

# Management accounting in context

# 1

All organisations are concerned about revenues and costs in the pursuit of their mission. Whether their outputs are management services, fast food, the latest designer fashions or outcomes from a not-for-profit endeavour, managers must understand the influence of revenues and costs on their operations or risk losing control. Managers use management accounting information to make decisions related to strategy, budgeting, production planning and pricing, among others. Of the many candidates for this opening vignette, Sundrop Farms stands out as an illustration of many of the themes that run through this book.

## INNOVATION IN THE AUSTRALIAN OUTBACK: TRANSFORMING SEAWATER AND SUNLIGHT INTO HIGH-VALUE OUTPUTS

In June 2016, Coles Supermarkets took delivery of its first consignment of truss tomatoes from Sundrop Farms, situated in Port Augusta, South Australia. Sundrop Farms represents an investment of \$180 million to \$200 million on exhausted farm-land, with little potential for traditional agriculture. After early experimentation and a four-year pilot project not far from the current site, Sundrop Farms attracted \$100 million in funding from KKR (Kohlberg Kravis Roberts), a global private equity company, which it added to funding from the Saumweber family (Philipp Saumweber is the Chief Executive Officer [CEO] of Sundrop Farms) and others, including \$6 million from the South Australian government. Starting with four employees, Sundrop Farms now employs 150 people, operates at full capacity and produces 350 tonnes of truss tomatoes per week, the demand for which is estimated to increase at an annual rate of 15–20%. It sells all of its production to Coles Supermarkets, according to the terms of a 10-year contract signed with Coles in 2014.

Sundrop Farms transforms seawater and sunlight into high-value truss tomatoes—one product and one variety. Although the investment is high, giving rise to high fixed costs, Saumweber estimates that the depreciation of the investment amounts to less than 50% of the amount that would be spent on fossil fuels were it not for the solar installation. According to Leigh Oliver, director of KKR in Australia: ‘This is an agricultural investment without the traditional risks. The highly cyclical nature of natural effects

## LEARNING OBJECTIVES

- 1 Describe management accounting and explain its role.
- 2 Describe the constituents of the value chain, how the value chain relates to the supply chain, and the dimensions of performance that customers expect.
- 3 Describe planning, control and decisions.
- 4 Explain the meaning of strategy and the way in which management accounting might influence strategic decisions.
- 5 Describe and apply the five-step guide to decisions.
- 6 Explain the way in which accounting organisations influence management accountants’ conduct and effectiveness and, given the context, apply the code of ethics.



Patryk Kosmider/Shutterstock

Sources: Neales, S. 2016, ‘Desal and solar prove the perfect tomato sauce’, *The Australian*, 11 June, <<http://www.theaustralian.com.au/national-affairs/desal-and-solar-prove-the-perfect-tomato-source/news-story/9972772591dd39cbf4a774a0ee93555b>>, accessed 16 December 2016; Neales, S. 2016, ‘This is the future of farming’, *The Weekend Australian Magazine*, no date, <<http://www.theaustralian.com.au/life/weekend-australian-magazine/this-is-the-future-of-farming/news-story/99fd0a207d8b6aa0768c32fd61b3d00e>>, accessed 15 December 2016; Sundrop Farms ABC Landline coverage, YouTube, <[https://www.youtube.com/watch?v=KCup\\_B\\_RHM4#t=213.079941](https://www.youtube.com/watch?v=KCup_B_RHM4#t=213.079941)>, accessed 17 December 2016; ABC, A Taste of Landline, series 2, episode 4, <<http://iview.abc.net.au/programs/taste-of-landline/RA1603Q004S00>>, accessed 17 December 2016; Thieberger, V. 2015, ‘The company that’s growing food in the desert’, *Business Spectator*, 20 November, <<http://www.theaustralian.com.au/business/the-company-thats-growing-food-in-the-desert/news-story/8ad288c3f55d7759b434a4e6ca6c11be>>, accessed 16 December 2016.

on agriculture and unexpected floods and fires are avoided. With the effect of 300 days of sunlight a year, harnessed by 24 000 mirrors focused on a tower 127 metres tall, which in turn channels the energy into four greenhouses with a combined area of 20 hectares, safeguarding 440 000 tomato vines and ensuring their access to abundant sunlight, opportunities for expansion are considerable. First, the farm currently produces only one variety of tomato and capsicums are suited to this process, with research continuing with other produce. Potential locations in other parts of the world include the Middle East, Portugal and California.’

## LEARNING OBJECTIVE

1

Describe management accounting and explain its role.

## Management accounting and its role

‘Management accounting is the sourcing, analysis, communication and use of decision-relevant financial and non-financial information to generate and preserve value for organisations’.<sup>1</sup>

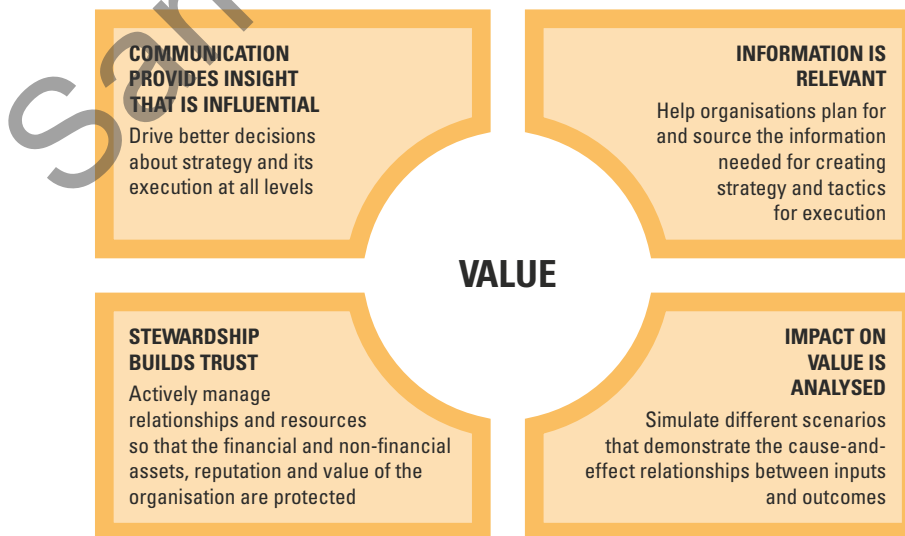
Managers seek information to help them to carry out their responsibilities. Information resides in various disciplines, including management accounting information systems, marketing and others. For managers in the world of practice, the boundaries of these disciplines are blurred. **Management accounting** serves managers by meeting their information needs. It affects and is affected by other relevant variables, and operates in context. The dictionary definition of context is ‘the circumstances that form the setting of an event, statement or idea’ and the word ‘context’ derives from the Latin: *contextus*, a combination of *con* ‘together’ and *texere* ‘to weave’.<sup>2</sup> We emphasise ‘context’ in this book because management accounting is interwoven with the factors or variables that are relevant to the decisions that need to be taken.

Although it is beyond the scope of this chapter to elaborate on and apply the global management accounting principles, the principles are consistent with the philosophy and approach that we have adopted in this book and you are encouraged to visit the CGMA (Chartered Global Management Accountant) website. Notice that value is centre-stage, consistent with the definition of management accounting that precedes Figure 1.1. Note carefully the four quadrants that surround value, and that communication is prominent among them. It does not matter how good your technical knowledge is, or how accurately you can answer multiple-choice and short-answer questions—without clear communication you will

**FIGURE 1.1**

### The Global Management Accounting Principles

Source: AICPA and CIMA. 2014, *Global Management Accounting Principles. Effective management accounting: Improving decisions and building successful organisations*, <[http://www.cgma.org/Resources/Reports/Pages/GlobalManagementAccountingPrinciples.aspx?utm\\_source=cimaglobal&utm\\_medium=principles-page&utm\\_campaign=principles2014](http://www.cgma.org/Resources/Reports/Pages/GlobalManagementAccountingPrinciples.aspx?utm_source=cimaglobal&utm_medium=principles-page&utm_campaign=principles2014)>, p. 9, accessed 17 December 2016. © 2017, Association of International Certified Professional Accountants. Used by permission.



<sup>1</sup> AICPA and CIMA. 2014, *Global Management Accounting Principles. Effective management accounting: Improving decisions and building successful organisations*, <[http://www.cgma.org/Resources/Reports/Pages/GlobalManagementAccountingPrinciples.aspx?utm\\_source=cimaglobal&utm\\_medium=principles-page&utm\\_campaign=principles2014](http://www.cgma.org/Resources/Reports/Pages/GlobalManagementAccountingPrinciples.aspx?utm_source=cimaglobal&utm_medium=principles-page&utm_campaign=principles2014)>, p. 8, accessed 17 December 2016.

