

ch01

Student: _____

1. The value chain comprises activities from research and development through the production process, but does not include activities related to the distribution of products or services.
True False
2. Administrative functions are not included as part of the value chain because they are implicitly included in every business function.
True False
3. Under the value chain concept, instead of perceiving whether individual activities in the chain add value, customers only consider the overall utility of the goods or services they purchase.
True False
4. A *cost driver* is a factor that causes costs.
True False
5. A cost can be considered a differential cost for one particular course of action but not for another course of action.
True False
6. A responsibility center can be a department, division, or segment, but not a subsidiary of the parent company.
True False
7. It is important that the manager assigned to lead a responsibility center be held accountable for its operations.
True False
8. Budgeting is primarily used to determine year-end bonuses based on managerial and organizational performance.
True False
9. Managers are usually responsible for the revenues needed to achieve the targets set during the budgeting process, but not the resources consumed to achieve those targets.
True False
10. Cost data can be used for one managerial decision but not for another managerial decision.
True False
11. Financial accounting information is designed for decision-makers who are directly involved in the daily management of the firm.
True False
12. It is more important for financial accounting information to be comparable between firms than to be useful for managerial decision-making.
True False
13. Cost accounting information developed for managers to use in making decisions must comply with generally accepted accounting principles (GAAP) and international financial reporting standards (IFRS).
True False
14. Cost accounting information can be used by managers to defraud customers, creditors, and owners.
True False

15. Benchmarking is a continuous process of measuring a company's products, services, or activities against competitors' performance.
True False
16. Activity-based costing (ABC) is a management tool that focuses on the continuous improvement of all dimensions of a business.
True False
17. Customer satisfaction is an example of a non-financial performance measure.
True False
18. Managers face ethical situations on a daily basis, while accountants face them infrequently.
True False
19. A person who makes unethical decisions in their personal life is likely to make unethical decisions in their professional life.
True False
20. Ethical behavior depends more on a firm's code of conduct than the individual's personal beliefs.
True False
21. The Value chain is comprised of the activities that take place during the production process.
True False
22. Cost accounting plays a significant role in management decision making.
True False
23. Cost accounting provides information only for cost accounting purposes.
True False
24. Cost accounting is broader in scope than financial accounting.
True False
25. Financial accounting receives information only from cost accounting activity.
True False
26. Financial accounting provides financial and nonfinancial information that helps managers in the decision making process.
True False
27. A value chain consists of the major subassemblies that add value to a product.
True False
28. The lean thinking model focuses on reducing defects to as close to zero as possible.
True False
29. The set of activities that transforms raw resources into the goods and services of an organization is called:
 - A. Value chain.
 - B. Supply chain.
 - C. Demand chain.
 - D. Cost-benefit analysis.
30. Which of the following activities would not be considered a value-added activity?
 - A. Production
 - B. Marketing
 - C. Accounting
 - D. Distribution

31. Which of the following statements is false?
- A. In essence, the value chain and the supply chain are similar; each creates something for which the customer is willing to pay.
 - B. Accounting systems are important because they provide all the information for decisions commonly made by managers.
 - C. The supply or distribution chain is a linked set of organizations that exchange goods and services in combination to provide a final product or service to the customer.
 - D. Eliminating nonvalue-added activities always reduces costs without affecting the value of the product to customers.
32. Managers do not make decisions about future events based on:
- A. Perfect information.
 - B. Estimated information.
 - C. Actual information.
 - D. Financial information.
33. Which of the following is a nonvalue-added activity?
- A. Product design
 - B. Customer service
 - C. Research and development
 - D. Rework of defective items
34. (CMA adapted) An accounting system that collects financial and operating data on the basis of the underlying nature and extent of cost drivers is
- A. full-absorption costing.
 - B. activity-based costing.
 - C. variable costing.
 - D. benchmarking.
35. (CMA adapted) Cost drivers are
- A. activities that cause costs to increase as the activity increases.
 - B. accounting techniques and practices used to control costs.
 - C. accounting reimbursements used to evaluate whether performance is proceeding according to plan.
 - D. a mechanical basis, such as machine hours, computer time, or factory square footage, used to assign costs to activities.
36. During 2013, the JKL Restaurant had sales revenues and food costs of \$800,000 and \$600,000, respectively. During 2014, JKL plans to introduce a new menu item that is expected to increase sales revenues by \$100,000 and food costs by \$40,000. Assuming no changes are expected for the other food items, operating profits for 2013 are expected to increase by
- A. \$260,000.
 - B. \$100,000.
 - C. \$60,000.
 - D. \$40,000.
37. (CMA adapted) The process of creating a formal plan and translating goals into a quantitative format is referred to as
- A. budgeting.
 - B. benchmarking.
 - C. cost-benefit analysis.
 - D. value-added analysis.
 - E. activity-based costing.
38. The field of accounting that depends on generally accepted accounting principles (GAAP) is called
- A. cost accounting.
 - B. financial accounting.
 - C. managerial accounting.
 - D. responsibility accounting.
 - E. international accounting.

39. Which field of accounting emphasizes relevancy over comparability?
- A. Cost accounting
 - B. Financial accounting
 - C. Responsibility accounting
 - D. International accounting
40. The just-in-time (JIT) method of production focuses on
- A. increasing sales revenue.
 - B. reducing inventories.
 - C. increasing customer service.
 - D. reducing operating expenses.
 - E. increasing product quality.
41. (CIA adapted) The primary reason for adopting total quality management (TQM) is to achieve
- A. reduced delivery time.
 - B. reduced delivery charges.
 - C. greater customer satisfaction.
 - D. greater employee participation.
 - E. better managerial decisions.
42. According to the Institute of Management Accountants (IMA), the final step in resolving an ethical dilemma is to
- A. resign from the organization.
 - B. call the IMA's ethics hotline.
 - C. report the circumstances to a local newspaper.
 - D. consult with an objective, independent advisor.
 - E. discuss the situation with an immediate supervisor.
43. According to the Institute of Management Accountants (IMA), the first step in resolving an ethical dilemma is to
- A. resign from the organization.
 - B. call the IMA's ethics hotline.
 - C. report the circumstances to a local newspaper.
 - D. consult with an objective, independent advisor.
 - E. discuss the situation with an immediate supervisor.
44. Which of the following is not one of the basic standards of the Institute of Management Accountants (IMA) Code of Ethics?
- A. Competence
 - B. Confidentiality
 - C. Honesty
 - D. Integrity
 - E. Credibility
45. Which of the following is not one of the overarching ethical principles of the Institute of Management Accountants (IMA) Code of Ethics?
- A. Competence
 - B. Responsibility
 - C. Honesty
 - D. Objectivity
 - E. Fairness
46. The financial plan of the revenues and resources needed to carry out activities and meet financial goals is called
- A. performance measure.
 - B. benchmarking.
 - C. budgeting.
 - D. responsibility center.
 - E. lean accounting.

47. The cost accounting system that minimizes wasteful or unnecessary transaction processes is
- A. performance measure.
 - B. benchmarking.
 - C. budgeting.
 - D. responsibility center.
 - E. lean accounting.
48. Continual process of measuring a company's own products, services or activities against competitors' performance is
- A. performance measure.
 - B. benchmarking.
 - C. budgeting.
 - D. responsibility center.
 - E. lean accounting.
49. The costing method that first assigns costs to activities and then assigns them to products based on the products' consumption of activities is called
- A. lean accounting.
 - B. responsibility centers.
 - C. activity-based costing.
 - D. budgeting.
 - E. outsourcing.
50. Having one or more of the firms' activities performed by another firm or individual in the supply or distribution chain is called
- A. lean accounting.
 - B. responsibility centers.
 - C. activity-based costing.
 - D. budgeting.
 - E. outsourcing
51. The system that identifies the costs of producing low-quality items is called
- A. customer relationship management.
 - B. distribution chain.
 - C. total quality management.
 - D. cost of quality.
 - E. enterprise resource planning.
52. The system that allows firms to target profitable customers by assessing customer revenue and costs is called
- A. customer relationship management.
 - B. distribution chain.
 - C. total quality management.
 - D. cost of quality.
 - E. enterprise resource planning.
53. Information technology that links the various processes of the company into a single comprehensive information system is called
- A. customer relationship management.
 - B. distribution chain.
 - C. total quality management.
 - D. cost of quality.
 - E. enterprise resource planning.

