

Instructor's Manual

Management Control Systems Performance Measurement, Evaluation, and Incentives

Fourth edition

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§ *New case* in this 4th edition of the text.

* *Updated case* from the 3rd edition of the text.

All other cases as in the 3rd edition.

Overview of changes in cases from the 3rd to the 4th edition:

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1. *Armco, Inc.: Midwestern Steel Division*
2. *Loctite Company De Mexico, S.A. de C. V.*
3. *Lincoln Electric Co.*
4. *AirTex Aviation*
5. *Toyota Motor Sales*
6. *Citibank Indonesia*
7. *HCC Industries*
8. *Patagonia, Inc.*
9. *Tsinghua Tongfang*
10. *First Commonwealth Financial Corporation*
11. *Southern California Edison*
12. *Formosa Plastics Group, Inc.*
13. *Financial Reporting Problems at Molex, Inc.*
14. *Landale PLC*
15. *ConAgra Grocery Products Company*
16. *Lincoln Electric: Venturing Abroad*
17. *TECO Electric & Machinery Co. Ltd.*
18. *City of Yorba Linda, California*
19. *Waikerie Co-Operative Producers Ltd.*
20. *Boston Lyric Opera*

Note: ***These cases are still available for use. Please contact the authors and/or publisher for access to the case text and teaching notes.***

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1. *Office Solutions, Inc.*
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4. *Better Beauty, Inc.*
5. *Atlantis Chemical Industries*
6. *Wessanen NV*
7. *The Stimson Company*
8. *Multiple Versions of the Plan*
9. *Vitesse Semiconductor Corporation*
10. *Corbridge Industries, Inc.*
11. *King Engineering Group, Inc.*
12. *Dortmunder-Koppel GmbH*
13. *Johansen's: The New Scorecard System*
14. *Mainfreight*
15. *Howard Building Corporation, Inc.*
16. *Fine Harvest Restaurant Group (A) and (B)*
17. *Arrow Motorcar Corporation*
18. *Bio/Precise Medical Devices, Inc.*
19. *Andrew G. Scavell, Chief Risk Officer*
20. *Wired PLC*
21. *Mean Screens USA, Inc.*
22. *Ethics@Cisco*
23. *SCI Ontario: Achieving, Measuring, and Communicating Strategic Success*

Cases updated from 3e: 10 [indicated with * in the Table of Contents above]

1. *Axeon N.V.*
2. *Zumwald AG*
3. *Behavioral Implications of Airline Depreciation Accounting Policy Choices*
4. *Las Ferreterías de México, S.A. de C.V.*
5. *Industrial Electronics*
6. *Haengbok Bancorp*
7. *Olympic Car Wash*
8. *Hoffman Discount Drugs, Inc.*
9. *Desktop Solutions, Inc. (A) and (B)*
10. *Conservative Accounting in the General Products Division*

Introduction

One constant in the teaching of virtually all courses in management control systems (MCSs) is their heavy use of the case method of instruction. Even instructors who are most comfortable lecturing and/or who like to describe the management control issues through relatively formal (e.g., agency theory) models find it useful to use cases to illustrate the lecture points or the key parameters in the models. This textbook is set up to facilitate the teaching of MCS cases. In addition to the text material, the book includes 70 cases of great variety. Thus, it can be used in courses in which instructors use a case in virtually every class, or it can be used in courses in which only a few cases are used. The model syllabi in the following sections of this manual show this variation: there are syllabi for courses where there is a case in every session, and there are syllabi for courses that use a mixed approach where lectures (without cases) are followed by a session dedicated to the analysis of a case pertaining to the foregoing lecture.

Our own teaching style involves the use of many cases, with considerable student participation in the discussions. This type of course makes some students, particularly those who have not experienced a case course before, possibly uncomfortable, at least initially. We thus sometimes find it necessary to “sell” the advantages of the case method. To this end, instructors can use the note called “**The Case Method of Instruction: Suggestions for Students,**” which can be handed out either in or before the first day of class. This note is included in this manual for your consideration and possible use.

As for course organization, there is no single one-size-fits-all or “template” approach. Management control is a complex, multi-dimensional subject, and courses in MCSs can be organized in many ways. The outline of the textbook provides one way that we have found useful for organizing the materials. The model syllabi included in the following sections of this manual show some variation, which we have ourselves implemented and tweaked over the years depending on level, length, and purpose of the given course, among other considerations (e.g., whether or not there are visitors for some sessions or part of the course).

Even with the same outline, instructors can choose to use quite different sets of cases and different case orderings. This is because, unlike simple problems, most of the cases included in the book describe rich real-world examples, and real-world examples usually do not illustrate just one point.

Consider, for example, the Statoil case, which is included in Chapter 11 (Remedies to the Myopia Problem) because Statoil uses a key-performance-indicator (KPI) structure that is Balanced Scorecard-like to deal with some issues associated with more traditional approaches to performance measurement, as discussed in Chapter 10 (Financial Performance Measures and their Effects). But the case can also be used effectively with Chapter 8 (Planning and Budgeting) because Statoil separates the functions of target setting, forecasting and resource allocation using the principles of “Beyond Budgeting.” Statoil also relies quite substantially on subjective performance evaluations in determining incentives as discussed in Chapter 9 (Incentive Systems). Finally, students have to consider the industry characteristics, the organization structure, the characteristics of the personnel in key positions, and the company’s history (e.g., a recent merger), none of which are dealt with in any specific chapter but which are important to understand when evaluating the effectiveness of a MCS. All told, the case can be used to focus on any of these issues, but also as a powerful integrative case cutting across several topics related to the design and operation of a management control system. If the

instructor is looking to illustrate “Beyond Budgeting” in a more focused manner, then using the new Mainfreight case is probably a good choice. The Mainfreight case could have been slotted in Chapter 8 (Planning and Budgeting), but we slotted it in Chapter 11 (Remedies to the Myopia Problem) because the company is keen to try and mitigate the alleged dysfunctional consequences of presumably rigid and possibly myopic traditional budget and target setting processes.

