Chapter 1
Managerial Accounting and the Business Environment

Solutions to Questions

1-1 Managerial accounting is concerned with providing information to managers for their use internally in the organization. Financial accounting is concerned with providing information to stockholders, creditors, and others outside of the organization.

1-2 Essentially, the manager carries out three major activities in an organization: planning, directing and motivating, and controlling. All three activities involve decision making.

1-3 The Planning and Control Cycle involves the following steps: formulating plans, implementing plans, measuring performance, and evaluating differences between planned and actual performance.

1-4 The manager relies on feedback to assure that activities are under control; that is, to assure that things are going according to plan.

1-5 A line position is directly related to the achievement of the basic objectives of the organization. A staff position is not directly related to the achievement of those objectives; rather, it is supportive, providing services and assistance to other parts of the organization.

1-6 In contrast to financial accounting, managerial accounting: (1) focuses on the needs of the manager; (2) places more emphasis on the future; (3) emphasizes relevance and flexibility, rather than precision; (4) emphasizes the segments of an organization; (5) is not governed by GAAP; and (6) is not mandatory.

1-7 At the final assembly stage in a JIT system, a signal is sent to the preceding workstation as to the exact parts and materials that will be needed over the next few hours for the final assembly of products. Only those parts and materials are provided. The same signal is sent back through each preceding workstation so that a smooth flow of parts and materials is maintained with no buildup of inventories at any point. Thus, all workstations respond to the "pull" exerted by the final assembly stage.

The "pull" approach just described can be contrasted to the "push" approach used in conventional systems. In a conventional system, inventories of parts and materials are built up—often simply to keep everyone busy. These semi-completed parts and materials are "pushed" forward to the next workstation whether or not there is actually any customer demand for the products they will become part of. The result is large stockpiles of work in process inventories.

1-8 A number of benefits accrue from reduced setup time. First, reduced setup time allows a company to produce in smaller batches, which in turn reduces the level of inventories. Second, reduced setup time allows a company to spend more time producing goods and less time getting ready to produce. Third, the ability to rapidly change from making one product to making another allows the company to respond more quickly to customers. Finally, smaller batches make it easier to spot manufacturing problems before they result in a large number of defective units.

1-9 The main benefits of a successful JIT system are reductions in: (1) funds tied up in inventories; (2) space requirements; (3) throughput time; and (4) defects.

1-10 In the Plan phase, data are analyzed to identify a possible cause for a problem and a solution is proposed. In the Do phase, an experiment is conducted. In the Check phase, data from the experiment are analyzed. In the Act phase, the solution is implemented if the experiment was successful. If the experiment was not successful, the Plan phase is restarted. This cycle closely parallels the scientific method.

1-11 TQM generally approaches improvement in a series of small steps that are planned and implemented by teams of front-line workers. Process Reengineering involves completely redesigning business processes from the ground up—often with the use of outside consultants.

1-12 If Process Reengineering is successful, fewer workers are needed. If management responds by reducing the payroll, morale will almost certain suffer. In addition, if change is imposed from above by outsiders, it is likely to be resisted and resented.

1-13 Some benefits from improvement efforts come from cost reductions, but the primary benefit is often an increase in capacity with no increase in required resources. Increases in capacity are beneficial only at the constraint. At other areas, increases in capacity just add to the already-existing excess capacity. Therefore, improvement efforts should often focus on the constraint.

1-14 If people generally did not act ethically in business, no one would trust anyone else and people would be reluctant to enter into business transactions. The result would be less funds raised in capital markets, fewer goods and services available for sale, lower quality, and higher prices.

Exercise 1-1 (10 minutes)

1. Managerial accounting, Financial accounting
2. Planning
3. Directing and motivating
4. Feedback
5. Decentralization
6. Line
7. Staff
8. Controller
9. Budgets
10. Performance report
11. Chief Financial Officer
12. Precision; Nonmonetary data

Exercise 1-2 (10 minutes)

1. Just-In-Time
2. Benchmarking
3. Pull
4. Setup
5. Total Quality Management; Process Reengineering
6. Plan-Do-Check-Act cycle
7. Business process
8. Non-value-added activities
9. Constraint
10. Nonconstraint

Exercise 1-3 (15 minutes)

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

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

Problem 1-4 (30 minutes)