54. A management method by which the organization seeks to excel on all dimensions of quality is called
- customer relationship management.
 - distribution chain.
 - total quality management.
 - cost of quality.
 - enterprise resource planning.
55. Which of the following is not a key financial manager in an organization?
- Chief financial officer
 - Treasurer
 - External auditor
 - Controller
 - Cost accountant
56. Which of the following is not normally considered part of the value chain?
- Research and development
 - Purchasing
 - Administration
 - Distribution
 - Customer service
57. In 2013, the Turnkey Company had consulting revenues of \$1,000,000 while costs were \$750,000. In 2014, Turnkey will be introducing a new service that will generate \$150,000 in sales revenues and \$60,000 in costs. Assuming no changes are expected for the other services, operating profits are expected to increase by
- \$250,000.
 - \$150,000.
 - \$90,000.
 - \$60,000.
58. In 2013, the MoreForLess Company had revenues of \$2,000,000 and costs of \$1,500,000. During 2014, MoreForLess will be introducing a new product line that is expected to increase sales revenue by \$200,000 and costs by \$160,000. Assuming no changes are expected for the other products, the operating profits are expected to increase by
- \$540,000.
 - \$200,000.
 - \$160,000.
 - \$40,000.
59. Moving of inventory is an example of a(n)
- cost-benefit analysis.
 - value-added activity.
 - activity-based cost.
 - nonvalue-added activity.
60. Costs that change in response to a particular course of action are
- differential costs.
 - cost-benefit analysis.
 - activity-based costs
 - cost drivers.
61. Which of the following activities would not be included in the value chain of a manufacturing company?
- Research and Development
 - Customer Service
 - Design
 - Accounting

62. A firm's replies to customers' questions via email would be an example of which element of the value chain?
- Customer Service
 - Marketing
 - Design
 - Supply
63. The delivery of products or services to customers is an example of which element in the value chain?
- Production
 - Design
 - Marketing
 - Distribution
64. The extended value chain:
- is a set of consecutive operations or processes that begins with purchasing resources and ends with providing products or services that customers value.
 - is a related set of tasks, manual or automated, that transforms inputs into identifiable outputs.
 - incorporates how companies obtain their resources and distribute their products and services, using the services of other organizations.
 - 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.
65. Manufacturing firms use the value chain to take steps to improve the overall profitability of the firm by:
- placing greater emphasis on the value chain.
 - moving to an emphasis on upstream activities in the value chain.
 - moving to an emphasis on downstream activities in the value chain.
 - finding low-cost manufacturing locations.
66. During which step of the value chain process will a manufacturing company determine whether or not it has added utility?
- The Design component
 - The Purchasing process
 - The Production activity
 - Added utility occurs in all steps.
67. Which of the following types of organizations can most benefit from the implementation of value chain?
- Service firms
 - Not-for-profit organizations
 - Manufacturing firm.
 - All types of organizations can benefit from the implementation of value chain
68. Which of the following statements concerning the value chain is false?
- The goal of a value chain is to find areas where a company can either add value or reduce cost.
 - The value chain focuses on the entire production process, as well as the sale of the product and service after the sale.
 - If a company cannot compete in a specific area of the value chain, it might outsource that portion of the value chain to another entity which can perform it better.
 - Successful firms are ones that operate within the entire value chain, thereby overseeing every aspect of the value chain for the customer.
69. Which of the following could be considered part of the value chain in a service firm?
- Inspection of product
 - Advertising
 - Raw materials
 - Distribution

70. Place the four components in the order they appear along the value chain: A = Customer service; B = Design; C = Distribution; and D = Production.
- A. ABDC
 - B. ACDB
 - C. BDCA
 - D. BADC
71. The value chain is the order of business components in which:
- A. value is deducted from the products or services of a business.
 - B. value is proportionally added to the products or services of a business.
 - C. products or services are evaluated according to their value to the distribution chain.
 - D. utility is added to the products or services of an organization.
72. Cost accounting
- A. provides information on material usage.
 - B. provides information on the profitability of customer orders.
 - C. provides information on the efficiency of service department labor.
 - D. All of these.
73. Financial accounting
- A. focuses on the future.
 - B. must comply with GAAP (generally accepted accounting principles).
 - C. reports include detailed information on the various operating segments of the business.
 - D. is prepared for the use of management.
74. The individual who would most likely use only financial accounting information in making decisions is a
- A. vice president of marketing.
 - B. factory supervisor.
 - C. department manager.
 - D. company stockholder.
75. The financial accounting system is the primary source of information for
- A. decision making on the factory floor.
 - B. improving the performance level of customer service.
 - C. planning the budget for next year.
 - D. preparing the income statement for stockholders.
76. Cost accounting provides all of the following with the exception of
- A. pricing information from marketing studies.
 - B. nonfinancial information regarding the cost of operational efficiencies.
 - C. financial information on the cost of acquiring resources.
 - D. information for managerial accounting and financial accounting.
77. The primary objective of financial accounting is
- A. profitability analysis.
 - B. providing information for management decision making.
 - C. cost planning and cost controls.
 - D. reporting to investors, creditors, and government authorities.
78. Financial accounting provides a historical perspective, while cost accounting emphasizes
- A. reporting to stockholders.
 - B. a current perspective.
 - C. the future.
 - D. past transactions.

79. Which of the following does not represent a main focus of cost management information?

- A. Internal auditing and control
- B. Performance measurement
- C. Planning and decision making
- D. Preparation of financial statements

80. Surf Boards, Inc. had the following summarized results for the month ending July 30:

	<u>Actual</u>	<u>Budget</u>
Revenues	\$60,000	\$52,000
Costs	<u>53,600</u>	<u>45,600</u>
Operating profits	<u>\$ 6,400</u>	<u>\$ 6,400</u>

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.

81. Surf Boards, Inc. had the following summarized results for the month ending July 30:

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Operating profits	<u>\$ 6,400</u>	<u>\$ 6,400</u>

Assume that the budget was based on the sale of 104 surfboards at \$500 each and the actual results reflect the sale of 104 surfboards. What is 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 net income.
- C. If costs as a percentage of revenues had remained at the budgeted level, net income would be \$985 above budget.
- D. If costs as a percentage of revenues had remained at the budgeted levels, net income would be \$4,000 above budget.

82. Surf Boards, Inc. had the following summarized results for the month ending July 30:

	<u>Actual</u>	<u>Budget</u>
Revenues	\$60,000	\$52,000
Costs	<u>53,600</u>	<u>45,600</u>
Operating profits	<u>\$ 6,400</u>	<u>\$ 6,400</u>

Assume that an additional 10 surfboards were sold at the regular price, during additional store opening hours. What is 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 were needed, as net income increased.
- 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. All of these.