To give another example, the Catalytic Solutions, Inc. case, which is included in Chapter 11 (Combinations of Measures and other Remedies to the Myopia Problem) to illustrate the use of nonfinancial performance measures, also can be effectively used with Chapter 2 (Results Controls), Chapter 6 (Designing and Evaluating MCSs), and Chapter 9 (Incentive Compensation Systems). It deals with designing and evaluating a new, first-time incentive system (Chapter 6) to motivate employees toward generating desired organizational outcomes (Chapter 2) that are primarily nonfinancial and long-term in nature (Chapter 11).

For a final example, consider the new case Andrew G. Scavell, Chief Risk Officer. We placed it in Chapter 14 because we also have the Don Russell, CFO case there. Both cases give students an insight into these important controller and risk management roles at the C-suite level. However, the Andrew Scavell case can also be taught pertinently with Chapter 13 focused on corporate governance and related board responsibilities and concerns, of which enterprise risk management (ERM) certainly is one. In Chapter 13, the Andrew Scavell case goes nicely together with the Entropic Communications, Inc. case. Indeed, instructors who wish to spend a bit more time on risk management could easily teach both the Entropic and Andrew Scavell cases, in this order in two consecutive sessions, (which would allow assigning Chapters 13 and 14, respectively, as the key reading for each of the consecutive sessions accordingly). The Andrew Scavell case also discusses the implementation process of the “new” ERM system, which dovetails with the coverage in Chapter 6—designing and evaluating MCSs. Finally, given the intricate connection of ERM in this case company with the planning and budgeting systems, the case also could be taught in connection with Chapter 8.

Because we can slot each case in only one chapter, and to help instructors with their case choice decisions, we included in this manual a so-called “**Case Matrix**” showing the multiple links between cases and chapters.

The following pages also show several course organizations we use in various teaching programs. The first syllabus (**Model Syllabus 1**) is for an undergraduate half-semester course taught in a two-classes-per-week format over 7 weeks. The second syllabus (**Model Syllabus 2**) shows the contents of a 5-week module focused on management control as part of a 4-module senior undergraduate management accounting course taught in a two-classes-per-week format (through a combination of weekly lectures and seminars). The third syllabus (**Model Syllabus 3**) is for a 15-week semester-long elective course in the MBA program, thus providing 30 sessions (2 class meetings per week) of materials in this topic area. The fourth syllabus (**Model Syllabus 4**) shows a 10-week term format to offer these materials to MSc students, again through two meetings per week. For this course, the first session of the week is usually lecture-like, whereas the second one is focused on a case analysis related to that week’s topic. The final syllabus (**Model Syllabus 5**) is essentially Model Syllabus 3 but offered as a single 3-hour class meeting per week. A format with one long class each week makes it difficult, but not impossible, to use two cases each week. Instead of using two cases, instructors may choose to use lectures, in-class exercises, video clips, etc., to break up the format.

You will also see that we used some cases “out of order,” that is, in conjunction with a chapter reading different from the chapter in which the case is included in the book. That is why

we emphasize that both the inclusion of the cases in the chapters and these guides are merely illustrative. We encourage instructors to adapt the materials to their own organization and teaching emphasis. In so doing, we hope that the alternatives illustrated in the case matrix will prove helpful.

Finally, some teaching materials have been made available electronically on the publisher's website (www.pearsoned.co.uk/merchant). These include, particularly, instructional PowerPoints for each chapter of the book developed by the second author of this book, as well as databases and Excel spreadsheets for the Vitesse Semiconductor Corporation case; the VisuSon, Inc. case; the Bank of the Desert (A) and (B) cases; and the Fine Harvest Restaurant Group (A) and (B) cases.

The Table of Contents also shows which cases have been removed from the prior edition, which ones are new to this edition, and which have been updated. Instructors wishing to continue to use some of the cases that we may have removed, please contact the authors and/or publisher for access to these cases and teaching notes. Please also contact us with any other suggestions or comments. We can be reached at:

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Model Syllabus 1

Accounting 476—Performance Measurement Issues

Leventhal School of Accounting, University of Southern California

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Class Hours	Tue/Thu 2:00–3:50 p.m.
Classroom	ACC 310
Office Hours	By appointment. Arrange by e-mail. I will do my best to accommodate your schedule.
Prerequisites	ACCT 372
Honor Code	The Leventhal School Student Honor Code took effect on September 1, 1993. All students are subject to the Code and are responsible for familiarizing themselves with it. If needed, copies may be obtained from the receptionist in ACC 101.
Text	K. A. Merchant & W. A. Van der Stede (2017), <i>Management Control Systems: Performance Measurement, Evaluation, and Incentives</i> . London: Financial Times/Prentice-Hall, 4th edition.