<sup>2</sup> Stevenson, A. & Waite, M., editors. 2011, *Concise Oxford English Dictionary*, 12 ed., Oxford University Press, Oxford.

have limited or no impact as a management accountant or Chief Financial Officer (CFO). Clear communication includes the ability to listen, the ability to converse clearly and the ability to write clear and coherent reports. Related to this is the ability to select and present relevant information. While the availability of data can be an issue, the current over-abundance of data is perhaps a bigger challenge. The ability to analyse and demonstrate cause-and-effect relationships to identify impacts on value emphasises the focus on value and strengthens the previously mentioned principles; and trust underlies all.

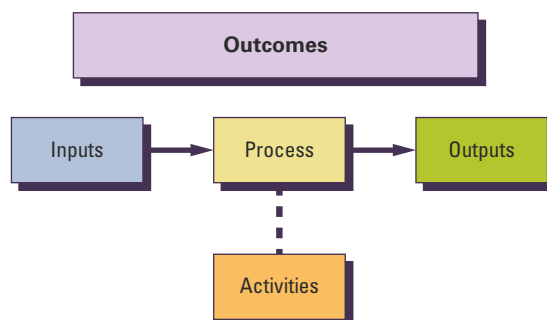
We refer repeatedly in this book to the basic business model identified in the CGMA publication<sup>3</sup> (see Figure 1.2). An ability to focus on the physical characteristics of an organisation's activities will facilitate the design and operation of management accounting systems and enhance your understanding of concepts. For example, cost as an abstract concept is bound to be elusive. A well-known management accounting academic is renowned to have said: 'I have never seen a cost walk into a room, have you?' You haven't met a cost, because 'cost' is an abstract concept. Managers manage the activities that underlie costs; they do not manage costs directly.

Accounting systems process data relating to economic events and transactions, such as sales and purchases of materials, and transform them into information that is useful for reporting to external users and internal users. Among the latter, the information is helpful to managers, sales representatives, production supervisors and others. Management accountants collect, categorise, summarise and analyse data. For example, they collect costs by category, such as materials, labour and shipping, and summarise the detail to determine total costs by month, quarter or year. They analyse the results to highlight, for example, how costs have changed relative to revenues from one period to the next.

They also provide the information found in the income statement, the balance sheet,<sup>4</sup> the statement of cash flows, and performance reports, such as the cost of operating a factory or of providing a service. Managers use management accounting information to: choose, communicate and implement strategy; coordinate product design, production and marketing decisions; evaluate performance; administer the activities, businesses or functional areas they oversee; and coordinate these activities within the framework of the organisation. This book focuses on how management accounting assists managers in these tasks.

Management accounting information is governed by the key questions: (1) how will this information help managers do their jobs better?; and (2) do the benefits of producing this information exceed the costs? The reports do not have to follow set principles or rules.

Managers with different responsibilities often require the information in an accounting system to be presented or reported in different ways. For example, a sales manager, a distribution manager and a production manager would have quite different interests in sales order information. A sales manager may be interested in the total dollar amount of sales, to determine the commissions to be paid; a distribution manager may be interested in the sales order quantities by geographical region and by customer-requested delivery dates, to ensure



**FIGURE 1.2**

The basic business model: inputs–process–outputs–outcomes

<sup>3</sup> See footnote 1.

<sup>4</sup> These terms for financial statements will be used throughout the book because they are commonly understood and widely used. However, the official terms are 'statement of comprehensive income' and 'statement of financial position' according to a 2009 revision to AASB 101.

timely deliveries; and a production manager may be interested in the quantities of various products and their desired delivery dates, to enable scheduling of production.

An ideal database—sometimes called a data warehouse or infobarn—consists of small, detailed pieces of information that can be used for multiple purposes. For instance, the sales order database will contain detailed information about product, quantity ordered, selling price and delivery details (place and date) for each sales order. The database stores information in a way that allows managers to access the information they need. Many companies are building their own enterprise resource planning (ERP) systems, single databases that collect data and feed it into applications that support the company's business activities, such as purchasing, production, distribution and sales.

### Three guidelines

Three guidelines that help management accountants provide value to their companies in strategic and operational decisions are: (1) analyse benefits and costs; (2) give full recognition to behavioural and technical considerations; and (3) use different costs for different purposes.

#### Benefit–cost analysis

Management accountants continually face resource allocation decisions, such as whether to purchase a new software package or hire a new employee. A **benefit–cost analysis** is appropriate for these decisions because resources should be used only if the expected benefits to the company exceed the expected costs. Do not be put off when expected benefits and costs are difficult to quantify; it is better to recognise them and make an estimate than to ignore them.

Think about a company that conducts its business with historical record-keeping and little formal planning. Its management team thinks that it may be time for its first budgeting system. A budgeting system compels managers to plan ahead, to compare actual with budgeted information and to take corrective action. This is a major benefit of a budgeting system. The budgeting system entails investments in physical assets, in training managers and others, and in ongoing operations. These are the major costs. Once the budgeting system is in place, the new information can be expected to lead to different decisions that create more profits than the decisions that would have been made using the historical system. The expected benefits of the new budgeting system thus exceed the expected costs.

#### Behavioural and technical considerations

The benefit–cost criterion assists managers in deciding whether, say, to install a proposed budgeting system instead of continuing to use a historical system. Consider the human (the behavioural) side of the decision to use budgeting. Budgets induce a different set of decisions within an organisation because of better collaboration, planning and motivation. A management accounting system has two simultaneous missions—one technical and the other behavioural. The technical considerations help managers make wise economic decisions by providing them with the desired information (e.g. costs in various value-chain categories) in an appropriate format (e.g. actual results versus budgeted amounts) and at the preferred frequency (e.g. weekly versus monthly). Appropriate attention to behavioural issues motivates managers and other employees to aim for the goals of the organisation.

Managers and management accountants are aware that management is not confined to technical matters. It is primarily a human activity that should focus on how to help individuals do their jobs better, for example by helping them to understand the activities that add value and those that do not. Moreover, when workers underperform, behavioural considerations suggest that managers should do more than send them a report highlighting their underperformance; they should also personally discuss with the workers ways to improve performance.

#### Different costs for different purposes

As in many other domains, 'one size fits all' does not apply to management accounting. Different costs serve different purposes. A cost concept used for external accounting reports may not be appropriate for internal reporting to managers.

Consider the advertising costs associated with Vodafone launching a major new product. The product is expected to have a useful life of two years or more. For external reporting to shareholders, television advertising costs for this product are an expense in the income statement in the year they are incurred, as required by International Financial Reporting Standards (IFRS) and other authoritative standards. However, management accountants at Vodafone could capitalise these advertising costs and amortise them over several years if they believe that doing so would provide a more accurate and fairer measure of the performance of the managers who launched the new product. Differences also arise across different management decisions; the central criterion for short-term decisions is cost behaviour (fixed and variable costs), whereas traceability and cause-and-effect relationships are central to activity-based costing. Chapter 2 focuses on different costs for different purposes.

## Management accountants in organisations

Most organisations distinguish between line management and staff management; the management accountant is part of staff management. In practice, we might find management accountants whose responsibilities blur across other accounting-related activities and whose titles and positions might vary from organisation to organisation.

**Line management**, such as production, marketing and distribution management, is directly responsible for attaining the goals of the organisation. For example, managers of production divisions might target particular levels of budgeted operating profit, certain levels of product quality and safety, and compliance with environmental laws. **Staff management**, such as management accountants and information technology and human resources management, exists to provide advice and assistance to line management. A plant manager (a line function) may be responsible for investing in new equipment. A management accountant (a staff function) works as a business partner of the plant manager by preparing detailed operating cost comparisons of pieces of equipment. In this book, we regard the management accountant as the chief management accounting executive. By reporting and interpreting relevant data, the management accountant influences managers towards making better-informed decisions as they implement their strategies. Where an organisation is large enough to employ both a CFO and a management accountant, the management accountant reports to the CFO.

The **chief financial officer** or **financial director** is a staff manager who reports to the managing director or CEO and is the executive responsible for the financial operations of an organisation and managing the accounting or finance function. While the specific responsibilities of the CFO vary between organisations, they may include the following:

- **financial reporting** to managers for planning, control and decision making, and to shareholders
- **strategy**—defining strategy and allocating resources to implement strategy
- **treasury**—overseeing banking, short- and long-term financing, investments and cash management
- **risk management**—managing financial risk of interest-rate and exchange-rate changes and derivatives management
- **taxation**—managing income taxes, goods and services tax (GST) and tax planning
- **investor relations**—communicating with, responding to and interacting with shareholders.

An independent internal audit group function reviews and analyses financial and other records to attest to the integrity of the organisation's financial reports and to adherence to its policies and procedures.

In most organisations, there are also informal relationships that managers must understand when they attempt to implement their decisions. Examples of informal relationships are friendships of a professional or personal nature among managers and the personal preferences of top management about the managers they rely on in decision making. Increasingly,

organisations such as Honda and Dell are using teams to achieve their objectives. These teams include both line and staff management so that all inputs into a decision are available simultaneously.

Think about managers engaged in designing and implementing strategies, and the organisational structures within which they work. Then think about management accountants' roles. It should be clear that the successful management accountant must have technical and analytical competence *as well as* behavioural and interpersonal skills. The next section describes some desirable values and behaviours and why they are so critical to the partnership between management accountants and managers. We will elaborate on these values and behaviours in subsequent chapters of this book.