83. Lucena Corporation purchased a machine 7 years ago for \$339,000 when it launched product X05K. Unfortunately, this machine has broken down and cannot be repaired. The machine could be replaced by a new model 360 machine costing \$353,000 or by a new model 280 machine costing \$332,000. Management has decided to buy the model 280 machine. It has less capacity than the model 360 machine, but its capacity is sufficient to continue making product X05K. Management also considered, but rejected, the alternative of dropping product X05K and not replacing the old machine. If that were done, the \$332,000 invested in the new machine could instead have been invested in a project that would have returned a total of \$426,000. In making the decision to buy the model 280 machine rather than the model 360 machine, the differential cost was:
- A. \$21,000.
 - B. \$87,000.
 - C. \$7,000.
 - D. \$14,000.
84. A responsibility center has a manager assigned to lead the unit, taking responsibility for the unit's operations and resources, and the unit may be called a
- A. department.
 - B. division.
 - C. segment.
 - D. All of these.
85. Al's Brake Shop had sales revenues and operating costs in 2014 of \$650,000 and \$525,000, respectively. In 2015, Al's plans to expand the services it provides to customers to include lubrication services. Revenues are expected to increase by \$85,000 and operating costs by \$50,000 as a result of this expansion. Assuming that there are no changes to the existing brake business, operating profits would be expected to increase during 2015 by
- A. \$125,000.
 - B. \$85,000.
 - C. \$160,000.
 - D. \$35,000.
86. Al's Brake Shop had sales revenues and operating costs in 2014 of \$650,000 and \$525,000, respectively. In 2015, Al's plans to expand the services it provides to customers to include lubrication services. Revenues are expected to increase by \$85,000 and operating costs by \$50,000 as a result of this expansion. Assuming that there are no changes to the existing brake business, what is the amount of operating profits that are expected to be earned in 2015?
- A. \$125,000
 - B. \$85,000
 - C. \$160,000
 - D. \$35,000
87. The goals and objectives of establishing budgeting in an organization include all of the following except:
- A. the ability to decide whether goals can be achieved.
 - B. the resources needed to carry out its tasks.
 - C. anticipated revenues to be generated.
 - D. the consistent application of generally accepted accounting principles.
88. In 2013, the Turnkey Company had consulting revenues of \$1,000,000 while operating costs were \$750,000. In 2014, Turnkey will be introducing a new service that will generate \$150,000 in sales revenues and \$60,000 in operating costs. Assuming no changes are expected for the other services, the differential operating costs for 2014 will be
- A. \$250,000.
 - B. \$150,000.
 - C. \$90,000.
 - D. \$60,000.

89. In 2013, the Turnkey Company had consulting revenues of \$1,000,000 while operating costs were \$750,000. In 2014, Turnkey will be introducing a new service that will generate \$150,000 in sales revenues and \$60,000 in operating costs. Assuming no changes are expected for the other services, the differential revenue for 2014 will be
- \$250,000.
 - \$150,000.
 - \$90,000.
 - \$60,000.

90. San Juan, Inc. is considering two alternatives: A and B. The costs associated with the alternatives are listed below:

	<u>Alternative A</u>	<u>Alternative B</u>
Material costs	\$35,000	\$57,000
Processing costs	36,000	57,000
Building costs	12,000	28,000
Equipment rental	19,000	19,000

Are the materials costs and processing costs differential in the choice between alternatives A and B? (Ignore the building costs and equipment rental in this question.)

- Neither materials costs nor processing costs are differential.
 - Both materials costs and processing costs are differential.
 - Only processing costs are differential.
 - Only materials costs are differential.
91. San Juan, Inc. is considering two alternatives: A and B. The costs associated with the alternatives are listed below:

	<u>Alternative A</u>	<u>Alternative B</u>
Material costs	\$35,000	\$57,000
Processing costs	36,000	57,000
Building costs	12,000	28,000
Equipment rental	19,000	19,000

If only the differential costs of the two decisions are considered, the total cost of Alternative B is

- \$161,000.
 - \$131,500.
 - \$59,000.
 - \$102,000.
92. Two alternatives, identified X and Y, are under consideration at Hayden Corporation. Costs associated with the alternatives are listed below.

	<u>Alternative A</u>	<u>Alternative B</u>
Material costs	\$44,000	\$56,000
Processing costs	37,000	59,000
Building costs	14,000	14,000
Equipment rental	11,000	11,000

Are the materials costs and processing costs differential in the choice between alternatives X and Y? (Ignore the building costs and equipment rental in this question.)

- Both materials costs and processing costs are differential
- Only materials costs are differential
- Only processing costs are differential
- Neither materials costs nor processing costs are differential

93. Two alternatives, identified X and Y, are under consideration at Hayden Corporation. Costs associated with the alternatives are listed below.

	<u>Alternative A</u>	<u>Alternative B</u>
Material costs	\$44,000	\$56,000
Processing costs	37,000	59,000
Building costs	14,000	14,000
Equipment rental	11,000	11,000

What is the differential cost of Alternative Y over Alternative X?

- A. \$140,000
B. \$123,000
C. \$34,000
D. \$106,000
94. Which of the following cost accounting methods does not help firms keep the supply chain "lean" and add value throughout the chain?
A. Target costing
B. Activity-based costing
C. Throughput-costing
D. Performance measures
95. An Enterprise Resource Planning System can best be described as
A. a collection of programs that use a variety of unconnected databases.
B. a single database that collects data and feeds it into applications that support each of the company's business activities, such as purchases, production, distribution, and sales.
C. a database that is primarily used by a purchasing department to determine the correct amount of a particular supply item to purchase.
D. a sophisticated means of linking two or more companies to facilitate their planning processes.
96. The approaches and activities of managers in short-run and long-run planning and control decisions that increase value for customers and lower costs of products and services are known as
A. value chain management.
B. enterprise resource planning.
C. cost management.
D. customer value management.
97. R&D, production, and customer service are business functions that are all included as part of
A. the value chain.
B. benchmarking.
C. marketing.
D. the supply chain.
98. Cost leadership can improve on execution through
A. improved automation and a higher output of products.
B. benchmarking and total quality management.
C. cost cutting and downsizing of personnel.
D. improvements in product development.
99. All of the following are examples of total quality management practices except
A. redesign of a product to reduce its parts by 50 percent.
B. reduction in the movement required in a manufacturing job.
C. separating the sales and services functions.
D. raising raw material quality standards.

100. Which area(s) of a business can be improved by using a just-in-time (JIT) system?
- A. Production, purchasing, and delivery
 - B. Production only
 - C. Purchasing only
 - D. Production and purchasing only
101. The _____ is primarily responsible for cost accounting and financial accounting.
- A. COO (Chief Operating Officer)
 - B. CIO (Chief Information Officer)
 - C. treasurer
 - D. controller
102. All of the following individuals would report to the Chief Financial Officer (CFO) except the
- A. controller.
 - B. internal auditor.
 - C. production manager.
 - D. treasurer.
103. Examples of the controller's functions include all except
- A. cost accounting policies.
 - B. budgeting.
 - C. investor relations.
 - D. general ledger.
104. Cost accounting is an integral part of the _____ function in an organization.
- A. treasurer's
 - B. controller's
 - C. internal auditor's
 - D. president's
105. All of the following actions enhance the new focus on making cost accounting information more relevant in helping a firm achieve strategic goals except
- A. increasing emphasis on the management accountant as a business partner.
 - B. increasing emphasis on external financial reporting.
 - C. decreasing emphasis on financial statement inventory cost valuation.
 - D. increasing emphasis on timely and useful information.
106. All of the following are examples of total quality management practices except
- A. redesign of a product to reduce its parts by 50 percent.
 - B. reduction in the movement required in a manufacturing job.
 - C. separating the sales and services functions.
 - D. raising raw material quality standards.
107. The Institute of Management Accountants' (IMA) standards of ethical conduct for management accountants includes the elements of
- A. competence, confidentiality, integrity, and relevance.
 - B. competence, confidentiality, integrity, and credibility.
 - C. competence, confidentiality, independence, and objectivity.
 - D. competence, accuracy, integrity, and independence.
108. According to the IMA Code of Ethics, what should a management accountant do if a significant ethical situation can't be resolved?
- A. The accountant should confront the guilty party and demand the unethical action be stopped.
 - B. The accountant should try to rationalize and understand the position of the other party.
 - C. The accountant should say nothing about the matter until he or she has retired.
 - D. The accountant should first discuss the matter with the immediate supervisor.