Course Objectives

This course is designed to broaden and deepen your conceptual and technical understanding of accounting as it is used for management purposes. The emphasis in the course is on *financial controls*, which dominate in importance at managerial levels in all but the smallest organizations. Using financial controls requires managers to make decisions about: (1) responsibility structures (e.g., cost centers, profit centers), (2) performance measures (e.g., market, financial, and/or nonfinancial measures and their combinations), (3) performance evaluations, which take into consideration performance targets or other benchmarks, and (4) rewards (including performance-dependent compensation). The course is issue-oriented, with current and emerging issues as a major focus.

The course is built around a textbook—Merchant and Van der Stede's *Management Control Systems*. The text will be supplemented with some additional materials that will be distributed via Blackboard.

The focus of most of the classes will be on a case that brings the topics “to life” and provides issues for us to discuss. The readings are intended to provide background that is useful for informing the case discussions. For each case, I will provide some Discussion Questions. These questions are intended to help frame and focus your reading and consideration of the course materials.

The cases require advance preparation and thought. I encourage you to prepare the cases in a study group. Much of the learning comes from sharing and discussing your ideas with your peers.

Grading

In-class quizzes	50 points
E-mail questions and class participation	50 points
Final exam	<u>100 points</u>
<i>Total</i>	<i>200 points</i>

The **quizzes** will be given in a few classes on an unannounced basis. As protection against the possibility of a bad day or an unlucky absence, in computing my course grades I will disregard the lowest quiz score.

On the bottom of many of the class assignments, you will see that I have included an “**e-mail question**.” Prior to noon before our class pertaining to that assignment, please send me an e-mail message answering the question(s) for that day's class. This is not intended to be a time-consuming obligation. Your answers should be brief—**three sentences or less** for each question.

Your answers to the e-mail questions serve multiple purposes. First, they help me to get to know you and to see how you think. Second, these messages open the communication channels between us. Since you have to send me a message, it is easy to append another thought. In the past, some students have used this opportunity to ask a question on another topic or to give me some feedback about the course. I welcome this. I might also respond immediately to your e-mail question answer. Third, your e-mail answers help me orient the class discussion. For example, they help me both to judge the mindset of the class and to find people with unique perspectives. Finally, the questions are functional because they encourage good advance preparation. The regularity with which you input your e-mail question answers on a timely basis and the quality of your answers will form part of your participation grade.

I assign a material proportion of the grade based on **class participation**. I do this for several reasons. First, it improves my grading accuracy. I think I can learn more from hearing you share your ideas in a long series of classes than I can from reading what you write in a short exam session. I keep track of participation in every class.

But perhaps more important than that, grading class participation motivates class participation, and having highly interactive class sessions helps the learning process. Active class participation encourages students to be well prepared and thus to become active, rather than

passive, learners. Participation provides students with the opportunity to gain from the experiences and talents of everyone in the class. Moreover, class participation helps students improve their oral communication skills. This is important because research shows that people in the business world tend to spend very little time reading and even less time writing reports. A great deal of managers' and other professionals' interactions with others are through oral communication.

Class participation evaluations will be based primarily on the quality of the participation in classroom discussions. To be clear on what I am looking for regarding class participation, and to further aid in your preparation, I have listed below some characteristics of effective class participation:

- (1) Does the student make points that are especially pertinent to the discussion? Do they increase the understanding of the class or are they simply a regurgitation of the problem or case facts?
- (2) Is there continuity in one's contribution from what has been said previously during class, or are the comments disjointed, isolated, or tangential? The best class contributions are those that reflect not only excellent preparation, but also good listening, interpretive, and integrative skills.
- (3) Do the comments reflect a willingness to put forth new, challenging ideas or are they always agreeable and "safe"?
- (4) Is the participant able and willing to interact with others by asking questions, providing supportive comments, or challenging **constructively** what has been said?

Your participation will be evaluated based on a near-continuous scale, the end points of which can be described as follows:

Outstanding Contributor: This person's contributions reflect exceptional preparation, and the ideas offered are always substantive and provide major insights and direction for the class. If this person were not a member of the class, the quality of the discussions would be diminished significantly.

Unsatisfactory Contributor: This person may be absent from class or someone who rarely participates in class discussion. Alternatively, this person's contribution in class reflects inadequate preparation and/or understanding. Ideas offered are not substantive and provide few, if any, insights and never a constructive direction for the class. Integrative comments and effective arguments are absent. Class comments are either obvious, isolated from the main discussion, or confusing to the class.

The **final exam** will be a take-home exam, likely a case or two. You can take this exam as an individual or as a group. The groups can be as large as four people. In the middle of the course, I will ask you to tell me if you will be taking the exam as an individual or in a group, and if in a group, who is included in your group. The answers to the final exam must be deposited in my mailbox in the lobby of the School of Accounting Building by the deadline.

Schedule of Classes

Session 1

Topic: Performance Measurement and the Control Function of Management

In this first class, we will go over the syllabus and get to know each other. Then I will provide a general lecture on management controls and the control uses of performance measures that we will focus on in this course. Finally, we will discuss a short case that will set the stage for our further discussions.

Reading: MV, Chapter 1

Session 2

Topic: Results Controls

In this class, we will examine and critique the performance measurement and incentive system used in a business with which all of you have some familiarity—automobile retailing. The company is privately held, and it makes use of some “nonfinancial” performance measures. In the case, we see a simple use of transfer pricing. We will examine incentives at and below management levels of the organization. Moreover, we see some evidence of people “playing games” with the measures. Understanding the causes, consequences and remedies of game playing is a recurring theme in this course.