1. See the organization chart on the following page.

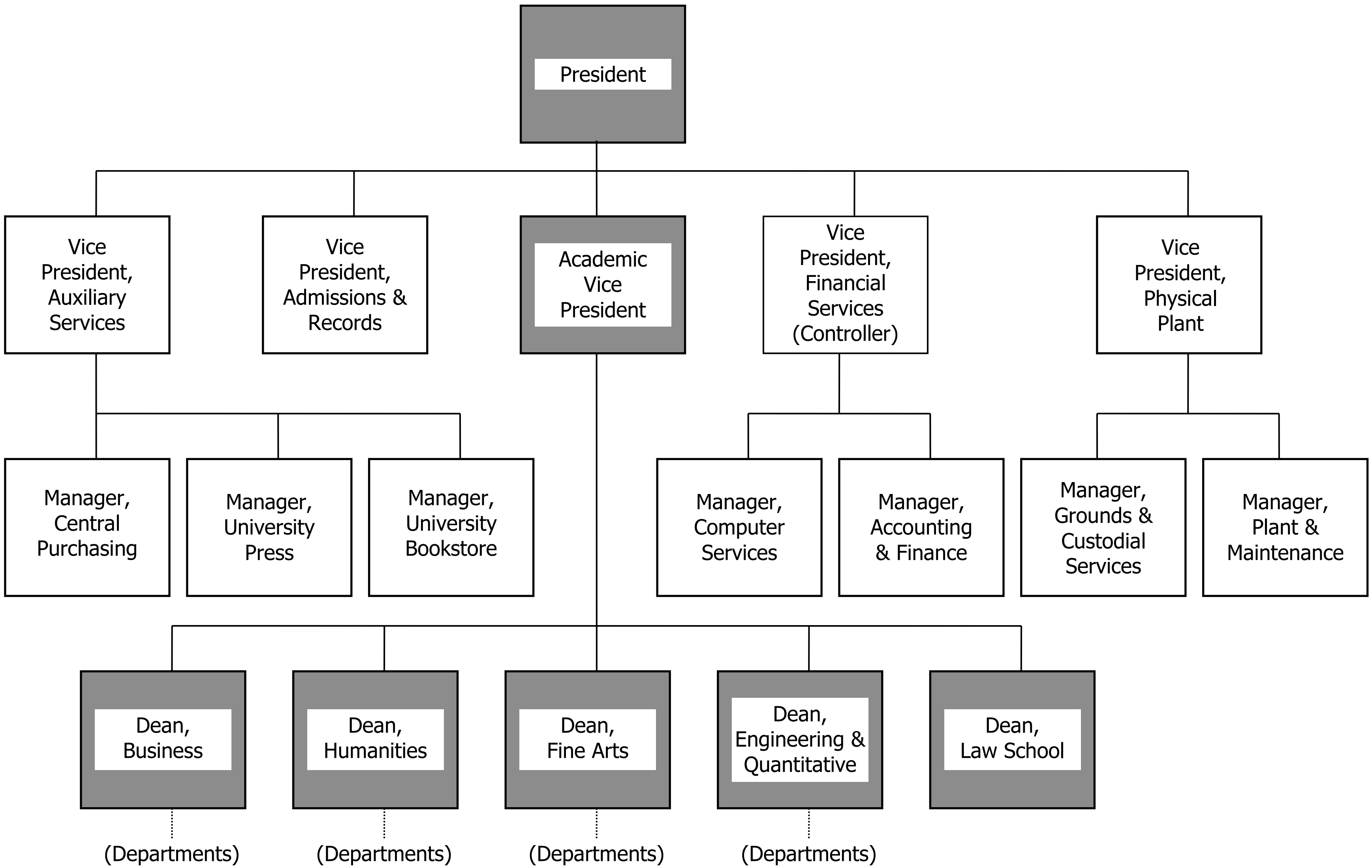
2. Line positions would include the university president, academic vice-president, the deans of the four colleges, and the dean of the law school. In addition, the department heads (as well as the faculty) would be in line positions. The reason is that their positions are directly related to the basic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

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

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

Problem 1-4 (continued)

1. Organization chart:



Problem 1-5 (20 minutes)