109. With the enactment of the Sarbanes-Oxley Act of 2002, all public companies are now required by the SEC to disclose whether or not the company has
- an audit committee.
 - human resources guidelines.
 - a code of ethics.
 - a management compensation plan.
110. Which of the following is not an ethical standard of competence in the Standards of Ethical Conduct for Management Accountants?
- Development of professional knowledge and skills
 - Preparation of complete and clear reports and recommendations of relevant and reliable information
 - Refraining from engaging in activities that would discredit the profession
 - Performing professional duties in accordance with relevant laws, regulations and technical standards
111. The Sarbanes Oxley Act of 2002 requires an effective internal control system for publicly owned firms. Therefore, with regards to strategic investment decisions, it is important that management consider including
- internal audits of strategic decisions.
 - a code of ethics.
 - a system of preparing and reporting on investment decision.
 - All of these.
112. Where there is a lack of good performance measures, it is difficult to motivate managers by using
- performance-based incentives.
 - monetary rewards.
 - compensation.
 - rewards for products.
113. Which of the following is a **true** statement regarding performance evaluation?
- Managers should be evaluated on those things over which they have influence.
 - Managers should be evaluated on the performance of the entire organization.
 - Sales personnel do not have complete control over the level of sales.
 - Managers should not be evaluated on those things over which they have influence, if they do not have complete control over them.
114. Honda incurs many types of costs in its operations. Place the number of the appropriate stage in the value chain in Column 2 in the blank next to each cost in column 1.

	Cost	Stage in the Value Chain
_____	Transportation costs to ship vans to customers	1. Customer Service
_____	Labor costs for factory workers	2. Distribution
_____	Overtime costs for scientists working on new engine technology	3. Research & Development
_____	Utilities cost for the design testing center	4. Marketing
_____	Costs to survey customers about their satisfaction	5. Production
_____	Costs to sponsor a sporting event	6. Design

115. Northern King is an integrated provider of genetically engineered corn. Many types of costs are incurred in its operations. Place the number of the appropriate stage in the value chain in Column 2 in the blank next to each cost in column 1.

Cost	Stage in the Value Chain
_____ Warehouse costs to store seed awaiting shipment to customers	1. Customer Service
_____ Utility costs for seed mill	2. Distribution
_____ Equipment costs in genetics laboratory	3. Research & Development
_____ Labor costs to run help line call center	4. Marketing
_____ Costs to prepare advertising campaign in national agriculture magazine	5. Production
_____ Costs to contract with growers to provide seed	6. Purchasing

116. Cindy's Limo Service provides transportation services in and around Middleville. Its profits have been declining, and management is planning to add a package delivery service that is expected to increase revenue by \$275,000 per year. The total cost to lease additional delivery vehicles from the local dealer is \$60,000 per year. The present manager will continue to supervise all services. However, labor and utilities costs will increase by 40% and rent and other costs will increase by 15% when the package delivery service is added.

**Cindy's Limo Service
Annual Income Statement
Before Expansion**

Sales revenue	\$ 960,000
Costs:	
Vehicle leases	400,000
Labor	290,000
Utilities	50,000
Rent	100,000
Other costs	60,000
Manager's salary	<u>120,000</u>
Total costs	<u>\$1,020,000</u>
Operating profit (loss)	<u>\$ (60,000)</u>

- a. Prepare a report of the differential costs and revenues if the delivery service is added.
- b. Should management start up the delivery service? Explain your answer.

117. Looman Inc. is a management consulting firm that specializes in management training programs. In-Line Manufacturing Inc. has approached Looman to contract for management training for a one-year period. Last year's income statement for Looman is as follows:

Revenues	<u>\$360,000</u>
Costs	
Labor	120,000
Equipment lease	12,000
Rent	24,000
Utilities	8,400
Supplies	23,600
Other costs	14,400
Manager's salary	<u>80,000</u>
Total costs	<u>282,400</u>
Operating profit	<u>\$ 77,600</u>

To satisfy the In-Line contract, another part-time trainer will need to be hired at \$42,000. Supplies will increase by 12% and other costs will increase by 15%. In addition, new equipment will need to be leased at a cost of \$2,500.

- What are the differential costs that would be incurred if the In-Line contract is signed?
- If In-Line will pay \$55,000 for one year, should Looman accept the contract? Explain your answer.

118. The Anderson Company reported the following results for the manufacture and sale of one of its products known as Bangers during the most recent year.

Sales (6,500 Bangers at \$130 each)	\$845,000
Cost of sales	390,000
Distribution costs	65,000
Advertising expense	275,000
Salaries	25,000
Building costs	<u>145,000</u>
Operating loss	<u>(\$55,000)</u>

The Anderson Company is trying to determine whether or not to discontinue the manufacture and sale of Bangers. The operating results reported above for last year are expected to continue in the foreseeable future if the product is not dropped. The building costs represent the costs of production facilities and equipment that the Bangers product shares with other products produced by Anderson. If the Bangers product were dropped, there would be no change in the building costs of the company. Management has determined that discontinuing the manufacture and sale of Bangers will have no effect on the company's other product lines. Determine the change in operating profits that will happen if the manufacture and sale of Bangers is discontinued.

119. The management of Godzilla Corporation is considering dropping product XYZ123. Data from the company's accounting system appear below:

Sales	\$260,000
Cost of goods sold	125,000
Building expenses	88,000
Selling and administrative expenses	75,000

All building expenses of the company are fully allocated to products in the company's accounting system. Further investigation has revealed that \$42,000 of the building expenses and \$48,000 of the selling and administrative expenses will not be incurred if product XYZ123 is discontinued.

- According to the company's accounting system, what are the operating profits earned by product XYZ123?
- What would be the impact on the company's overall operating profits if product XYZ123 is dropped? Should the product be dropped?

120. The management of Mystical Corporation has been concerned for some time with the financial performance of its product E35R and has considered discontinuing it on several occasions. Data from the company's accounting system appear below:

Sales	\$650,000
Cost of goods sold	\$293,000
Building expenses	\$221,000
Selling and administrative expenses	\$150,000

In the company's accounting system all building expenses of the company are fully allocated to products. Further investigation has revealed that \$95,000 of the building expenses and \$85,000 of the selling and administrative expenses will not be incurred if product E35R is discontinued.

- According to the company's accounting system, what are the operating profits (losses) earned by product E35R?
- What would be the effect on the company's overall operating profits if product E35R is dropped?

121. Place the letter of the appropriate element of an organization's value chain in Column 2 in the blank next to each operation in Column 1.

<u>Column 1</u>	<u>Column 2</u>
___ Crate and Barrel's replies to customers' questions on merchandise	A. Research and Development
___ Updating Pottery Barn's electronic Internet catalogue of sporting goods and spring merchandise.	B. Design
___ Development of new software applications at Oracle.	C. Supply
___ Inspection of incoming chip parts at IBM.	D. Production
___ Contracting with Federal Express to ship computers to customers at Gateway	E. Marketing
___ Writing of software programs at IBM's Lotus Division.	F. Distribution
___ Creation of new movie ideas at Paramount Pictures	G. Customer Service

122.131 vors 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	<u>25,000</u>
Total Costs	<u>81,000</u>
Operating Profits (Losses)	<u>(\$6,000)</u>

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.

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

123. 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:

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

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?

124. Place the letter of the appropriate business function of the value chain in Column 2 in the blank next to each cost item in Column 1.