Reading: MV, Chapters 2 and 9

Prepare for Class: Case—Puente Hills Toyota

Assignment Question:

Evaluate the performance measurement and incentive systems used at Puente Hills Toyota. What changes would you recommend, if any?

E-mail Question:

As a first approximation, which of the following statements do you believe is most correct, and why:

- I. People are people. They respond approximately equally to many things, including pay-for-performance systems.
- II. To work well, management and incentive systems must be tailored to fit the specific employee group (e.g., nationality, role, age, and gender).

Session 3

Topic: Financial Responsibility Structures

The focus of this session is on one of the main management control system choices—design of the organization's authority and financial responsibility structures.

Reading: MV, Chapter 7

Prepare for Class: Case—Kranworth Chair Corporation (KCC)

Assignment Questions:

1. Identify the most important key recurring decisions that must be made effectively for KCC to be successful. In KCC's functional organization, who had the authority to make these decisions? Who has the authority to make these decisions in KCC's new divisionalized organization?
2. Did KCC's top management go too far in decentralizing the corporation? Did they not go far enough? Or did they get it just right? Why?
3. Evaluate KCC's new performance measurement and incentive system. Assuming that KCC will retain its new divisionalized organization structure, what changes would you recommend, if any? Why?
4. Assume that the R&D function is to be decentralized (given to the divisions). Would this necessitate changes to KCC's performance measurement and incentive system? If so, which and why? If not, why not?

E-mail Question:

The vast majority of corporations are decentralized to a considerable degree. What kinds of organizations are best run in a largely *centralized* manner, and why?

Session 4

Topic: Planning and Budgeting

Most firms beyond minimal size, but not all, engage in often extensive planning processes, the annual component of which is called budgeting. The Mainfreight case that we will discuss in this session, however, illustrates the functioning of a large, successful international logistics company that does *not* engage in an annual budgeting process. The goal in this case is to think about what budgeting is, and what it is not, and how Mainfreight can succeed without having a budget, which is a control system element that most companies think is essential. One of the key points of discussion of this session, therefore, is to consider whether there are valid, effective alternatives to budget-based performance management systems, and if so, whether these really are what they claim to be or just budgeting processes under a different guise?

Reading: MV, Chapter 8, and Chapter 3

Prepare for Class: Case—Mainfreight

Assignment Questions:

1. At the very least, Mainfreight's management systems are nontraditional.
 - a. What are the key elements of Mainfreight's results control systems?
 - b. Why did Mainfreight managers decide to take a nontraditional approach?
 - c. How does Mainfreight perform the functions typically fulfilled by budgets? Or are some of those functions really not that important?
 - d. Does the Mainfreight system address the limitations of traditional budgets? Does it introduce new limitations?
2. Is Mainfreight a well-controlled organization?
3. Should companies that now use an annual budgeting process try to emulate some or all of the management systems used by Mainfreight? Why or why not?

E-mail Question:

Mainfreight's top executives, three of whom are qualified accountants, maintain that their company does not prepare budgets. Is that contention accurate? How should one determine whether a company prepares a budget or not?

Session 5

Topic: Performance Measures

Today's discussion focuses on a company that does not place much emphasis on financial measures of performance. Why? What do they do instead?

Reading: MV, Chapters 10 and 11

Prepare for Class: Case—Catalytic Solutions, Inc.

Assignment Question:

Evaluate the CSI performance measurement and compensation systems. What changes would you suggest be made, if any? Explain.

E-mail Question:

Fast forward 10 years. Assume that CSI has been successful. It is now a much larger, public company. It has three operating divisions (investment centers) that focus on different markets. Would you expect the CSI measurement and compensation system to be different at that time? If so, how and why? If not, why not?

Session 6

Topic: Performance evaluations

In this class, we will continue our discussion of performance evaluations. How can/should firms deal with the effects of uncontrollable events that often obscure managers' impacts on performance measures?

Reading: MV, Chapter 12

Prepare for Class: Case 1—Olympic Car Wash

Assignment Question:

How large should the bonus pool be for the Aalst location?

Prepare for Class: Case 2—Beifang Chuang Ye Vehicle Group

Assignment Question:

To what extent, if at all, should Mr. Zhou provide incentive compensation for his employees when his company is losing money? Why? What factors did you take into consideration in making your judgment?

E-mail Question:

Some companies make performance evaluation and bonus adjustments to protect managers from the harmful effects of many uncontrollable factors. Other companies make no such adjustments. Is one of these approaches clearly inferior, or is this just a "management style" choice?

Session 7

Topic: Enterprise Risk Management

Our focus in this session is on enterprise risk management, a newly developing tool aimed at helping companies address all the various kinds of risks they might face.

Prepare for Class: Case—Entropic Communications, Inc.

Assignment Questions:

1. Why did Entropic implement a formal enterprise risk management (ERM) process?
2. Do you think the company realized the benefits of ERM as envisioned by COSO? Why or why not?
3. What changes would you suggest for making the ERM process at Entropic more effective?

E-mail Question:

ERM is currently one of the hottest topics being written about in management, accounting, and corporate governance practitioner journals. Virtually every company is looking at the technique

and deciding whether and how to use it. Do you think the ERM technique is a fad that will soon disappear or an improvement that will provide enduring benefits to a broad range of companies?