## Management accounting beyond the numbers<sup>5</sup>

Many people outside the accounting profession perceive accountants to be just 'numbers people'. Although management accountants are undoubtedly adept financial managers, their skills do not stop there. The characteristics and skills of successful management accountants extend beyond the numbers, enabling them to

- *work well in cross-functional teams and as a business partner.* In addition to being technically competent, the best management accountants work well in teams, learn about business issues, understand the motivations of different individuals, respect the views of their colleagues and show empathy and trust.
- *promote fact-based analysis and make tough-minded, critical judgements without being adversarial.* Management accountants raise tough questions for managers to consider, especially when preparing budgets. They do so thoughtfully and with the intent of improving plans and decisions. Before the investment bank JP Morgan lost more than \$6 billion on 'exotic' financial investments (credit default swaps) in 2012, management accountants should have raised questions about these risky investments and the fact that the firm was essentially betting that improving economic conditions abroad would earn it a large profit.
- *lead and motivate people to change and be innovative.* Implementing new ideas, however good they may be, is difficult. When the United States Department of Defense (DoD) began consolidating more than 320 finance and accounting systems into a common platform, the accounting services director and his team of management accountants held meetings to make sure that everyone in the agency understood the goal for such a change. Ultimately, the DoD aligned each individual's performance with the transformative change and introduced incentive pay to encourage personnel to adopt the platform and drive innovation within this new framework.
- *communicate clearly, openly and candidly.* Communicating information is a large part of a management accountant's job. When premium car companies such as Rolls Royce and Porsche design new models, management accountants work closely with engineers to ensure that each new car supports a carefully defined balance of commercial, engineering and financial criteria. These efforts are successful because management accountants clearly communicate the information that multidisciplinary teams need to deliver new innovations profitably.
- *have high integrity.* This precludes their succumbing to pressure from managers to manipulate financial information. Their primary commitment is to the organisation

5 Akroyd, C. & Maguire, W. 2011, 'The roles of management control in a product development setting', *Qualitative Research in Accounting & Management* 8(3); Garling, W. 2007, 'Winning the transformation battle at the Defense Finance and Accounting Service', May–June; Nixon, B., Burns, J. & Jazayeri, M. 2011, 'The role of management accounting in new product design and development decisions', *Research Executive Summary Series*, 9(1), Chartered Institute of Management Accountants, London, November; Worthen, B. 2012, 'H-P says it was duped, takes \$8.8 billion charge', *The Wall Street Journal*, November; Gollakota, K. & Vipin, G. 2009, *WorldCom Inc.: What went wrong*, Richard Ivey School of Business Case No. 905M43, The University of Western Ontario, London, ON, <[http://cb.hbsp.harvard.edu/cb/web/product\\_detail.seam?R=905M43-PDF-ENG](http://cb.hbsp.harvard.edu/cb/web/product_detail.seam?R=905M43-PDF-ENG)>; United States Senate Permanent Subcommittee on Investigations. 2013, *JPMorgan Chase Whale trades: A case history of derivatives risks and abuses*, Government Printing Office, Washington, DC, 15 March.

and its stakeholders. In 2015 Toshiba, the Japanese maker of semiconductors, consumer electronics and nuclear power plants, wrote down US\$1.9 billion of earnings that had been overstated over the previous seven years. The problems stemmed from managers setting aggressive profit targets that subordinates could not meet without inflating divisional results by understating costs, postponing losses and overstating revenues.

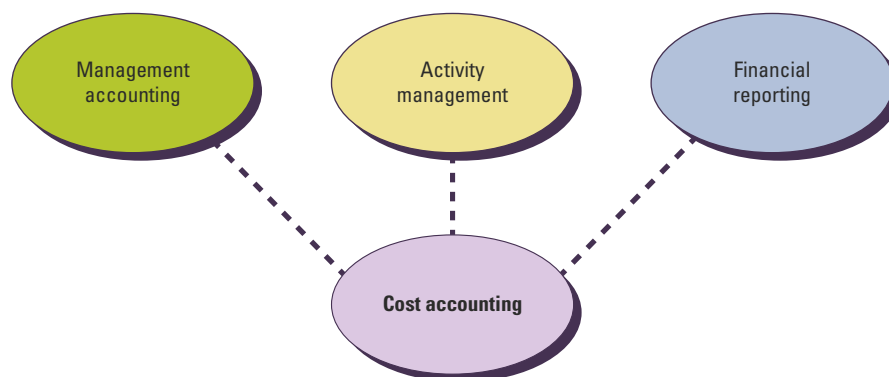
## Roots and interdisciplinary connections

Although management accounting has its roots in cost accounting, its growing prominence in the support of management has increased its connections with other disciplines over time (see Figure 1.3). Examples, among others, are: financial statement analysis—ratios such as return on investment in evaluating performance (chapter 20); finance—present values and related metrics for capital investment appraisal (chapter 18); corporate governance—accountability and sustainability (chapter 21); and internal and external auditing (planning and control) (chapter 11).

Cost accounting provides information for management accounting and financial accounting. **Cost accounting** measures, analyses and reports financial and non-financial information relating to the costs of acquiring or using resources in an organisation. For example, estimating the cost of a product is a cost accounting process that answers the financial accountant's inventory-valuation needs for providing management with information to make decisions, such as choosing which products to offer. The cost information collected is a function of the management decisions being made—hence different costs for different purposes, as noted above. Thus, the distinction between management accounting and cost accounting is not clear-cut, and we often use these terms interchangeably in the book.

As mentioned earlier, managers manage activities; they cannot manage costs directly.<sup>6</sup> By managing activities, which consume resources, managers affect resource consumption, and thus costs, in their quest to increase value to customers and to achieve the organisation's goals. Decisions in this area relate to issues such as the amounts and kinds of materials used, changes in plant processes and changes in product designs, programs that enhance customer satisfaction and quality, research and development (R&D), and marketing programs to promote 'blockbuster' new products. Managing activities shifts the emphasis from ascertaining costs to influencing resource consumption and is inextricably linked with revenue and profit planning. Managers often deliberately incur additional costs to enhance revenues and profits, for example in advertising and product modifications.

**Financial accounting**, also frequently referred to as *financial reporting*, focuses on reporting to external stakeholders, such as investors, lenders, suppliers and government agencies. It measures and records business transactions and provides financial statements that are governed by IFRS and regional and national modifications thereof. Since 2002 the internationalisation of financial reporting has led to significant convergence of the way in



**FIGURE 1.3**

Cost accounting supports management accounting, activity management and financial reporting

<sup>6</sup> You are likely to see or hear references to 'cost management' in presentations and various publications. The term is a misnomer because managers cannot manage costs—they can only manage activities. Although we avoid the term for this reason, the term 'cost management' may appear in this book from time to time because it is widely used.

**TABLE 1.1** Major differences between management accounting and financial accounting

	Management accounting	Financial accounting
Purpose of information	Helps managers make decisions to achieve an organisation's goals	Communicates an organisation's financial position and performance to investors, banks, regulators and other outside parties
Primary users	Managers of the organisation	External users, such as investors, banks, regulators and suppliers
Focus and emphasis	Future-oriented (budget for 2019 prepared in 2018)	Past-oriented (reports on 2018 performance prepared in 2019)
Rules of measurement and reporting	Internal measures and reports are based on benefit–cost analysis; they do not have to follow regulations for external users	Financial statements must be prepared in accordance with external reporting requirements and be certified by external, independent auditors
Time span and type of reports	Varies from hourly information to 15–20 years, with financial and non-financial reports on products, departments, regions and strategies	Annual and quarterly financial reports, primarily on the organisation as a whole
Behavioural implications	Designed to influence the behaviour of managers and other employees	Primarily reports economic events but also influences behaviour because managers' compensation is often based on reported financial results

**DECISION POINT 1**

What is management accounting and what is its role?

which the income statement, balance sheet and statement of cash flows are presented. While an examination of these statements as prepared for external stakeholders is beyond the scope of this book, we recognise that managers' compensation is often directly affected by the numbers in these financial statements. Consequently, managers are interested in both management accounting and financial accounting.

Table 1.1 summarises the major differences between management accounting and financial accounting. At the same time, note that reports such as balance sheets, income statements and cash flow statements are common to both management accounting and financial accounting.

**LEARNING OBJECTIVE 2**

Describe the constituents of the value chain, how the value chain relates to the supply chain, and the dimensions of performance that customers expect.

