they may be increased as economic conditions improve. Total discretionary expenditures will also vary as certain activities lose their funding and new discretionary activities are initiated.

   DIF: Moderate OBJ: 15-5

5. How does strategic staffing fit in with departmental staffing?

ANS:
Strategic staffing is based on a department's needs related to its long-range objectives and those of the overall company. The department looks at its needs to see how a combination of temporary and permanent personnel fills the bill. By using temporary personnel, flexible staffing is provided that helps insulate the jobs of permanent personnel. Also, when temporary personnel are used by a department, the overall cost of organizational fringe benefits is reduced, thereby saving funds for other needs.

DIF: Moderate OBJ: 15-5

6. Discuss the various elements of the cost control process.

ANS:
Cost understanding is one element of a cost control system. An organization needs to understand that costs may change from one period to the next or understand why costs differ from budgeted amounts. Total variable costs will increase/decrease with different levels of activity. Costs can also change due to inflation/deflation creating general price-level changes. Costs also change because of supply/supplier cost adjustments. Lastly, costs may change because of quantity purchased by the organization.

Cost containment is another element of the cost control process. Cost containment is defined as the practice of minimizing, to the extent possible, period-to-period increases in per-unit variable and total fixed costs. Cost containment is possible for costs that rise due to competition, seasonal variations, and quantities purchased.

A third element of the cost control process is cost avoidance. Cost avoidance is defined as the practice of finding acceptable alternatives to high-cost products and/or not spending money for unnecessary goods/services.

A final element of the cost control process is cost reduction. Cost reduction means lowering current costs especially for goods/services that may not be needed currently.

DIF: Moderate OBJ: 15-2

7. What are the five steps in implementing a system of cost control?

ANS:
1. Investigate and understand the types of costs incurred by the organization.
2. Communicate the need for cost consciousness to all employees.
3. Motivate employees through education and incentives.
4. Compare actual results to budgets and analyze for future methods of improvement.
5. View cost control as a long-run process not a short-term solution.

DIF: Moderate OBJ: 15-3

8. What are the usual sources for cash in an organization?

ANS:
1. Sale of equity or debt securities or other short-term instruments.
2. Sale of assets that are no longer necessary or productive.
3. Sale of goods for a profit in the normal production/sales cycle.
4. Loans from banks or other financial institutions.

DIF: Easy OBJ: 15-6

9. What are four generic strategies that may be used in cost management to deal with uncertainty?

ANS:
1. Explicitly considering uncertainty when estimating future costs by using statistical tools such as least squares regression.
2. Structuring costs to adjust to uncertain outcomes.
3. Using options and forward contracts to mitigate price risk through hedging.
4. Insuring against occurrences of specific events.

DIF: Moderate OBJ: 15-9

10. What are the two main sources of uncertainty in cost management?

ANS:
1. Lack of identification or understanding of cost drivers. Some portion of a cost is not predictable based on the cost driver.
2. Unforeseen events that cannot be fully planned for. It is not possible to fully eliminate uncertainty; however management should make every effort to minimize its impact.

DIF: Moderate OBJ: 16-8

PROBLEM

1. Bertrand Company has made the following information available for the month of January:

Actual	Standards
1,500 units produced	2 DLH per unit @ $10
2,400 DLH used @ $10.25 per DLH	

Assume that Bertrand hires part-time employees for production of these units.

Compute the price and efficiency variances.

ANS:

2,400 × $10.25	$24,600	
2,400 × $10.00	24,000	
Price variance	$ 600	U
2,400 × $10.00	$24,000	
(1,500 × 2) × $10.00	30,000	
Efficiency variance	$ 6,000	F

DIF: Moderate OBJ: 15-5

2. Romano Company has provided the following information for the month of July:

Actual	Standards
800 units produced	2 DLH per unit @ $5.00
Actual DL cost $6,750	$1 fixed overhead per DLH

Assume that Romano hires full-time employees who are paid a total of $6,500 per month.

Compute the spending and volume variances.

ANS:

Actual labor cost	$6,750	
Budgeted labor cost	6,500	
Spending variance	$ 250	U
Budgeted labor cost	$6,500	
(800 × 2) × $5	8,000	
Volume variance	$1,500	F

DIF: Moderate OBJ: 15-5

3. Roach and Associates provided the following information relative to the times and costs to prepare a simple last will and testament:

Standards	Actual
2 DLH @ $50 per DLH	500 simple wills were prepared during the year
	1,100 DLHs utilized during the year @ $52 per DLH

Compute the price and efficiency variances.

ANS:

1,100 × $52	$57,200	
1,100 × $50	55,000	
Price variance	$ 2,200	U
1,100 × $50	$55,000	
(500 × 2) × $50	50,000	
Efficiency variance	$ 5,000	U

DIF: Moderate OBJ: 15-5

Hanks Corporation

Hanks Corporation manufactures and sells baseball bats. For a recent period, its production and sales objectives were each set at 20,000 units. Also, for this period the firm had estimated costs as follows:

Variable production costs	$3 per unit
Variable selling costs	$2 per unit
Committed fixed costs	$30,000 per period

Discretionary fixed costs	$40,000 per period

4. Refer to Hanks Corporation. For this question only, assume that Hanks Corporation actually produced and sold 18,000 bats. Hanks Corporation's operations for the period would (on an overall basis) be regarded as efficient if total costs were below what amount?

   ANS:
   First, remember how fixed and variable costs change when volume changes. Fixed costs remain constant in total and variable costs remain constant on a per-unit basis. To be regarded as efficient, the company's costs would need to be at or below the flexible budget for 18,000 units. The flexible budget for all costs would be:

   [18,000 × ($3 + $2)] + $30,000 + $40,000 = $90,000 + $70,000 = $160,000

   DIF: Moderate

5. Refer to Hanks Corporation. For this question only, assume Hanks Corporation actually produced and sold 19,000 bats. At this level of operation, Hanks Corporation's total costs were $170,000. Evaluate Hanks Corporation's success in terms of effectiveness and efficiency.

   ANS:
   Hanks Corporation was not entirely effective in reaching its goal because its objective was to produce and sell 20,000 bats. It only produced and sold 19,000. Its operations would still be regarded as efficient if it contained costs below the flexible budget for 19,000 units, which would be:

   [19,000 × ($3 + $2)] + $30,000 + $40,000 = $95,000 + $70,000 = $165,000.

   Since its actual costs were $170,000, the company was neither effective nor efficient in achieving its operating objectives.

   DIF: Moderate

6. Refer to Hanks Corporation. Note that the budget for discretionary fixed costs is $40,000. If actual discretionary fixed costs were $50,000, could cost control have still been effective? Explain.

   ANS:
   Yes, cost control could have been effective. Company managers may have deliberately and consciously overspent on certain items because of opportunities or challenges that emerged during the period. For example, advertising expenses may have been increased because new competitors entered the baseball bat market, or research and development expenditures may have been boosted because of the discovery of a new metal alloy that could revolutionize the baseball bat market. Another explanation would be that cost control was effective, but costs increased dramatically for uncontrollable reasons (severe inflation).

   DIF: Easy