Session 8

Topic: Management Control Impacts of the Sarbanes-Oxley Act

In this session we will focus on the benefits and costs the Sarbanes-Oxley Act (SOX) from the corporate perspective.

Reading: MV, Chapter 13

Prepare for Class: Case—Pacific Sunwear of California, Inc.

Assignment Questions:

1. Evaluate the process that PacSun went through to comply with SOX, and particularly SOX Section 404. Was that process as effective and efficient as it could have been?
2. Are the “significant deficiencies” that were identified in each of the two years of the audit evidence of control system flaws or largely irrelevant technical violations? Another way to phrase this question might be: Should disclosure of these deficiencies have had a negative effect on PacSun’s stock price?
3. PacSun executives seem convinced that the costs of complying with SOX were greater than the benefits to the company. Why did PacSun not benefit from the compliance process to the same extent as some other companies? Or were their compliance costs just too high?

E-mail Question:

Judging now with some benefits of hindsight, was SOX a good law?

Session 9

Topic: Earnings Management and the Roles of Controllers and CFOs

In this session, we will examine some of the important roles that controllers and CFOs play in their organizations, particularly in times of stress.

Reading: MV, Chapter 14

Prepare for Class: Case—Don Russell: Experiences of a Controller/CFO

Assignment Questions:

1. Was Don Russell a good controller for Cook and Spector, Inc.? Why or why not?
2. Does Don have the power to force ETI top management to make a correcting accounting entry? If not, what should he do? If so, should he force the entry to be made, and how large should it be?

3. Are earnings management practices such as took place at C&S and ETI smart? Are they ethical?
4. Does Don Russell have an obligation greater than that of other employees to try to ensure that his corporation acts ethically?

E-mail Question:

All things considered, was Don Russell a good controller for Cook and Spector, Inc.? Did he deserve hearty congratulations and a nice bonus or a boot out the door? Explain briefly.

Session 10

Topic: Corporate Governance and the Roles of Boards of Directors

In this class, we will focus broadly on systems of corporate governance and the roles and obligations of boards of directors.

Reading: MV, Chapter 13 (already assigned for Session 9)

Prepare for Class: Case—Arrow Motorcar Corporation

Assignment Questions:

1. Why did Arrow Motorcar Corporation have a board of directors before it went public? How (if at all) do the legal and moral obligations of private-company directors differ from those of directors of publicly-held companies?
2. Evaluate the board composition and actions. All things considered, did the board act properly? Did the board members choose the optimal time to terminate Billy Ray Repko?
3. What should the board members do now (March 22, 2016)?
4. What could have prevented or minimized the problems that Arrow faced?

E-mail Question:

If the Sarbanes-Oxley law had been passed before the time of this case, do you think the problems faced by the board of Arrow Motorcar Corporation would have occurred? Explain.

Session 11

Topic: Industry application: A Sales Incentive System

Managers at Office Solutions, Inc., are considering a significant change in the compensation plan for some of the company's sales representatives. Are they on the right track? Can we give them suggestions for improvement of their ideas? I expect that the key managers at Office Solutions will be in our class to listen to our suggestions and to engage in an active discussion with the class.

Prepare for Class: Case—Office Solutions, Inc.

Assignment Questions:

1. Evaluate the new approach for compensating the sales representatives at Office Solutions. In your critique, consider, at a minimum:
 - The recognition of the two different types of representatives;
 - The performance measures;
 - The performance standards;
 - The forms, mixes and amounts of compensation.
2. Why are at least some of the representatives resistant to the change? How should that resistance be addressed?
3. Would Office Solutions be better off if all of its sales representatives were good at “hunting”? If so, how should the company move in that direction?

E-mail Question:

Bob Mairena has realized that most of his older sales representatives, those over the age of 50, are not good at generating new accounts (p. 6 in the case). Is this problem fixable, maybe through the compensation system, or should the company somehow find a way to employ only young reps? If the latter, how might that be accomplished?

Session 12

Topic: Industry Application: A “billings scorecard”

In this class, we will discuss an innovative results-control approach to solution of a problem that is usually addressed with development and enforcement of sets of policies and procedures.

Reading: MV, Chapter 6

Prepare for Class: Case—Game Shop, Inc.

Assignment Questions:

1. Why was GSI’s production quality control performance so much better than its billing performance?
2. Evaluate the billing improvement effort and each of the elements of the system that emerged. Comment specifically on the billing scorecard, detention meetings, P-CARs, and any other system elements that you believe are relevant.
 - a. In considering the scorecard, be sure to address the following questions: What are the Scorecard and each of its measures trying to accomplish? Are these the right measures? Does each measure add unique value? Are the measures weighted appropriately in importance? Are the business unit grades generally consistent across measures? Can any of the measures be distorted or gamed?

- b. Do you believe that David's improvement efforts will close the gap between production and billing performance enough to meet project goals? Explain?
 - c. Do you have any suggestions to improve the billing process? Explain.
3. GSI's ultimate goal is "perfection." Can this system be used to achieve billing perfection as it is designed, or will changes have to be made, or might even a totally different approach be necessary? Explain.
4. The Billing Scorecard is a results-accountability approach to address the problem, chosen because this company's culture is "metrics centric." What are the advantages and disadvantages of using a results-accountability approach? What other alternatives might have been used to solve the problem?