1. No, Sarver did not act in an ethical manner. In complying with the president's instructions to omit liabilities from the company's financial statements he was in direct violation of the IMA's *Standards of Ethical Conduct for Management Accountants.* He violated both the "Integrity" and "Objectivity" guidelines on this code of ethical conduct. The fact that the president ordered the omission of the liabilities is immaterial.
2. No, Sarver's actions can't be justified. In dealing with similar situations, the Securities and Exchange Commission (SEC) has consistently ruled that "…corporate officers…cannot escape culpability by asserting that they acted as 'good soldiers' and cannot rely upon the fact that the violative conduct may have been condoned or ordered by their corporate superiors." (Quoted from: Gerald H. Lander, Michael T. Cronin, and Alan Reinstein, "In Defense of the Management Accountant," *Management Accounting,* May, 1990, p. 55) Thus, Sarver not only acted unethically, but he could be held legally liable if insolvency occurs and litigation is brought against the company by creditors or others. It is important that students understand this point early in the course, since it is widely assumed that "good soldiers" are justified by the fact that they are just following orders. In the case at hand, Sarver should have resigned rather than become a party to the fraudulent misrepresentation of the company's financial statements.

Problem 1-6 (30 minutes)

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

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

2. Reasons for conflict between line and staff positions include the following.

   - Line managers perceive staff managers as threats to their authority, especially when staff persons have functional authority.
   - Line managers may become uncomfortable when they grow dependent on staff expertise and knowledge.
   - Line managers may perceive staff managers as overstepping their authority, having a narrow perspective, or stealing credit. Staff managers, on the other hand, may perceive line managers as not utilizing their expertise, not giving staff enough authority, or resisting staff's ideas.

Problem 1-6 (continued)

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

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

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

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

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

(CMA Unofficial Solution, adapted)

Problem 1-7 (20 minutes)

1. If all automotive service shops routinely tried to sell parts and services to customers that they didn't really need, most customers would eventually figure this out. They would then be reluctant to accept the word of the service representative that a particular problem needs to be corrected—even when there is a legitimate problem. Either the work would not be done, or customers would learn to diagnose and repair problems themselves, or customers would hire an independent expert to verify that the work is really needed. All three of these alternatives impose costs and hassles on customers.

2. As argued above, if customers could not trust their service representatives, they would be reluctant to follow the service representative's advice. They would be inclined not to order the work done even when it is really necessary. And, more customers would learn to do automotive repairs and maintenance themselves. Moreover, customers would be unwilling to pay as much for work that is done since customers would have reason to believe that the work may be unnecessary. These two effects would reduce demand for automotive repair services. The reduced demand would reduce employment in the industry and would lead to lower overall profits.

Problem 1-8 (30 minutes)

1. Adam Williams has an ethical responsibility to take some action in the matter of GroChem Inc. and the dumping of toxic wastes. The *Standards of Ethical Conduct for Management Accountants* specifies that management accountants should not condone the commission of acts by their organization that violate the standards of ethical conduct. The specific standards that apply are as follows.
   - **Competence.** Management accountants have a responsibility to perform their professional duties in accordance with relevant laws and regulations.
   - **Confidentiality.** Management accountants must refrain from disclosing confidential information unless legally obligated to do so. However, Adam Williams may have a legal responsibility to take some action.
   - **Integrity.** Management accountants have a responsibility to:
     - refrain from either actively or passively subverting the attainment of the organization's legitimate and ethical objectives.
     - communicate favorable as well as unfavorable information and professional judgments or opinions.
   - **Objectivity.** Management accounts must fully disclose all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, comments, and recommendations.

Problem 1-8 (continued)

2. The *Standards of Ethical Conduct for Management Accountants* indicates that the first alternative being considered by Adam Williams, seeking the advice of his boss, is appropriate. To resolve an ethical conflict, the first step is to discuss the problem with the immediate superior, unless it appears that this individual is involved in the conflict. In this case, it does not appear that Williams' boss is involved.

   Communication of confidential information to anyone outside the company is inappropriate unless there is a legal obligation to do so, in which case Williams should contact the proper authorities.

   Contacting a member of the Board of Directors would be an inappropriate action at this time. Williams should report the conflict to successively higher levels within the organization and turn only to the Board of Directors if the problem is not resolved at lower levels.

3. Adam Williams should follow the established policies of the organization bearing on the resolution of such conflict. If these policies do not resolve the ethical conflict, Williams should report the problem to successively higher levels of management up to the Board of Directors until it is satisfactorily resolved. There is no requirement for Williams to inform his immediate superior of this action because the superior is involved in the conflict. If the conflict is not resolved after exhausting all courses of internal review, Williams may have no other recourse than to resign from the organization and submit an informative memorandum to an appropriate member of the organization.

(CMA Unofficial Solution, adapted)

Group Exercise 1-9

Students' answers will depend on the specific experiences they had while working.