Column 1	Column 2
___ cost of customer order forms	A Research and development
___ cost of paper used in manufacture of books	B Design
___ cost of paper used in packing cartons to ship books	C Production
___ cost of paper used in display at national trade show	D Marketing
___ depreciation of trucks used to transport books to college bookstores	E Distribution
___ cost of the wood used to manufacture paper	F Customer service
___ salary of the scientists attempting to find another source of printing ink	
___ cost of defining the book size so that a standard-sized box is filled to capacity	

125. Springfield Manufacturing produces electronic storage devices, and uses the following three-part classification for its manufacturing costs: materials, labor, and support costs. Total support costs for January were \$300 million, and were allocated to each product on the basis of labor costs of each line. Summary data (in millions) for January for the most popular electronic storage device, the Big Bertha, was:

Material costs	\$9,000,000
Labor costs	\$3,000,000
Support costs	\$8,500,000
Units produced	40,000

- a. Compute the manufacturing cost per unit for each product produced in January.
- b. Suppose production will be reduced to 30,000 units in February. Speculate as to whether the unit costs in February will most likely be higher or lower than unit costs in January; it is not necessary to calculate the exact February unit cost. Briefly explain your reasoning.

126. Match each business function with its representative cost driver.

	Function	Insert letter of appropriate driver (A through F)
1.	Purchasing	
2.	Billing	
3.	Shipping	
4.	Computer Support	
5.	Personnel	
6.	Customer Service	

The list of representative cost drivers in the right column below are randomized with respect to the list of functions in the left column. That is, they do not match.

Function	Representative Cost Driver
Purchasing	A. Number of employees
Billing	B. Number of shipments
Shipping	C. Number of customers
Computer Support	D. Number of invoices
Personnel	E. Number of desktop computers
Customer Service	F. Number of purchase orders

Required:

127. A restaurant is deciding whether it wants to update its image or not. It currently has a cozy appeal with an outdated décor that is still in good condition, menus and carpet that need to be replaced anyway, and loyal customers. Identify the following for the restaurant management:
- Costs that are relevant to this decision.
 - Costs that would not be differential to this decision.
 - Any qualitative factors that should be considered.
128. You have been employed as an entry-level management accountant for a little under a year. You suspect that your immediate supervisor is involved in a significant fraud involving diverting of company assets to personal use. Briefly describe the steps you might take to resolve this dilemma.

129. Healthy Dog, Inc., currently manufactures three different types of scientifically balanced dog food. The firm is considering eliminating one of the three products. What factors should be taken into account in making this decision?
130. Comstock Mining Company mines iron ore for production into various metal products. During recent years, the company has had large fluctuations in its inventories of metal ingots. Much of the volatility of the inventory levels is due to the variability of demand by the company's largest customers, automobile manufacturers. For large orders, the company has the technology to quickly shift production from one product to another. Explain how the company can improve its inventory control system and give the advantages of whatever you recommend.
131. JIT is a large, publicly held Corporation. The company does about 80% of its work in government contracts. All contracts use a cost plus fixed fee basis; costs of jobs are agreed upon by contract. Any overruns will result in losses to the company. The company controller, Brendan Behan CPA, CMA, is discussing two current jobs with the Job Supervisor, Ashlee Beth. Job 100 is currently coming in under budget, but due to construction problems, Job 102 is 20% over budget. Behan is considering the possibility of having employees who work on Job 102 record their time to Job 101. What are the implications of this decision?

132. The owner of a small retail business asks, "Why do I need cost accountants? My CPA produces financial statements, which are sufficient for me to discover my costs. Look at my Income Statement. I expect sales to increase by 10% next year, so I am planning on a 10% increase in profits. I don't need a cost accountant to tell me that."

**Income Statement For the Year
Ending December 31**

Sales	\$457,234
Cost of Goods Sold	<u>296,348</u>
Gross Margin	160,886
Selling Costs	(76,234)
Administrative Costs	<u>(62,350)</u>
Profit before Taxes	<u><u>\$ 22,302</u></u>

Use your knowledge of the concept of differential costs and explain why a cost accountant would question the conclusion that a 10% increase in sales would yield a 10% increase in profit.

133. Create a diagram of the value chain by putting the following components into the correct order: a) purchasing; b) marketing and sales; c) research and development; d) customer service; e) distribution; f) design; g) production.
134. Explain the difference between a value chain, a supply chain, and a distribution chain.
135. Compare financial accounting and cost accounting using the following concepts: users of the information; important criteria; who establishes or defines the system; and how to determine an accounting treatment.

136. The IMA Code of Ethics describes three basic steps a cost accountant should take when faced with an ethical conflict: Discuss, clarify, and consult. Describe each of these three steps.

137. Respond to this comment: "Since cost accountants just prepare accounting data for internal management, cost accountants do not need to be concerned with GAAP or IFRS."

138. What are characteristics of information used in decision making?

139. The Finger Curl is a small but prosperous hair cutting salon. Sally Henry, 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, Henry 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., 2013). The Finger Curl's income statement for the most recent year is presented below.

Required:

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

The Finger Curl
Income Statement for the Year Ended December 2014

Sales Revenue		\$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 Profits		 <u>\$ 58,000</u>

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

140. The manager of a profit center of a large electronics manufacturing corporation made some projections regarding sales and profits for the upcoming final quarter of the year. The managers' performance evaluation and compensation depended significantly on his ability to meet budget goals. The manager discovered that the final quarter would have to be a particularly good quarter in order to meet these goals. He decided to implement a sales program offering liberal payment terms in order to pull some sales that would normally occur next year into the current year. Customers accepting delivery in the fourth quarter would not have to pay the invoice for 140 days. Also, he sold some equipment that was not being used and realized a significant profit on the sale.

Are these actions ethical? Why or why not?

141. The controller of one division of a large diversified firm is compensated by salary plus bonus. The bonus is a significant part of total compensation, and is based directly on the profits of the division. Thus, the controller has an incentive to find ways to increase profits, including the delay of discretionary expenses such as research and development, delay of maintenance and repair of manufacturing equipment, and delay of sales promotions.

Is finding ways to increase profits as described above unethical? Why or why not? Who is to blame, if anyone?

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

Anderson'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.

1. 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?
2. What is the role of the cost management expert in this program?
3. Finally, why should the machine operators be involved, as they are not engineers?

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

143. Sandra Pilsden, the Vice-President for Human Resources in Learning, 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	<u>\$439,350</u>

Pilsden 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.

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

144. Levi's Strauss and Co., maker of Levi's familiar 501 and 505 brands of jeans, also make a "Signature" brand that was introduced several years ago for discount retailers such as Wal-Mart. Levi's strategy with the new jeans was to sell a competitively priced pair. The jeans were to be about one-half the price of the familiar 501 and 505 jeans. To get costs down Levi's would:

- Use cheaper fabrics and materials.
- Shun costly mass-market advertising.
- Strictly limit the number of fits, styles, and colors.
- The Signature brand had a good first year of sales; assume that results for the second year and later are not yet in.

- Assess the new strategy at Levi. What do you think are the potential benefits and risks?
- How will the firm's value chain and balanced scorecard change as a result of the new strategy?

145. Mr. Lee is the production Manufacturing Manager of Cathy Company. It is the beginning of the month and he storms into the controllers department, clutching a large folder of reports. "Why am I getting so many reports? I don't need them nor do I want all the details. I've delegated responsibility to my managers so I don't have to worry about details. You've got to do something about this, John." John, the controller, starts to think about the problem that seems to have come about as the company decentralized with many layers of responsibility. He has a vague memory of something he learned from his old cost accounting class and has called you, his former professor, for some advice or suggestions in order to reduce the paper flow.

Briefly describe the concept of the hierarchy of performance reports.