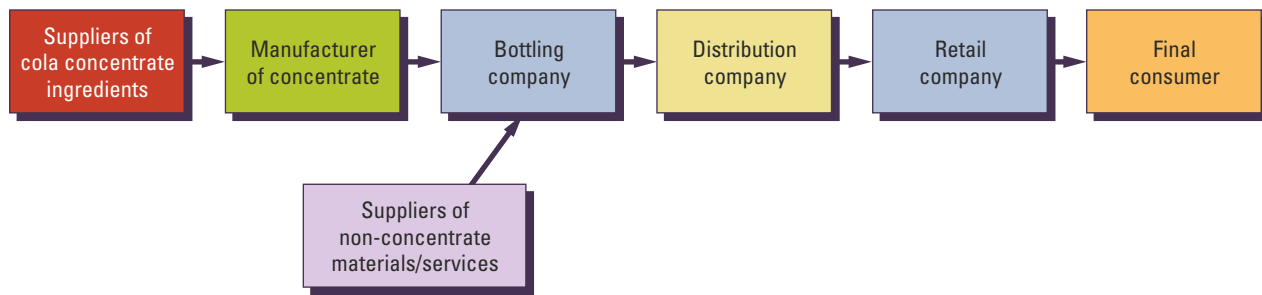
**The supply chain, the value chain and key success factors**

Customers demand much more than a fair price from companies; they also expect a high-quality product or service delivered in a timely way. The entire customer experience determines the value that s/he derives from a product or service. In this section, we explore how managers and workers go about creating that value.

**The supply chain and the value chain**

The term **supply chain** (see Figure 1.4) describes the flow of goods, services and information from the initial sources of materials and services to the delivery of products to consumers, regardless of whether those activities occur in the same organisation or in other organisations. By analysing activities, managers are able to integrate and coordinate them across suppliers and customers in the supply chain, as well as across business functions in an individual company's value chain, with a view to reducing costs. For example, many companies play a role in bringing soft drinks like Coke and Pepsi to consumers. Both The Coca-Cola Company and Pepsi Bottling Group contract with their suppliers (such as plastic and aluminium companies and sugar refiners) to deliver small quantities of materials directly to the production floor frequently, to reduce materials handling costs. Customers of these companies similarly manage their supply chains: supermarkets often ask these and other suppliers to manage inventory at both their warehouse and the supermarket, thus reducing inventory levels in the supply chain.

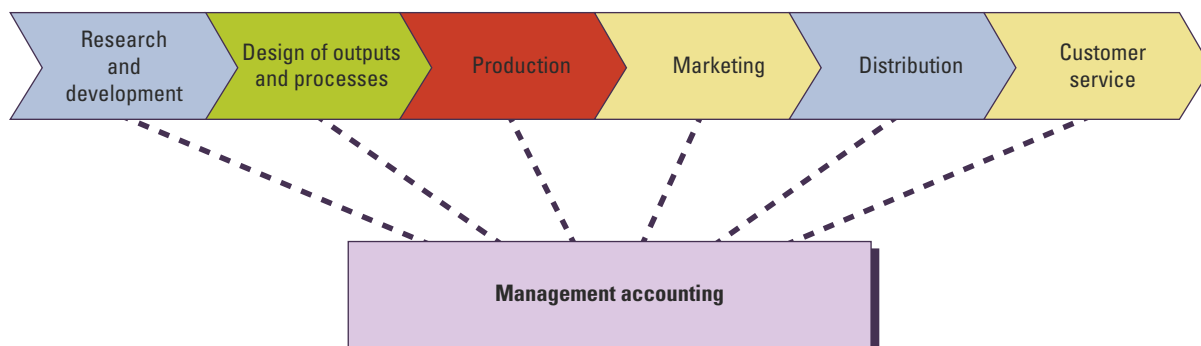


**FIGURE 1.4** Supply chain for a cola bottling company

Companies make a strategic decision to create and add value by operating across the entire supply chain for the industry or to select a segment of it. The selected segment constitutes the **value chain** for the business, that is, the sequence of business functions or activities through which the organisation is able to add value in producing outputs. Beyond the value chain, managers can work with other parties in the supply chain to add value and reduce costs. Management accountants track the costs incurred in each value chain category, to reduce its costs and to improve efficiency. Cost information also helps managers make benefit–cost trade-offs. For example, is it cheaper to buy products from outside vendors or to produce in-house? Is it worthwhile to invest more resources in design and production if it reduces costs in marketing and customer service or increases revenues?

Figure 1.5 shows six business functions: research and development, design of outputs and processes, production, marketing, distribution and customer service. We illustrate these business functions using Sony’s television division.

1. **Research and development**—generating and experimenting with ideas related to new products, services or processes. At Sony, this function includes research on alternative television signal transmission (analogue, digital, high definition) and on the clarity of different shapes and thicknesses of television screens.
2. **Design of products, services or processes**—detailed planning and engineering of products, services or processes. Design at Sony includes determining the number of component parts in a television set and the effect of alternative product designs on quality and manufacturing costs.
3. **Production**—acquiring, coordinating and assembling resources to produce a product or a service. Production of a Sony television set involves the efforts of people and the use of machines and equipment to acquire and assemble the electronic parts, the cabinet and the packaging used for shipping. Screening of a movie at Village Theatres similarly involves the efforts of people and the use of machines and equipment to acquire the movie and

**FIGURE 1.5** Managers in different parts of the value chain

# CONCEPTS IN ACTION

## Supplier and customer perspectives on managing the supply chain

In 2011, the Australian Competition and Consumer Commission (ACCC) brought an unconscionable conduct action against Coles regarding the way in which it had dealt with its suppliers. Following a recent question from financial journalist Alan Kohler, John Durkan, the CEO of Coles, responded that the incident referred to a small group of suppliers, to whom Coles had apologised, and that Coles had paid its fine and had taken action to improve matters. Part of this action was to appoint Jeff Kennett, a former premier of Victoria, as arbitrator of supplier-related issues and to ensure that suppliers had easy access to him. Durkan emphasised the importance that Coles places on suppliers:

‘So over the period of time, we’ve focussed on our suppliers and our supplier base actually because the only way we can absolutely get the quality of products that we need and our customers want and the lower prices is by having the right supplier base . . . So we’ve been moving to longer term contracts now for seven years or eight years. And, as I said, we’ve been dealing with mainly these family-owned businesses for decades.’

Coles has a 10-year agreement with Murray Goulburn Co-operative Co. Ltd for milk, and in 2014 signed a 10-year

supply agreement with Sundrop Farms for its full production at Port Augusta, some 17 million kilograms a year of truss tomatoes, at a fixed price. It expects demand for truss tomatoes to grow at an annual rate of 15–25%. Durkan pointed out that this provides security of supply for Coles, including during the winter months when tomatoes are otherwise scarce and expensive.

Sundrop started delivering its first tomatoes to Coles in the first half of 2016, pursuant to the agreement with Coles referred to above. How does this style of supply-chain arrangement suit the supplier, in this case, Sundrop Farms? Sundrop’s technology, process and planting cycle ensures that tomatoes are picked 10 weeks after planting over 50 weeks a year, which is central to being able to supply Coles’ supermarkets continuously; six double-container truckloads leave the farm every day for distribution to supermarkets and consumers in Perth, Darwin, Adelaide, Melbourne, Sydney and Brisbane. The long-term contract protects Sundrop from the uncertainties that remain, allowing it to concentrate on improving production, technology and efficiency and to continue with experimentation without being concerned with finding and dealing with many separate customers. After 10 years of the Coles contract, Sundrop is able to consider re-negotiating or putting its glasshouses to work on other tomato varieties or indeed other crops such as capsicums or cucumbers.

*Sources:* ABC, A Taste of Landline, series 2, episode 4, <<http://iview.abc.net.au/programs/taste-of-landline/RA1603Q004S00>>, accessed 17 December 2016; Bartholomeusz, S. & Kohler, A. 2015, ‘Coles runs its own race’, *Business Spectator*, 30 November, <<http://www.theaustralian.com.au/business/business-spectator/coles-runs-its-own-race/news-story/55b27e917c6dada310ed51cc0820e621#differentiate>>, accessed 16 December 2016; Neales, S. 2016, ‘Desal and solar prove the perfect tomato sauce’, *The Australian*, 11 June, <<http://www.theaustralian.com.au/national-affairs/desal-and-solar-prove-the-perfect-tomato-source/news-story/9972772591dd39cbf4a774a0ee93555b>>, accessed 16 December 2016; Neales, S. 2016, ‘This is the future of farming’, *The Weekend Australian Magazine*, no date, <<http://www.theaustralian.com.au/life/weekend-australian-magazine/this-is-the-future-of-farming/news-story/99fd0a207d8b6aa0768c32fd61b3d00e>>, accessed 16 December 2016; Sundrop Farms ABC Landline coverage, YouTube, <[https://www.youtube.com/watch?v=KCup\\_B\\_RHM4#t=213.079941](https://www.youtube.com/watch?v=KCup_B_RHM4#t=213.079941)>, accessed 17 December 2016.

related inputs such as food and drink and to project the movie onto the screen. As noted above, the term *production* can be used to refer to both products (tangible outputs) and services (intangible outputs), while **manufacturing** refers only to products.