E-mail Question:

Would you include billing performance among a short list of "critical success factors" for GSI? If so, why has it apparently not received much attention from management up until now? If not, why all the concern now?

Session 13

Topic: Industry application: A bank

In this session, we will focus on the performance measurement/management control challenges in the wholesale banking industry.

Reading: MV, Chapters 4, 5

Prepare for Class: Case—Haengbok Bancorp

Assignment Questions:

1. Evaluate Haengbok Bancorp's system of controlling the behaviors of the account managers in the Los Angeles branch. What changes would you suggest be made, if any? Explain. In your answer, comment specifically on the merits and demerits of the control philosophy and each of the significant individual control system elements, such as the use of mini profit centers and the associated performance measures and incentives.
2. Discuss the FETC loan application situation and the effects that outcome might have on the account managers' behaviors and performances? Does this example illustrate a problem that needs to be fixed? If not, why not? If so, how would you fix it? Explain.

E-mail Question:

Are any of the issues in this case or their preferred solutions affected in any way by the fact that the bank and its managers are Korean, rather than, say, American, French, or Chinese?

Session 14

Topic: Industry Application: A Hedge Fund

In this class, we will discuss issues related to performance evaluation and incentive compensation in a hedge fund. Our primary focus will be on the role of the hedge fund analysts.

Prepare for Class: Case—Raven Capital, LLC

Assignment Questions:

1. Assume the role of a Raven portfolio manager who has to allocate a bonus pool to the four analysts working primarily for him. Assume a 20% incentive fee for Raven. Use 30% of the incentive fee as the bonus pool to be allocated to the four analysts whose backgrounds and 2009 portfolio performances are described in Assignment Figures A and B (posted separately on Blackboard).
 - a. How would you allocate bonuses to these four analysts? What alternatives did you consider? Why did you make the choices you did?
 - b. Is there any other information you would like to have had available before making your decisions? If so, which?
 - c. Do you think you should pay out the entire bonus pool this year, or hold some money in a “bonus bank reserve”? Why or why not?
 - d. Should the proportions of the bonuses allocated vary depending on the size of the bonus pool available? Redo the allocations of the bonus pool to these four analysts assuming that because of a high water mark constraint, the incentive fees earned in 2009 were only \$300,000.
2. Evaluate the Raven performance evaluation and incentive compensation system. What changes would you recommend, if any?

E-mail Question:

What could Raven management do to make it possible to evaluate the analysts' performances more objectively? Should they make these changes?

After we discuss this case, I will provide a brief review of the major themes of the course and will hand out the final exam. It will be a take-home exam that is due in my mailbox, in the lobby of the Accounting building, by 5:00 p.m. on Thursday next week. You can work on the exam only in the group to which we agree you have been assigned.

Model Syllabus 2

London School of Economics

Department of Accounting

AC310

Advanced Managerial Accounting

Module 1

Michaelmas Term (Weeks 1–5)

Management Accounting in its Organizational Context: The Function of Management Control Systems

Professor Wim A. Van der Stede

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Introduction

Module 1 of AC310 is focused on the study of the quintessential role of management control in decentralized organizations. Our focus will be on the measurement and evaluation of the performances of organizational entities and their managers. Management accounting at this level of analysis is an integral part of companies' *management control systems*.

In this module, we will discuss what it means to have an organization be “in control,” what alternatives managers have for ensuring good control, and how managers should choose from among control system alternatives. Then we will focus on each of the elements of “financial control systems,” which provide the dominant form of control in the vast majority of decentralized organizations. These elements include financial target setting (as part of organizations' planning and budgeting processes), performance measurement and evaluation, and the assignment of various forms of organizational rewards, such as bonuses and promotions.

This module is intended as an introduction for individuals who will make business decisions, evaluate organizational performance, or evaluate others (and/or be evaluated) through the use of financial and nonfinancial information. In other words, the module is designed to be useful particularly for those who aspire to be managers, management consultants, or specialists in staff functions such as controllers, financial analysts, auditors, and human resource specialists.

Teaching Format

This module is taught as five lectures and five classes, and the materials in this module will be presented through both lectures and case study analyses. The case studies permit the exploration of management control issues in a broad range of settings (e.g., large and small firms, manufacturing and service firms, multinational firms, start-ups). Moreover, the foundational theories for the topics in this module have been introduced in AC211. An important objective of this module is, therefore, (1) to expand that knowledge through further study, and (2) to apply that knowledge to cases.

The case method of instruction, however, requires good advance preparation by the students. For the cases that we discuss in *class* settings, I expect *every* student to actively participate in the case analysis and discussion. Although during *lectures* not every student will have an opportunity to contribute to the discussion, I still expect active participation when I pose questions or solicit input from the students.

Course Materials

Merchant, Kenneth A., and Wim A. Van der Stede (2017), *Management Control Systems: Performance Measurement, Evaluation, and Incentives* (Prentice-Hall/Financial Times), 4th Edition. (Referred to as **MCS** in the schedule below.)

Some additional materials are distributed separately in the **course pack**.

Written Work

You are expected to hand in one essay for this module drawn from the list of “essay questions” listed throughout the schedule below. Because each essay question is related to a case study, you must turn in your essay of choice *at the beginning* of the session in which the case is discussed. An essay that is handed in after the case has been discussed in class will not be marked.