146. Adair Company has been busy over the first few years of its existence in penetrating its market and gaining a respectable market share. To facilitate this, Mr. Adair, the CEO, and his controller, Mr. Brown, have been developing the annual master budgets. To date this approach has worked well.

Adair has been acquired by a company in a related business but will continue to operate as an independent subsidiary. The CFO of the acquiring company, Mr. Horwitz, has suggested to Mr. Adair that, since it was expected that his company would continue to grow, it adopt a departmental budgeting system; a suggestion Mr. Adair agreed to readily. Mr. Horwitz explained to Adair's departmental managers the concepts of a departmental participative budgeting system and their involvement. The managers were encouraged to take the information and come back with suggestions which could then be put into a formal budget process.

- a. What benefits will accrue to Adair under this new budgeting system?
- b. What behavioral issues might arise for departmental managers and for production workers?
- c. What is the most probable long-term reaction of Adair's people to the participative budget system?

147. Traditionally, companies in the United States have employed a "push" manufacturing style. Studies in Activity Based Management and Quality Control have indicated that this approach is filled with many non-value-added activities, which increase overall costs and reduce profits. The "push" style is being replaced with a "pull" approach.

Briefly describe the major differences between the push and pull approaches. What non-value added activities are eliminated in a pull manufacturing system?

148. The New York Times recently reported that a number of publicly-held corporations have been accused of illegally doctoring hourly employees' time records. Examples included:

- Workers sued Family Dollar and Pep Boys, accusing managers of deleting hours from their time records.
- More than a dozen former Wal-Mart employees said in interviews and depositions that managers had altered time records to shortchange employees.
- The Department of Labor reached two back-pay settlements with Kinko's photocopy centers after finding that managers had erased time for 13 employees.

When interviewed, many of the managers cited pressure from upper-management and the impact of their actions on their own compensation as underlying causes for their actions. All of the companies strongly denied encouraging such illegal and unethical behavior by managers. Compensation experts interviewed agreed that the companies' incentive performance systems may have contributed to the managers' behavior. (*New York Times*, April 4, 2004)

- a. Explain how the incentive performance systems of the above named companies could have contributed to this illegal behavior by managers.
- b. Discuss the ethical issues involved in the design of incentive performance systems. In designing a performance-based incentive system, what measures should companies take to avoid illegal and unethical behavior by supervisors?

ch01 Key

1. FALSE
2. TRUE
3. FALSE
4. TRUE
5. TRUE
6. FALSE
7. TRUE
8. FALSE
9. FALSE
10. TRUE
11. FALSE
12. TRUE
13. FALSE
14. TRUE
15. TRUE
16. FALSE
17. TRUE
18. FALSE
19. TRUE
20. FALSE
21. FALSE
22. TRUE
23. FALSE
24. TRUE
25. FALSE
26. FALSE
27. FALSE
28. FALSE
29. A
30. C
31. B
32. A
33. D
34. B
35. A
36. C

37. A
38. B
39. A
40. B
41. C
42. A
43. E
44. C
45. A
46. C
47. E
48. B
49. C
50. E
51. D
52. A
53. E
54. C
55. C
56. C
57. C
58. D
59. D
60. A
61. D
62. A
63. D
64. C
65. D
66. D
67. D
68. D
69. B
70. C
71. D
72. D
73. B
74. D

75. D
76. A
77. D
78. C
79. A
80. C
81. C
82. D
83. A
84. D
85. D
86. C
87. D
88. C
89. B
90. B
91. C
92. A
93. C
94. C
95. B
96. A
97. A
98. B
99. C
100. A
101. D
102. C
103. C
104. B
105. B
106. C
107. B
108. D
109. C
110. C
111. D
112. A

113. A

	Cost	Stage in the Value Chain
2	Transportation costs to ship vans to customers	1. Customer Service
5	Labor costs for factory workers	2. Distribution
3	Overtime costs for scientists working on new engine technology	3. Research & Development
6	Utilities cost for the design testing center	4. Marketing
1	Costs to survey customers about their satisfaction	5. Production

114.

	Cost	Stage in the Value Chain
2	Warehouse costs to store seed awaiting shipment to customers	1. Customer Service
5	Utility costs for seed mill	2. Distribution
3	Equipment costs in genetics laboratory	3. Research & Development
1	Labor costs to run help line call center	4. Marketing
4	Costs to prepare advertising campaign in national agriculture magazine	5. Production
6	Costs to contract with growers to provide seed	6. Purchasing

115.

b. The decision to expand and offer the delivery service results in differential profits of \$55,000, so it is profitable to expand. Note that only differential costs and revenues figured in the decision. The manager's salary did not change, so it was not included.

	Status Quo No Delivery Service	Alternative With Delivery Service	Difference
	(1)	(2)	(3)
Sales Revenue	\$ 960,000	\$1,235,000	\$275,000
Costs:			
Vehicle leases	400,000	460,000	60,000
Labor	290,000	406,000	116,000
Utilities	50,000	70,000	20,000
Rent	100,000	115,000	15,000
Other costs	60,000	69,000	9,000
Manager's salary	120,000	120,000	0
Total costs	\$1,020,000	\$1,240,000	\$220,000
Operating profit (loss)	\$ (60,000)	\$ (5,000)	\$ 55,000

116. a.

b. Differential revenues of \$55,000 will exceed the differential costs of \$49,492. As a result, Looman will earn an additional \$5,508 in operating profit if it accepts the contract.

Differential Costs

Trainer	\$ 42,000
Supplies (12% x 23,600)	2,832
Other costs (15% x 14,400)	2,160
New equipment lease	<u>2,500</u>
	\$ 49,492

117. a. Differential costs incurred if the contract is signed:

Sales (6,500 Bangers at \$130 each)	(\$845,000)
Cost of sales	390,000
Distribution costs	65,000
Advertising expense	275,000
Salaries	<u>25,000</u>
Increase (decrease) in operating profits	<u>(\$ 90,000)</u>

118. Although the company's net operating profits would seem to increase by \$55,000 if the manufacture and sale of Bangers were discontinued, the building costs, which amount to \$145,000, would continue regardless. As a result, operating profits will actually decrease if the manufacture and sale of Bangers is discontinued as shown below. (Note that the decrease in revenues that would result will decrease operating profits and, as such, it is shown as a negative number below. The cost savings listed below would increase operating profits, which is why these amounts are shown as positive amounts below.)

Overall operating profits would decrease by \$45,000 if product R10C were dropped. Therefore, the product should not be dropped.

Sales	(\$260,000)
Cost of goods sold	125,000
Building expenses (\$88,000 - \$46,000)	42,000
Selling and administrative expenses (\$75,000 - \$27,000)	<u>48,000</u>
Increase (decrease) in operating profits	<u>(\$ 45,000)</u>

b. Impact on company's overall operating profits if product XYZ123 is dropped:

Sales	\$260,000
Cost of goods sold	125,000
Building expenses	88,000
Selling and administrative expenses	<u>75,000</u>
Operating profits (losses)	<u>(\$28,000)</u>

119. a. Operating profits (losses) earned by product XYZ123:

Overall operating profits would decrease by \$177,000 if product E35R were dropped. Therefore, the product should not be dropped.