4. **Marketing (including sales)**—promoting and selling products or services to customers or prospective customers. Sony markets its televisions through trade shows, advertisements in newspapers and magazines, and on the internet.
5. **Distribution**—delivering products or services to customers. Distribution for Sony includes shipping to retail outlets, catalogue vendors, direct sales via the internet and other channels through which customers purchase televisions.
6. **Customer service**—providing after-sales support to customers. Sony provides customer service on its televisions in the form of customer-help telephone lines, support on the internet and warranty repair work.

Each of these business functions is essential to Sony’s satisfying its customers and keeping them satisfied and loyal over time. Companies use the term *customer relationship management* (CRM) to describe a strategy that integrates people and technology in all business functions

to enhance relationships with customers, partners and distributors. CRM coordinates all customer-facing activities (i.e. marketing, sales calls, distribution and post-sales support) and the design and production activities necessary to get products to customers.

Although Figure 1.5 depicts the usual order in which different business functions occur, do not interpret this figure as implying that managers should proceed sequentially through the value chain when planning and managing activities. Companies gain (in terms of cost, quality and the speed with which new products are developed) if two or more managers of the individual business functions of the value chain work concurrently as a team. For example, inputs into design decisions by production, marketing, distribution and customer service managers often lead to design choices that reduce the total costs of the company.

Campbell Soup Company incurs the following costs:

- a. purchase of tomatoes by a canning plant for Campbell's tomato soup products
- b. purchase of materials for redesigning Pepperidge Farm biscuit containers to make biscuits stay fresh longer
- c. payment to Backer Spielvogel Bates, the advertising agency, for advertising work on the Healthy Request line of soup products
- d. salaries of food technologists researching the feasibility of a Prego pizza sauce that has minimal calories
- e. payment to Safeway for redeeming coupons on Campbell's food products
- f. cost of a toll-free telephone line used for customer enquiries about using Campbell's soup products
- g. cost of gloves used by line operators on the Swanson Fiesta breakfast food production line
- h. cost of hand-held computers used by Pepperidge Farm delivery staff serving major supermarket accounts.

### Required

Classify each cost item (a–h) as one of the business functions in the value chain in Figure 1.5 (p. 9).

1.1

**TRY IT!**

**Key success factors** are those functions, activities or business practices, defined by the market not the company, and as viewed by the customer, that are critical to the vendor/customer relationship. They revolve around skills, processes and systems, of which core competencies are a part. Core competencies focus on internal activities, practices and functions. When these competencies are aligned with key success factors, the value of the business relationship blossoms and grows for the benefit of both the company and the customer. When analysing key success factors, it is important to be realistic about both the drivers of the market and the drivers of the customers' needs. It is also key to understand and to define the position of the company in relation to its competitors.

Key success factors can exist in both the functional areas and the condition or circumstances of the company. Functional key success factors might include things such as proprietary processes (production); after-sale service or a highly trained sales force (marketing); on-time, perfect order delivery (supply chain); and online, real-time information exchange between company and customer (technology). Examples of key success factors relating to the condition or circumstances of the company could be: favourable market image or reputation; low-cost operations (not limited to production); location relative to customer; and exclusive production processes in production or supply chain.

The final step in the analysis of key success factors is to determine the total value of the factors that the business brings to the customer versus the key success factors that the competitors bring to the customer, and then to arrange the key success factors in order of priority from the viewpoint of the customer and focus on those functions, activities and

practices that are considered most important to the customer, bring the most value to the customer and are most clearly distinguished from competitors. Customers expect companies to use the value chain and supply chain to deliver ever-improving levels of performance regarding several (or even all) of the following:

- **Cost and efficiency**—managers of companies face continuous pressure to reduce the cost of the products or services they sell. To calculate and manage the cost of products, the management accountant tries to understand the tasks or activities (e.g. setting up machines or distributing products) that cause costs to arise. Managers monitor the marketplace to determine prices that customers are willing to pay for products or services. Management accountants calculate a target cost for a product by subtracting the operating profit per unit of product that the company thinks it can earn from the 'target price'. Managers work with management accountants to achieve the target cost by eliminating some activities (e.g. rework) and by reducing the costs of performing activities in all value-chain functions—from initial R&D to customer service. Increased global competition is placing even more pressure on companies to lower costs. Managers of companies around the world are cutting costs by outsourcing some of their business functions. Among Australian and New Zealand companies that have done so are: Macpac, a well-known maker of bushwalking and camping gear, which has moved its manufacturing operations to China and the Philippines; Westpac, which has outsourced jobs to India; and TPG, a telecommunications company, which has also outsourced its customer service operations to India. Indeed, FooBooOnLine has established an online portal as a contact point for buyers and suppliers of outsourcing services in the Asia-Pacific region.
- **Quality**—customers expect high levels of quality. Total quality management (TQM) is a philosophy in which management improves operations throughout the value chain to deliver products and services that exceed customer expectations. TQM encompasses designing the product or service to meet the needs and wants of customers, as well as making products with zero or minimal defects and waste and with low inventories. Management accountants evaluate the costs and revenue benefits of TQM initiatives.
- **Time**—time has many components. New product development time is the time it takes for new products to be created and brought to market. The increasing pace of technological innovation has led to shorter product life-cycles and the need for companies to bring new products to market more rapidly. The management accountant measures the costs and benefits of a product over its life-cycle. Customer response time describes the speed at which an organisation responds to customer requests. To increase customer satisfaction, organisations must complete activities faster and meet promised delivery dates reliably. Delays or bottlenecks occur when the work to be performed exceeds the available capacity. To increase output in these situations, managers need to increase the capacity of the bottleneck operation. The management accountant's role is to quantify the costs and benefits of relieving the bottleneck constraints.
- **Innovation**—a constant flow of innovative products or services is the basis for ongoing success. The management accountant helps managers evaluate investment and R&D decisions.

Management accountants help managers track performance on the chosen key success factors relative to the performance of competitors on the same factors. Tracking what is happening in other companies serves as a *benchmark* and alerts managers to the changes their own customers are observing and evaluating. The goal is for a company to *continuously improve* its critical operations, for example on-time arrival for Virgin Blue, customer access for online auctions at eBay and cost reduction at Sumitomo Electric. Sometimes, more fundamental changes in operations—such as redesigning a manufacturing process to reduce costs—may be necessary. However, successful strategy implementation requires more than value-chain and supply-chain analysis and execution of key success factors. It is the decisions that managers make that move them and their teams to develop, integrate and implement their strategies.

## DECISION POINT 2

How do managers and workers add value, and what are the dimensions of performance that customers expect?

## Planning, control and making decisions

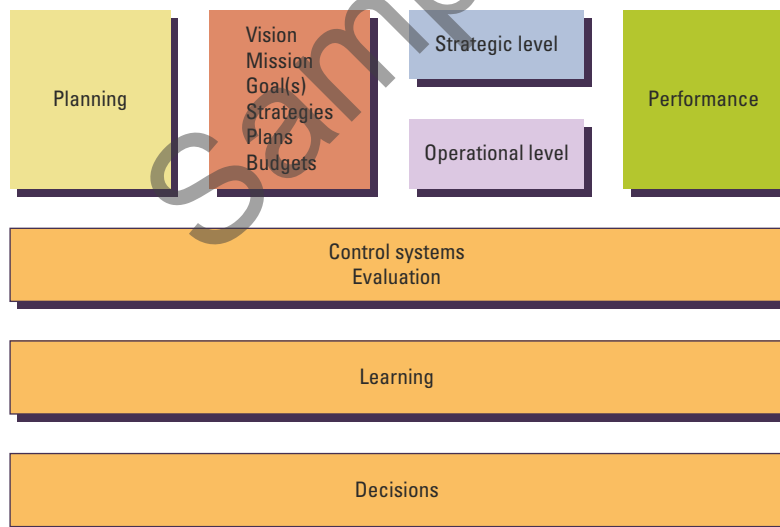
Managers plan, control, delegate and make decisions, among other things. These actions are interwoven; they are not discrete and distinct. A manager cannot control without a plan, and decisions permeate all actions: deciding to plan and how to plan, deciding to control and how to control, and deciding to delegate and to whom. These decisions occur on the way to other decisions in response to questions such as: What price should we charge? What product mix should we offer? Which market segment should we target? How do we improve efficiency and effectiveness? People within an organisation acquire inputs and manage processes to transform inputs into outputs.

**Planning** involves selecting organisational goals, predicting results under various ways of achieving those goals, deciding how to attain the desired goals and communicating both the goals and how to attain them to the entire organisation. Management accountants serve as business partners in these planning activities because they understand what creates value and the key success factors involved. Planning encompasses vision, mission, goal(s), strategies, plans and budgets. The different facets are organised in Figure 1.6, approximately according to the time horizons that apply—from long run to short run. ‘Strategies’ appear approximately in the middle because, although managers form them with a view to the long run, they must be continually implemented in the short term.<sup>7</sup> In a seminal article, Robert Anthony (1965)<sup>8</sup> presents a framework of planning and control systems, which distinguishes between strategic, management and operational (also subsequently referred to as task) planning and control to highlight the relationship between the levels and differing characteristics such as the time-frame involved, the reliance on external versus internal information, the frequency of reporting and the like. Although there is a difference between management control and operational control, we simplify to two levels: strategic and operational.