Assessment

Assessment will be based wholly upon a 3-hour written examination during the Summer Term covering exam questions from across all four modules of this course. Past examination papers are available on the Library’s website.

Module Schedule

Week 1—The Control Function of Management

Lecture 1: MCS Chapters 1–6

Class 1: *Puente Hills Toyota*

Case Questions (for advance preparation):

1. Evaluate the performance measurement and incentive systems in use at Puente Hills Toyota in terms of their overall effectiveness as a “results control” system.
2. Elaborate specifically on the specific features of the results control system in place at Puente Hills Toyota—strengths and weaknesses?
3. What factors are critical for Puente Hills Toyota’s success? What changes would you recommend, if any?

Essay Question (for written work): Considering that Puente Hills Toyota’s is probably quite a “typical” incentive system one might find in customer-driven, sales-focused organizations (in the United States), please comment on the following statement:

People are people and they respond equally to many things, including pay-for-performance systems, and thus incentive systems will work well anywhere and in any organization.

Week 2—Results Accountability

Lecture 2: MCS Chapter 7

Class 2: *Kranworth Chair Corporation*

Case Questions (for advance preparation):

1. Identify the most important key recurring decisions that must be made effectively for Kranworth Chair Corporation (KCC) to be successful. In KCC’s functional organization, who had the authority to make these decisions? Who has the authority to make these decisions in KCC’s new divisionalized organization?
2. Did KCC top management go too far in decentralizing the corporation? Did they not go far enough? Or did they get it just right? Why?
3. Evaluate KCC’s new performance measurement and incentive system. Assuming that KCC will retain its new divisionalized organization structure, what changes would you recommend, if any? Why?

Week 3—Planning and Budgeting

Lecture 3: MCS Chapter 8; and,

Hansen, Stephen C., David T. Otley, & Wim A. Van der Stede (2003). Recent Developments in Budgeting: An Overview and Research Perspective. *Journal of Management Accounting Research* 15, pp. 95–116.

Class 3: *Mainfreight*

Case Question (for advance preparation),

1. At the very least, Mainfreight's management systems are nontraditional.
 - a. What are the key elements of Mainfreight's results control systems?
 - b. Why did Mainfreight managers decide to take a nontraditional approach?
 - c. How does Mainfreight perform the functions typically fulfilled by budgets? Or are some of those functions really not that important?
 - d. Does the Mainfreight system address the limitations of traditional budgets? Does it introduce new limitations?
2. Is Mainfreight a well-controlled organization?
3. Should companies that now use an annual budgeting process try to emulate some or all of the management systems used by Mainfreight? Why or why not?

Essay Question (for written work): Mainfreight's top executives, three of whom are qualified accountants, maintain that their company does not prepare budgets. Is that contention accurate? How should one determine whether a company prepares a budget or not?

Week 4—Performance Measurement

Lecture 4: MCS Chapters 10–12; and,

Kaplan Robert S. & David Norton (2005), *The Balanced Scorecard: Measures that Drive Performance*, *Harvard Business Review*, July-August, pp. 172–180.

Ittner, Christopher D., & David F. Larcker (2003), *Coming up Short on Nonfinancial Performance Measurement*, *Harvard Business Review*, November, pp. 88–95.

Class 4: *Catalytic Solutions, Inc.*

Case Questions (for advance preparation):

1. Evaluate the composition of the compensation package at CSI.
 - a. What are the advantages and disadvantages of awarding stock options?
 - b. What are the advantages and disadvantages of awarding bonuses?
 - c. Was the relative importance placed on salaries, stock options, and bonus awards reasonable? Why should CSI offer a mix of rewards rather than providing its employees 100% of their compensation based on 100% salary? On 100% annual bonuses?
2. Evaluate the specific features of the annual bonus plan in 2001 and 2002. Comment on:
 - a. the choice of the number of measures used, the specific measures used, and the changes in the plan between years;
 - b. the relative proportions of financial vs. nonfinancial measures;
 - c. the decision to base rewards on company-wide, rather than individual, performance;

- d. the amount of subjectivity allowed in determining the bonus awards;
- e. the calibration (target difficulty) of the bonus plans.

Essay Question (for written work): Fast-forward 10 years. Assume that CSI has been successful. It is now a much larger, public company. It has three operating divisions (investment centers) that focus on different markets. What would you expect the CSI measurement and compensation systems to look like at that time? Why?

Week 5—Incentive Systems

Lecture 5: MCS Chapter 9; and,

Van der Stede, Wim A. (2007), The Pitfalls of Pay-for-Performance, *Finance & Management*, 150, December, 10–13.

Van der Stede, Wim A. (2009), Designing Effective Reward Systems, *Finance & Management*, 168, October, 6–9.

Class 5: *Houston Fearless 76, Inc.*

Case Questions (for advance preparation):

1. Why are Houston Fearless 76, Inc. (HF76) managers unhappy with the company's existing sales incentive plan? Are weaknesses in this plan a major cause of the company's performance problems?
2. Evaluate the new incentive plan being contemplated. What modifications would you make to the proposed new plan, if any? How would you address the unresolved issues?
3. Are there any significant impediments to the successful implementation of the new incentive plan? If so, which?
4. Would you make any changes to the system providing bonuses to sales assistants? If so, which?