Sales	(<u>\$650,000</u>)
Cost of goods sold	293,000
Building expenses	95,000
Selling and administrative expenses	<u>85,000</u>
Increase (decrease) in operating profits	<u>(<u>\$177,000</u>)</u>

b. Impact on company's overall operating profits if product E35R is dropped:

Sales	\$650,000
Cost of goods sold	\$293,000
Building expenses	\$221,000
Selling and administrative expenses	<u>\$150,000</u>
Operating profits (losses)	<u>(<u>\$14,000</u>)</u>

120. a. Operating profits (losses) earned by product E35R:

Column 1	Column 2
<u>G</u> Crate and Barrel's replies to customers' questions on merchandise	A. Research and Development
<u>E</u> Updating Pottery Barn's electronic Internet catalogue of sporting goods and spring merchandise.	B. Design
<u>B</u> Development of new software applications at Oracle.	C. Supply
<u>C</u> Inspection of incoming chip parts at IBM.	D. Production
<u>F</u> Contracting with Federal Express to ship computers to customers at Gateway	E. Marketing
<u>D</u> Writing of software programs at IBM's Lotus Division.	F. Distribution
<u>A</u> Creation of new movie ideas at Paramount Pictures	G. Customer Service

121.

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.

	<u>Status Quo</u>	<u>Alternative: Add Sandwiches</u>	<u>Difference</u>
Sales	\$75,000	\$135,000	\$60,000
Costs:			
Food supplies	20,000	50,000	30,000
Labor	16,000	22,400	6,400
Utilities	4,000	4,000	0
Rent	12,000	12,000	0
Other	4,000	4,400	400
Manager's salary	<u>25,000</u>	<u>25,000</u>	<u>0</u>
Total Costs	<u>81,000</u>	<u>117,800</u>	<u>36,800</u>
Operating Profits (Losses)	<u>(<u>\$6,000</u>)</u>	<u>(<u>\$17,200</u>)</u>	<u>(<u>\$23,200</u>)</u>

122. a.

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.

Additional mortgage cost	\$ 2,000
Private school savings	(2,000)
Tax savings (\$700 x 20%)	(175)
Increased auto cost (\$800 x 20%)	160
Increased utilities (\$500 x 10%)	50
Net Increase (decrease)	<u>\$ 35</u>

123. 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:

	Column 1	Column 2
<u>D</u>	cost of customer order forms	A Research and development
<u>C</u>	cost of paper used in manufacture of books	B Design
<u>E</u>	cost of paper used in packing cartons to ship books	C Production
<u>D</u>	cost of paper used in display at national trade show	D Marketing
<u>E</u>	depreciation of trucks used to transport books to college bookstores	E Distribution
<u>C</u>	cost of the wood used to manufacture paper	F Customer service
<u>A</u>	salary of the scientists attempting to find another source of printing ink	
<u>B</u>	cost of defining the book size so that a standard-sized box is filled to capacity	

124.

b. Unit costs should be higher in February if only 30,000 units are to be produced. Indirect manufacturing costs most likely include both fixed and variable components. Since fewer units are expected to be produced in February, total fixed costs will be spread over fewer units. This will result in an increase in total cost per unit since variable costs per unit will most likely not change with the decreased production.
 $(\$9,000,000 + \$3,000,000 + \$8,500,000) \div 40,000 = \512.50 per unit.

125. a. Unit costs for January were:

	Function	Insert letter of appropriate driver (A through F)
1.	Purchasing	F
2.	Billing	D
3.	Shipping	B
4.	Computer Support	E
5.	Personnel	A
6.	Customer Service	C

126.

c. Qualitative considerations include whether the restaurant will lose that cozy appeal it currently has, if the restaurant needs to be closed for renovations it may result in loss of customers, and new customers may not be the type of customer they want to attract.

b. Costs that are not differential include replacing the menus and the carpet since they need to be replaced whether the image is updated or not.

a. Relevant costs include a one-time cost of the renovation for the updated image, and a change in future sales which includes an increase in sales due to the updated image, decrease in sales due to loss of that cozy appeal, and loss of sales due to being closed or having a limited serving area during renovation.

127. For the decision of whether to update the restaurant's image:

128. The management accountant should first consult any internal company procedures concerning the resolution of ethical issues, and make sure these procedures are followed as closely as possible. At the same time, the management accountant should make sure that the facts are accurate, and are not based on rumors or inaccurate information. If these policies do not resolve the situation, the management accountant should present the facts to the next higher managerial level. The relevant ethical issues should be clarified with an objective advisor (e.g., Institute of Management Accountants hotline). The management accountant should consider consulting with an attorney to be aware of his or her own rights and responsibilities. If all internal review procedures have still not resolved the ethical situation, the managerial accountant might have to resign and write an informative letter to an appropriate representative of the organization, and perhaps notify other parties.

129. In deciding whether or not to eliminate a product, the firm should determine if costs that can be eliminated will exceed the revenues that will be lost. The firm needs to classify the costs into those costs which will be eliminated and therefore are relevant, and which costs will continue even if the product is deleted. Costs that often continue are those costs which have been allocated rather than incurred directly by the product. The firm must also look to see if any other products may be harmed by the elimination of the product. Maybe the products are complements, and loss of one sale will result in loss of another. The firm should consider whether another product's sales might increase if the product is deleted, which could be an opportunity to earn more contribution from another area. Can the firm use the space freed up for some other purpose that could generate additional inflows, which is an opportunity cost? The firm must also look at how its reputation among its customers for selling a full line of products might be damaged as a result of this decision.

5. Reductions in paperwork.
4. Reduction in total manufacturing costs; and
3. Reduction in risks of obsolete inventories;
2. Reductions in carrying and handling costs of inventories;
1. Lower inventory requirements;

130. The company can probably benefit from changing to a just-in-time system for inventory control. This would allow the company to be responsive to actual needs rather than finished goods inventory building. The advantages would be:

131. This is clearly an unethical practice. Since the contract price is a legally binding document, JIT would first be violating a legal arrangement with the government. The company could be held liable for the excess charges. This could result in fines, interest and punitive damages; criminal and civil charges could be levied against the employees knowingly involved in these practices. The practice also misleads managers who rely on accurate cost information for pricing, cost control and other decisions. If the jobs are cost plus fixed fee, the client is paying more than he should for the work. In fact, a government indictment could have ramifications of future lost business, not only with the government, but also other potential customers. In addition, Brendan and Ashlee could be faced with the loss of their jobs and reputations. As a CPA, Brendan could further lose his professional certification by violating the Code of Ethics of the American Institute of CPAs.

132. The primary purpose of this exercise is to challenge students to think beyond the material presented in the chapter and to write/justify their responses. Answers will vary in depth and breadth, but should mention the change in costs may not be linear, some costs are certainly fixed and others are variable, and the above changes are based on estimates of changes in the cost drivers.

133. c) research & development → f) design → a) purchasing → g) production → b) marketing and sales → e) distribution → d) customer service

134. The value chain is the set of activities that expand the entire transformation process from raw resources into goods or services purchased and consumed by the end users. The supply chain is the set of firms and individuals that sells goods and services to a firm. The supply chain is an input for a firm. The distribution chain is the set of firms or individuals that buy and distribute the goods from the firm. The distribution chain is the output

Concepts	Financial accounting	Cost accounting
Users of the information	External: investors, creditors, owners	Internal: managers
Important criteria	Comparability, decision relevance for investors	Decision relevance for managers, timeliness
Who establishes or defines the system	External standard-setting group	Managers
How to determine an accounting treatment	Standards and rules	Relevance for decision making

135.

Consult with an attorney about your rights and obligations.

Clarify the relevant issues and concepts by discussions with a disinterested party.

136. Discuss the conflict with your immediate supervisor or, if the immediate supervisor is involved, the next level in authority.

137. Although internal accounting is concerned with decision relevance for managers, the cost accountant still needs to be informed as to the GAAP/IFRS concepts regarding recording and measuring of costs.

Decision making also involves qualitative characteristics, which are the factors in a decision problem that cannot be expressed in numerical terms. Examples could include poor employee morale, the loss of control that occurs if certain processes are outsourced, and the harm done to an organization if a manager places his or her own goals over the goals of the organization. Quantitative analysis can be used to determine the cost of qualitative factors. Weighing the quantitative and qualitative factors in making decisions is the essence of management.