An organisation’s **mission statement** identifies the organisation’s purpose/objective, its output/market scope and the way it conducts its operations;<sup>9</sup> the output/market scope includes customer groups served, customer functions and technologies used.<sup>10</sup> A **statement of values** underpins the way in which the organisation conducts business. A **vision statement**, which is a

### LEARNING OBJECTIVE 3

Describe planning, control and decisions.



**FIGURE 1.6**

Planning and control systems

<sup>7</sup> The word ‘strategy’ is used equally to refer to ‘grand’ strategy, which overarches the entire organisation, and to specific strategies, as in marketing, pricing or competing. This is potentially confusing to newcomers and can be resolved only by examining the context in which the strategy is mentioned.

<sup>8</sup> Anthony, R. N. 1965, *Planning and control systems: A framework for analysis*, Division of Research, Graduate School of Business Administration, Harvard University.

<sup>9</sup> Maguire, W. & Bhowan, K. 1988, ‘The mission statement: Why bother with it?’, *Businessman’s Law*, 17: 189–190, 192.

<sup>10</sup> Abell, D. F., 1980, *Defining the business: The starting point of strategic planning*, Prentice Hall, Englewood Cliffs, NJ.

one-sentence statement of the organisation's long-term goal or objective, usually accompanies the mission statement. Not all organisations present these key statements in the same way, although sound statements do feature the key elements specified above. The *Concepts in action* feature opposite presents two examples, one profit-seeking (Westpac) and one not-for-profit (International Federation of Accountants [IFAC]). Note that Westpac has incorporated its mission and values into its statement of strategy, which is the focus of the next section.

A **budget** is the quantitative expression of a proposed plan of action by management, most often, but not always, for a time horizon of one year. It has the potential to encourage coordination and communication throughout a company, as well as with the company's suppliers and customers, because the process of preparing a budget crosses business functions. Although a budget is an important planning tool, it is arguably more powerful as a control tool. **Control** involves taking actions that implement the planning decisions, deciding how to evaluate performance, and providing feedback and learning to help future decision making. As mentioned above, a budget is also a control tool because it is a benchmark against which actual performance can be compared, thus providing a basis for evaluating performance. Planning and control activities must be sufficiently flexible to allow managers to seize opportunities unforeseen at the time the plan was formulated. Control should not pressure managers to cling to a plan when unfolding events, such as an opportunity for an unexpected advantage in the market, indicate that actions outside of that plan, such as spending more money for marketing, would significantly improve results from higher sales.

Performance measures tell managers how well they, the organisation as a whole and/or their responsibility centres are doing. Linking rewards to performance helps motivate managers. These rewards are both intrinsic (self-satisfaction for a job well done) and extrinsic (salary, bonuses, promotions linked to performance). **Learning** follows from examining past performance and systematically exploring ways to make better-informed decisions and plans in the future. Learning can lead to changes in goals, in the ways courses of action are identified, in the range of information collected when making predictions, and sometimes to changes in management.

## Sustainability

**Sustainability** is 'the ability to continue a defined behaviour indefinitely' and comprises environmental, economic and social sustainability: (1) 'environmental sustainability is the ability to maintain rates of renewable resource harvest, pollution creation, and non-renewable resource depletion that can be continued indefinitely'; (2) 'economic sustainability is the ability to support a defined level of economic production indefinitely'; and (3) 'social sustainability is the ability of a social system, such as a country, to function at a defined level of social well-being indefinitely'. Environmental, economic and social sustainability are frequently referred to as the 'three pillars of sustainability'.<sup>11</sup>

With the contemporary focus on sustainability, we expect companies to report on it in their corporate responsibility reports, to refer to it in their vision statements and to incorporate it into their strategies. From a societal viewpoint, management accounting contributes by bringing relevant costs and benefits of sustainability to the attention of decision makers in the public arena, such as city councillors or government ministers. At the organisational level, although at one time the decision to set up a new factory would have been made on the basis only of benefits and costs affecting the company concerned, today's management accountant would integrate sustainability issues into planning and control at both strategic and operational levels. Concern for sustainability requires that we now consider externalities, such as the pollution of air and water. Management accounting is well placed to inform these decisions by recognising both financial and non-financial benefits and costs.

The emergence of products and services that offer sustainable solutions is another manifestation of the centrality of sustainability. We have all no doubt noticed the attention

<sup>11</sup> Definitions from <thwink.org/sustain/glossary/Sustainability.htm#Definition>, accessed 21 December 2016.

# CONCEPTS IN ACTION

## Key organisational statements

### Westpac Banking Corporation: Our strategy and vision

Westpac's vision is to be one of the world's great service companies, helping our customers, communities and people to prosper and grow.

Our strategy seeks to deliver on this vision by providing superior returns for our shareholders, building deep and enduring customer relationships, being a leader in the community and being a place where the best people want to work.

In delivering on our strategy we are focused on our core markets of Australia, New Zealand and the near Pacific, where we provide a comprehensive range of financial products and services that assist us in meeting all the financial services needs of our customers. With our strong position in these markets, and nearly 13 million customers, our focus is on organic growth, growing customer numbers in our chosen segments and building stronger and deeper customer relationships.

A key element of this approach is our portfolio of financial services brands which enables us to appeal to a broader range of customers, and provides us with the strategic flexibility to offer solutions that better meet individual customer needs.

In implementing this strategy, we seek to grow customer numbers in chosen segments and increase the number of products per customer with a specific focus on deposits, and wealth and insurance cross sell.

Asia is an important market for us and we are progressively building our presence and capability across the region to better support Australian and New Zealand customers operating, trading and transacting in the region, along with Asian customers seeking financial solutions and services in Australia and New Zealand.

While continuing to build the business, the more challenging financial services environment has required us to focus on strengthening our financial position while at the same time improving efficiency. This strengthening has involved lifting the level and quality of our capital, improving our funding and liquidity position and maintaining a high level of asset quality and provisioning.

While we currently have a relatively low cost to income ratio, we continue to seek opportunities to streamline and simplify our business, to improve the quality of experience for customers and reduce our unit costs.

Our sustainability strategy supports this approach by anticipating and shaping the most pressing emerging social issues where we have the skills and experience to make a meaningful difference and drive business value. These areas are:

- Anticipating the big shifts of demographic and cultural change and their impact on our workplace and customers
- Creating economic solutions to environmental challenges
- Helping customers achieve sustainable financial futures in a changed landscape.

Our approach seeks to make sustainability part of the way we do business, embedded in our strategy, values, culture and processes.

We believe that successful execution of our strategy will lead to higher revenue per customer and strong credit quality (because we know our customers very well) and a superior cost profile.

Supporting our customer focused strategy is a strong set of company-wide values, which are well embedded in our culture. These are:

- Delighting Customers—by deeply understanding and exceeding expectations
- One Team—working together respectfully, valuing each other, to deliver the best outcomes for customers and the organisation
- Integrity—each employee accountable for their actions, their honesty and doing the right thing
- Courage—having the courage to deal with change - thinking boldly and finding new ways of doing things
- Achievement—pursuing personal, team and business excellence.

### IFAC's Vision, Mission and Values

IFAC's *vision* is that the global accountancy profession be recognized as a valued leader in the development of strong and sustainable organizations, financial markets and economies.

IFAC's *mission* is to serve the public interest by:

- Contributing to the development, adoption and implementation of high-quality international standards and guidance
- Contributing to the development of strong professional accountancy organizations and accounting firms, and to high quality practices by professional accountants
- Promoting the value of professional accountants worldwide
- Speaking out on public interest issues where the accountancy profession's expertise is most relevant.

IFAC's *values* are integrity, expertise and transparency. These values are the guiding principles that IFAC as an organization through its Council, Board, boards and committees, volunteers, and staff seeks to exemplify.

## SUSTAINABILITY IN ACTION

### Growing food in the desert, without using fossil fuel or fresh water; processing waste and planning waste out

Scott Bookmyer is Chief Operating Officer of KKR Asia and runs the KKR Australia business. As he puts it: 'Through our experience investing in agriculture companies, we recognize that the industry—while essential to feeding the world's growing population—can also be demanding on our planet's natural resources. For example, the agricultural sector consumes approximately 69% of the planet's fresh water, according to the World Wildlife Fund. Meanwhile, the UN's Food and Agriculture Organization estimates the greenhouse gas emissions from agriculture, forestry and fisheries have nearly doubled over the past 50 years, and could increase an additional 30% by 2050.' Relative to this outline, Bookmyer cites a number of authorities (World Wide Fund for Nature, May 2007; Sundrop Farms proprietary data using references by the European Commission on Climate Action, 2016; United States Department of Transportation's National Travel Survey, 2009; and Next Greencar, 2016) for key facts from Sundrop Farms, the subject of the opening vignette to this chapter: 'the 20 hectares of greenhouses together produce over 15 000 tons of delicious, carbon neutral, freshwater neutral tomatoes annually. Sundrop's technology achieves significant energy and pollution savings compared to traditional methods: approximately 26 000 tons of carbon dioxide per year—equivalent to removing 500 cars from our roads; more than 450 million litres of freshwater per year—equivalent to 180 Olympic size swimming pools; and more than two million litres of diesel per year—equivalent to driving a car around the equator 500 times.'