Model Syllabus 3

Accounting 537—Management Control Systems

Marshall School of Business, University of Southern California

Professor	Kenneth A. Merchant
Office	HOH 606
Telephone	(213) 821-5920
E-mail	kmerchant@marshall.usc.edu
Class Hours	Tue/Thu 12:30–1:50 p.m.
Classroom	JKP 202
Office Hours	By appointment. Arrange by e-mail. I will do my best to accommodate your schedule.
Honor Code	Students are expected to adhere to, and will be bound by, the University and School policies governing academic integrity.
Text	K. A. Merchant & W. A. Van der Stede (2017), <i>Management Control Systems: Performance Measurement, Evaluation, and Incentives</i> . London: Financial Times/Prentice-Hall, 4th edition.

Course Objectives

Firms' performance evaluation and incentive systems require managers to make many choices. They must design responsibility structures. If performance is defined in accounting terms, as is common at managerial levels of the firm, these structures are composed of configurations of cost centers, revenue centers, profit centers, and investment centers. They have to choose specific performance measures and make them operational. Just within the category of accounting-based measures, which are in common use, are measures with acronyms such as EBITDA, ROE, RONA, ROCE, ROI, RAROC, and RI. And, of course, many market-based and nonfinancial measures are also used frequently. Managers must select measurement windows (e.g., month, quarter, annual, multi-year) for any of the measures chosen. And they have to define the links between the measured performance and various forms of organizational rewards and punishments. Unless all of these choices are made well, problems can result. These systems can frustrate and demotivate employees or, worse, actually encourage them to do the wrong things.

This course presents knowledge of these “results-accountability” systems, with current practice and emerging issues as a major focus. Among the issues, we will discuss the advantages and disadvantages of traditional financial measures and nontraditional measures

such as EVA, EBITDA, and “pro-forma” earnings, as well as nonfinancial measures (e.g., customer satisfaction) and combinations found in dashboards and balanced scorecards. We will also discuss incentives-related topics, such as “stress-testing” and resource allocation uses of financial plans, the “beyond budgeting” movement, performance assessment by internal and operational auditors, and management implications of the Sarbanes-Oxley Act and the still-developing enterprise risk management (ERM) techniques.

The focus of most of the classes will be on discussions of specific cases developed from real-world practice. The assigned readings are intended to provide background that is useful for informing the case discussions. For each case assignment, I provide some Discussion Questions. These questions are intended to help frame and focus your reading and consideration of the course materials. In a number of the classes, I will invite a practitioner visitor to class both to add expertise and to “bring the topics to life.”

The course is built around a textbook—Merchant and Van der Stede’s *Management Control Systems*. The text is supplemented with a short monograph (de Kluyver’s *A Primer on Corporate Governance*):

(MV) K. A. Merchant & W. A. Van der Stede (2017), *Management Control Systems* (London: Financial Times/Prentice-Hall), 4th edition.

(deK) C. de Kluyver (2009), *A Primer on Corporate Governance* (New York: Business Expert Press).

Some additional materials also will be distributed on Blackboard.

Grading

Quizzes	40 points
Project 1	40 points
Project 2	40 points
Project 3	40 points
Class participation	40 points
Final exam	<u>100 points</u>
<i>Total</i>	<i>300 points</i>

Quizzes and Exams

The quizzes and the final exam will test **individual** (not group) work. The **quizzes** will focus on specific issues in the case being discussed that day in class. The **final exam**, will be a take-home exam in lieu of an exam during the final exam period. It will involve a case analysis. No make-up exams will be given (see LSOA policy on incompletes).

Projects

The projects will involve group analyses of cases that are supported by data provided on Excel spreadsheets. The first project is a capital budgeting exercise. The second is a budget “stress testing” exercise. The third involves comparative performance evaluations of a large number of bank branches. Some groups will be asked to present their analyses and conclusions in class.

Students can form their own working groups, but I will help if needed. The optimum (and maximum) group size is four. I will accept groups as small as three. As part of the grading process, I will ask students to grade each of their fellow group members. This is done to try to reduce the “free-rider” effect.

Class Participation

I assign a material proportion of the grade based on **class participation** for several reasons. First, it improves my grading accuracy. I think I can learn more from hearing you share your ideas in a long series of classes than I can from reading what you write in a few short exam sessions.

But perhaps more important than that, grading class participation motivates class participation, and having highly interactive class sessions helps the learning process. Active class participation encourages students to be well prepared and thus to become active, rather than passive, learners. Participation provides students with the opportunity to gain from the experiences and talents of everyone in the class. And class participation helps students improve their oral communication skills. This is important because research shows that people in business tend to spend very little time reading and even less time writing reports. A great deal of managers’ and other professionals’ interactions with others are through oral communication.

Class participation evaluation will be based primarily on the quality of the participation in classroom discussions. To be clear on what I am looking for regarding class participation, and to further aid in your preparation, I have listed below some characteristics of effective class participation:

- (1) Does the class member make points that are especially pertinent to the discussion? Do they increase the understanding of the class or are they simply a regurgitation of the problem or case facts?
- (2) Is there continuity in one’s contribution from what has been said previously during class, or are the comments disjointed, isolated, or tangential? The best class contributions are those that reflect not only excellent preparation, but also good listening, interpretive and integrative skills.
- (3) Do the comments reflect a willingness to put forth new, challenging ideas or are they always agreeable and “safe”?
- (4) Is the participant able and willing to interact with others by asking questions, providing supportive comments or challenging **constructively** what has been said?