Relevant and accurate information is of value only if it is timely, that is, available in time to make a decision. In an ideal world, the best information will be relevant, accurate, and timely. However, rarely does an organization operate in an ideal environment and some compromise may be needed -- particularly between accuracy and timeliness. More accurate information will take longer to produce. There is an inverse relationship between accuracy and timeliness, and the two characteristics must be balanced as to determine what is acceptable.

Information used in decision making must also be accurate or it will be of little use. Accurate information is precise. If cost information is imprecise because of incorrect calculations or incomplete records, the information will not be very useful. But, the information must also be relevant. Highly accurate but irrelevant data are of no value to the decision-maker.

138. Information used in decision making must be relevant, accurate, timely, and it may be qualitative in nature. Relevant information is pertinent to a decision, i.e., it will make a difference in the decision being made. Because different managerial problems usually require different data, a difficulty is deciding what information is relevant to the situation under review.

- Henry will have more responsibilities in overseeing the expansion, additional employees and more customers reducing the quality and quantity of personal time available.

- Offering a variety of services will allow Henry to quote package prices on different combinations of services.

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

- 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.

b. Other factors that Henry might consider are as follows:

Based on the financial analysis, Sally Henry 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.

The Finger Curl
Income Statement for the Year Ended December 2014

	Status Quo		Alternative Expand	Difference
Sales Revenue	\$220,000		\$55,000	\$275,000
Costs:				
Labor	\$52,000		26,000	\$78,000
Utilities	12,000	1	3,000	15,000
Supplies	45,000	2	11,250	56,250
Rent	18,000	3	3,600	21,600
Miscellaneous	5,000	4	500	5,500
Manager's Salary	<u>30,000</u>		<u>0</u>	<u>30,000</u>
Operating Profits	<u>\$58,000</u>		<u>\$10,650</u>	<u>\$68,650</u>

1 is 25% of \$12,000

2 is 25% of \$45,000

3 is 20% of \$18,000

4 is 10% of \$5,000

139. a. The financial implications of expanding the services offered by The Finger Curl are as follows:

- Sale of equipment - may be acceptable, a business decision that should be judged on how it affects the firm's operations and profits; may not be acceptable if done just to show a short term gain that would improve current period profit.
 - Attempt to pull sales from one period to another - may not be acceptable. If the purpose of the change in credit terms is simply to move sales from one period to another, then the result is misleading financial reports and fraudulent; if the objective is to increase sales through management of credit policies, then acceptable.
 - Liberal credit terms - Acceptable, a business strategy that should be judged on how it affects the firm's operations and profits
140. Each of the manager's actions needs to be considered separately:

Probably both the incentive system and the controller are to blame in this case. While it is not reasonable to expect that the firm can design a bias-free incentive system, it appears that the firm has not done an acceptable job of developing a system that will reward performance based upon the firm's critical success factors, instead of short-term profits only. Improvements in the incentive scheme are possible and necessary. On the other hand, the controller cannot be excused by taking advantage of the opportunity to manipulate profits. The standards are clear on the required professional behavior in this case, and the controller has ignored them for self-serving purposes.

141. Since the actions contemplated by the controller are not in the best interests of the company, these actions are probably not ethical, and are in conflict with the ethical standard of integrity. The situation displays both conflict of interests and an attempt to subvert the firm's performance incentive system.

3. 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.

2. 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).

142. 1. 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.

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

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

The total cost associated with outsourcing the function will be \$413,350 compared to \$439,350 if the payroll function is not outsourced. Therefore, Learning 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.

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

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

b. The firm's value chain will likely change little, as the manufacture of the jeans will continue to be produced in low-cost facilities worldwide. The largest difference in the jeans will be in the fabrics used, the design, and the variety of jeans offered. The balanced scorecard for Levi's is not likely to change much either, as noted above for the value chain. Levi Strauss uses the BSC in its shared services center in Eugene Oregon. Michael Porter's observation might be that the firm is in risk of getting "stuck in the middle" between the cost leadership and differentiation strategies.

- Customers may get bored and want more variety
- After a period of buzz, may sink below the radar
- Signature jeans could end up looking and feeling shoddy
- Could turn off department store customers of Levi's core jeans

144. a. Recent annual reports show that sales and profits on the Signature line are doing well. Levi's has a portion of its web site devoted to the Signature line ([http://www.levistrauss.com/signature.com](http://www.levistrauss.com/signature)). The risks of the new line are that it might pull the company from what has been a tradition of differentiated products (501, 505) to cost leadership (the Signature line), leaving consumers confused about the Levi brand. The risks of the new brand include:

As the reports are prepared, the total cost line, for example, from the cost center is included as one line in the performance report of the production department along with total costs for the production departments other work centers. The production department's total cost is included as a single line item in the report for the next level up, and so on. As one moves up the organization chart, the reports get more and more aggregated; as one moves down, they get more disaggregated.

145. The hierarchy of performance reports starts at the lowest level of responsibility and builds towards the top. Each manager receives the performance report for his or her own subunit in addition to the performance reports for the major subunits in the next lower level that he or she manages.

c. If there is a perception that the process has worked well, all involved will be motivated to continue with the process. If there is a feeling that things have not worked well or evaluations have been unfair, they will not work with the process.

b. Departmental managers will face some positive points in that they are more likely to be motivated to work with a budget they had a hand in developing. They also should accept the results of the performance evaluation and accountability more readily. Unfortunately, there may be tendencies to pad the budget before the fact or manipulate the figures after the fact in order to look better for the evaluation, especially if there are monetary rewards involved. Production workers will have some similar reactions depending on the degree of their involvement in the process. If they consider the budget fair, they will work with it; if not, they might sabotage it.

146. a. There will be improved communication and coordination between departments; problems might be identified sooner since the managers are closer to the action; and accountability and performance evaluation should be easier to do.

A pull manufacturer "pulls" production through the process by customer orders, rather than "pushes" them through with master production schedules. A sales order triggers a production order. The production order triggers orders to suppliers, who ship parts immediately. The Just-in-Time approach is flexible to customer needs and requires lower inventory costs than traditional methods. Because suppliers tend to be preapproved and more reliable, costs of quality are reduced. Non-value added activities such as storage, quality control, downtime, waiting time are avoided in a pull manufacturing system.

147. A push manufacturer begins by forecasting total orders for a time period. The manufacturer orders materials based on the forecast. Production schedules are produced based on the forecast. Production is then "pushed" through. Because production is based on sales, the company may end up producing units for which there is not as much demand as forecast, or have too few units available of a product for which there is heavy demand. This creates costs of storing excess inventory and opportunity cost of lost sales. In addition, because units are pushed through the system, the timing of receiving materials is not balanced to the production of activities, particularly at production bottlenecks, which results in a wasteful buildup of inventories, either temporary or permanent. Push production can reduce motivation to improve quality and can reinforce motivation to overuse non-bottleneck activities.

- Establishing an anonymous call-in line for employees to report possible unethical behavior.
 - Distributing paper time records to employees, so that they can challenge significant discrepancies in their reported hours.
 - Regular written reminders of "payroll integrity" from top management.
- b. Designers of performance-based incentive systems should identify the trade-offs between effective rewards, goal alignment, monitoring, and cost in designing an effective performance-based system. It is clear that upper-level management must strongly encourage ethical behavior by mid-level managers. Some of the possible measures that could be taken are:
148. a. Incentive performance systems can lead to unethical conduct when managers fear losing their jobs when they fail to keep costs down. In addition, when a significant part of the managers' compensation comes from bonuses based on minimizing costs or maximizing profits, managers may be tempted to underreport labor hours in order to cut payroll costs. Many of the managers cited pressure from supervisors to erase hours, refuse to pay overtime, and otherwise manipulate payroll records.

ch01 Summary

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