Sundrop Farms represents a ground-breaking development in agriculture: 'a hi-tech, capital-intensive system growing food sustainably and cleanly for the masses—all located in rocky, arid country where southeast Australia's cropping zones meet the outback and annual rainfall is less than 250 mm.' Located in an area with no arable land, Sundrop uses seawater and the light and heat of the sun to produce delicious tomatoes. Starting by growing truss tomatoes in the Australian outback, it is exploring opportunities to innovate and provide produce using renewable resources to address consumer needs worldwide. 'If you can farm successfully here, you can farm almost anywhere in the world,' says CEO Philipp Saumweber. 'I'm no eco-warrior, but I wanted to create a new business model for farming, based on a concept of doing more with less and growing in the most sustainable or restorative manner. This is what we have achieved.'

John Durkan, the CEO of Coles (see also the *Concepts in action* feature on page 10), regards Coles as an important part of the food-supply chain in Australia and asserts that Coles can make a difference by being a positive force for change in terms of the whole of the food industry. 'Now, we don't want to overplay our part in that, but we absolutely believe that we can do that if we invest either in direct investment or in tenure behind long-term contracts with some of the players in Australia.'

In recognition of the expensive and environmentally unfriendly effects of landfill, many have been motivated to develop processes for dealing with waste. One such venture is that of Tom Rudas, a microbiologist. Rudas has pointed out that 'if you put food into the ground, it potentially impacts on two fronts . . . It leaches and contaminates ground water and releases methane, which is a greenhouse gas that is 21 times worse than CO<sub>2</sub>.' Companies are increasingly forming and implementing strategies and applying the key success factors of cost and efficiency, quality, time and innovation to achieve long-term environmental, economic and social goals. The sustainability efforts of the Japanese copier company Ricoh include energy conservation, resource conservation, product recycling and pollution prevention. By designing products that can be easily recycled, Ricoh simultaneously improves its efficiency and the cost and quality of its products. Sustainability is important to these companies for several reasons:

- More and more investors care about sustainability. These investors make investment decisions based on a company's financial, social and environmental performance and raise questions about sustainability at shareholder meetings.
- Companies that emphasise sustainability find that sustainability goals attract and inspire employees.
- Customers prefer the products of companies with good sustainability records and boycott companies with poor sustainability records.
- Society and activist non-governmental organisations, in particular, monitor the sustainability performance of firms and take legal action against those that violate environmental laws. Countries with fast-growing economies, such as China and India, are now either requiring or encouraging companies to develop and report on their sustainability initiatives.

*Sources:* Bookmyer, S. 2016, 'Sundrop Farms: An agricultural solution to resources constraints', KKR, 7 November, <<http://www.kkr.com/global-perspectives/kkr-blog/sundrop-farms-agricultural-solution-resources-constraints>>, accessed 22 December 2016; Kaplan, M. 2009, 'Microbiologist realises a trashy vision', *The Weekend Australian*, 31 October–1 November, p. 30; Neales, S. 2016, 'Desal and solar prove the perfect tomato sauce', *The Australian*, 11 June, <<http://www.theaustralian.com.au/national-affairs/desal-and-solar-prove-the-perfect-tomato-source/news-story/9972772591dd39cbf4a774a0ee93555b>>, accessed 16 December 2016; Neales, S. 2016, 'This is the future of farming', *The Weekend Australian Magazine*, no date, <<http://www.theaustralian.com.au/life/weekend-australian-magazine/this-is-the-future-of-farming/news-story/99fd0a207d8b6aa0768c32fd61b3d00e>>, accessed 16 December 2016; Sundrop Farms ABC Landline coverage, YouTube, <[https://www.youtube.com/watch?v=KCup\\_B\\_RHM4#t=213.079941](https://www.youtube.com/watch?v=KCup_B_RHM4#t=213.079941)>, accessed 17 December 2016; ABC, A Taste of Landline, <<http://iview.abc.net.au/programs/taste-of-landline/RA1603Q004500>>, accessed 17 December 2016; Thieberger, V. 2015, 'The company that's growing food in the desert', *Business Spectator*, 20 November, <<http://www.theaustralian.com.au/business/the-company-thats-growing-food-in-the-desert/news-story/8a288c3f55d7759b434a4e6ca6c11be>>, accessed 16 December 2016.



currently paid to refuse collection. Whereas one wheelie-bin used to suffice, many local authorities are now offering three—one for landfill, one for recyclable paper, cardboard, cans, and plastic and glass bottles for processing into similar products, and one for garden waste to be processed into compost. Management accountants would be involved in assessing the benefits and costs of these services.

Among the many issues dealt with in this book, we place sustainability at centre-stage. Chapter 21 deals extensively with this topic and its interface with management accounting, outlining how sustainability is reported and measured. *Sustainability in action* boxes also appear in most chapters, showing how management accounting connects with sustainability.

### DECISION POINT 3

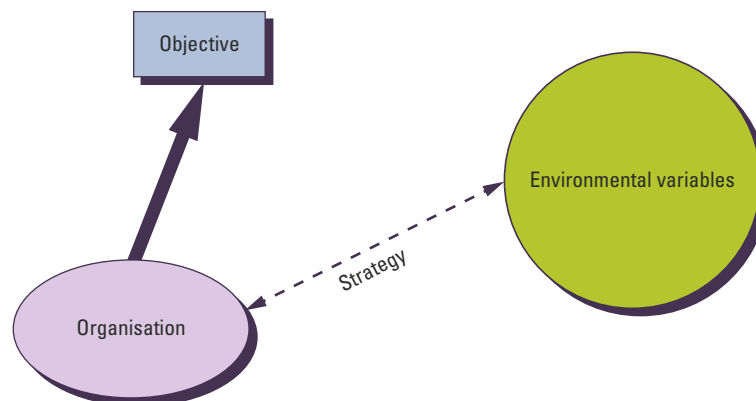
What are planning and control and how do they relate to management accounting?

## Strategy, the organisation and its environment

**Strategy** relates to how management matches an organisation's capabilities with the opportunities in the marketplace to accomplish its objectives. In other words, strategy describes how an organisation chooses to compete and highlights the opportunities its managers should evaluate and pursue if advantageous. Senior management sets the goal or objective of an organisation according to the influence of its stakeholders. Managers and employees are internal stakeholders, while external stakeholders include shareholders, lenders, creditors, suppliers, customers, the government and the community at large. In striving to achieve the objective, management formulates and executes strategy to achieve an optimal fit with its environment (see Figure 1.7).

In forming strategy, senior management must first thoroughly understand the organisation and its environment. There are several approaches that assist in forming strategy, one of which is a SWOT analysis. This entails an analysis of strengths, weaknesses, opportunities and threats. Managers can assess the potential of a strategy and their ability to achieve their goal by identifying and analysing the strengths and weaknesses inherent in the organisation's capacity and capabilities (internal analysis) and the opportunities and threats prevailing in its environment (external analysis).

Michael Porter developed a similar and more focused approach to industry analysis, which assists managers in assessing the attractiveness of an industry by identifying and analysing five forces: (1) competitors, (2) potential entrants into the market, (3) equivalent products, (4) bargaining power of customers, and (5) bargaining power of input suppliers.<sup>12</sup> The collective effect of these forces shapes an organisation's profit potential. In general, profit potential is greater when competition is limited or zero, there are few or weak potential entrants, there are few or no similar products in the market, there is a range of available suppliers, and customers are relatively undemanding. When competition is intense, there are strong potential entrants, there are many similar products in the market, there are few available suppliers, and customers are demanding. These are clearly two extremes; managers would need to assess each of the five forces to form an



## LEARNING OBJECTIVE 4

Explain the meaning of strategy and the way in which management accounting might influence strategic decisions.

**FIGURE 1.7**

Strategy: pursuing an organisation's objective by optimising the organisation's fit with its environment

<sup>12</sup> Porter, M. 1980, *Competitive strategy*, Free Press, New York; Porter, M. 1985, *Competitive advantage*, Free Press, New York; Porter, M. 1996, 'What is strategy?', *Harvard Business Review*, November–December, pp. 61–78.

overall view of the attractiveness of the industry. The formation and implementation of strategy receives further attention as we progress through the book, especially in chapters 9 and 15.

Organisations may be profit-seeking, ranging from small privately owned businesses to large companies listed on a stock exchange with many shareholders, or not-for-profit or public-sector organisations that operate locally, regionally, nationally or globally, with varying degrees of complexity. Globalisation has accelerated as countries enter into trade agreements that reduce barriers and encourage the provision of products and services across national boundaries. The nature, scope and complexity of organisations and their environments clearly vary. Notwithstanding this diversity, managers need to establish a vision, state a mission and set goals, which are all steps towards developing strategy, to mark out a direction for the organisation (see Figure 1.7).

Under this 'strategic umbrella', managers develop strategies to make decisions and guide activities. Scope and time horizon both feature in the shift from strategy to operations: from a broad canvass with a distant horizon to a more specific and tighter time-frame. As managers make decisions and direct activities at both strategic and operational levels, the organisation's performance parameters emerge. Strategic and management control systems that measure and compare performance with plans help both internal and external stakeholders to evaluate performance at strategic and operational levels.

Many managements of businesses follow one of two generic strategies: cost leadership or product differentiation. **Cost leadership** is an organisation's ability to achieve lower costs relative to competitors through productivity and efficiency improvements, elimination of waste, and tight cost control. **Product differentiation** is an organisation's ability to offer products or services that its customers perceive to be superior and unique relative to the products or services of its competitors, and to earn a premium based on that differentiation. Deciding between these strategies is a critical part of the responsibilities of senior management.

Cost leaders in their respective industries include JB Hi-Fi, Bunnings, The Chemist Warehouse, The Warehouse (New Zealand) and Walmart (consumer retailing in the USA). These companies have been profitable and have grown over the years by providing good-quality products and/or services at low prices. They provide products and services that are similar to—not differentiated from—those of their competitors, but at a lower cost to the customer. Lower selling prices, rather than unique products or services, provide a competitive advantage for these cost leaders. For example, Walmart creates value for its customers by locating stores in suburban and rural areas and by offering low prices on a wide range of product categories, with few choices within each product category. Consistent with this strategy, Walmart has developed the capability to keep costs down by aggressively negotiating low prices with its suppliers in exchange for high volumes and by maintaining a no-frills, cost-conscious environment with minimal sales staff. David Jones and Amcal Chemists choose not to compete on low price, but instead to generate their profits and growth based on their ability to offer differentiated or unique products or services, often at higher prices than those of their competitors. Apple Inc. has successfully differentiated its products in the consumer electronics industry, as have Johnson & Johnson in the pharmaceutical industry and Coca-Cola in the soft-drink industry. These companies have achieved differentiation through innovative product R&D, careful development and promotion of their brands, and the rapid push of products to market. Managers use differentiation to increase brand loyalty and charge higher prices.

However, the best-designed strategies and the best-developed capabilities are useless unless they are executed effectively. In the next section, we describe how management accountants help managers to take actions that create value for their customers.

## TRY IT! 1.2

MightyChip Pty Ltd (MCL) makes linear integrated circuit devices (LICDs) used in amplifiers, modems and communication networks. MCL produces a single specialised product, MCX10, a standard high-performance microchip that can be used in multiple applications. MightyChip designed the MMX10 after extensive market research and input from its customer base. A five-forces analysis reveals the following:

1. The MCX10 model faces severe competition based on price, timely delivery and quality. Companies in the industry have high fixed costs and persistent pressure to reduce selling prices and utilise capacity fully. Price reductions spur growth because it makes LICDs a cost-effective option in applications such as digital subscriber lines (DSLs).
2. The small profit margins and high capital costs discourage new entrants. Moreover, incumbent companies like MCL have experience in lowering costs and building close relationships with customers and suppliers.
3. MCL tailors the MCX10 to customers' needs and lowers prices by continuously improving MCX10's design and processes to reduce production costs. This reduces the risk of equivalent products or new technologies replacing MCX10.
4. Customers, such as EarthLink and Verizon, negotiate aggressively with MCL and its competitors to keep prices down because they buy large quantities of product.
5. To produce MCX10, MCL requires high-quality materials (such as silicon wafers, pins for connectivity, and plastic or ceramic packaging) and skilled engineers, technicians and production labour. The high level of skills required of suppliers and employees gives them bargaining power to demand higher prices and wages.

### Required

Recommend to management the generic strategy that MCL should pursue. Support your recommendations with clear reasoning drawn from the analysis of the five forces prevalent in this industry.

## Strategic decisions and management accounting

**Management accountants** work closely with managers in formulating strategy by providing information about the sources of competitive advantage, for example the cost, productivity or efficiency advantage of their company relative to that of competitors or the premium prices a company can charge relative to the costs of adding features that make its products or services distinctive. **Strategic management accounting** focuses specifically on strategic issues. Management accountants help to formulate strategy by helping managers to answer questions such as:

- Who are our most important customers, and how do we deliver value to them? For example, success in selling online has encouraged many businesses to develop the capability to sell online by building the necessary information and technology infrastructure. Toyota has built flexible computer-integrated manufacturing (CIM) plants that enable it to use the same equipment to produce a variety of cars in response to changing customer tastes.
- What substitute products exist in the marketplace, and how do they differ from our product in terms of price and quality? For example, Hewlett-Packard designs new printers after comparing the functionality, quality and price of its printers with other printers available in the marketplace.
- What is our most critical capability? Is it technology, production or marketing? How can we leverage it for new strategic initiatives? Kellogg Company, for example, uses the reputation of its brand to introduce new types of cereal. As reported in the opening vignette, the founders and managers of Sundrop Farms have developed technology to harness solar energy and seawater to produce tomatoes in the desert.
- Will adequate cash be available to fund the strategy, or will additional funds need to be raised?

In the next section, we introduce and illustrate the five-step guide to decisions, which is potentially useful in a variety of contexts; in this instance, for making a strategic decision.

### DECISION POINT 4

What is strategy and how do management accountants influence strategic decisions?

**LEARNING  
OBJECTIVE****5****The five-step guide to decisions**

Describe and apply the five-step guide to decisions.

Most managers are likely to find that an established approach or framework is useful in guiding their decision making. We suggest and apply a five-step guide to a strategic decision facing the *Daily News*, a city newspaper. We do not imply that it is the *only* guide that might be useful, nor do we guarantee that it will be fully applicable in all situations. However, the guide might be useful for many of the decision situations in this book, either in its present form or modified as required.

**Case: the *Daily News***

The *Daily News* is a newspaper published in Australia that differentiates itself from its competitors. It focuses on in-depth and well-researched news; employs highly qualified and experienced journalists; has developed a website to deliver up-to-the-minute news, interviews and analyses; has an automated, computer-integrated, state-of-the-art printing facility; has a web-based information technology infrastructure; and uses a distribution network that is one of the best in the newspaper industry.

Felicity Fawcett, the CEO of the *Daily News*, is well aware that profits fell last year, these having plateaued in the immediately preceding years. She turns to the five-step framework to guide her decision.

1. **Identify the problem.** The immediate problem is that profits have fallen and may continue to do so. The underlying problem may be that the premium earned from differentiation has been eroded by increasing costs without a commensurate increase in prices or in the volume of revenues, which may be attributable to *Daily News* operations, demand in the market, the actions of competitors or something else. Part of the problem is the level of uncertainty; Felicity does not know how any action that she might take is likely to affect profits.
2. **Gather relevant information.** Felicity decides to gather information to clarify the problem and diminish the uncertainties. She asks Tony Hall, the management accountant, to provide details of revenues and costs over the past few years; the marketing manager to survey representative readers to gauge how they might react to an increase in the newspaper's selling price; and the advertising sales manager to talk to current and potential advertisers to get a better understanding of the advertising market. Tony Hall provides information about past increases and decreases in prices and the effect on readership, and about past increases and decreases in advertising rates and their effect on advertising revenues. He also collects and analyses information on advertising rates charged by competing media outlets, including other newspapers.
3. **Identify and evaluate potential courses of action.** Felicity and the other managers thoroughly review and analyse the information gathered. The management team identifies three potential courses of action, which are not mutually exclusive: (1) reduce operating costs; (2) increase the selling price per newspaper; and (3) increase the rate per page charged to advertisers. They conclude from their evaluation that: (1) a major cost-cutting exercise might undermine the differentiation strategy by compromising the very features that justify a premium; (2) readers might be upset if management were to increase the price of the *Daily News*, with a consequent decrease in readership and reduction in revenue from this source; and (3) there is likely to be a market-wide increase in advertising rates in the near future, in which case an increase in *Daily News* advertising rates would have little effect on the number of pages of advertising sold.

Felicity recognises that considerable judgement is required when considering the consequences of the contemplated actions. She feels that gathering information, careful analysis and in-depth discussion within the management team should go a long way towards eliminating biased thinking. Nevertheless, she ponders the conclusion that the management team has reached. Have members of the team correctly judged readers' sentiments or has their thinking been overly influenced by anticipation of all the negative

publicity that the newspaper would get rather than an actual decline in readership? How sure is she that her competitors will increase advertising rates? Is her thinking in this regard biased by their past actions? Have circumstances changed? How confident is she that her sales representatives can convince advertisers to pay higher rates? Felicity tests her assumptions again and reviews her thinking. As a result, she feels confident about the judgements made.

4. **Make and implement a decision.** Based on the management team's evaluation, Felicity decides to (1) maintain operations at the current level; (2) apply continuous improvement in future; (3) add value at reasonable cost; (4) maintain the price of the *Daily News*; and (5) increase *Daily News* advertising rates. Felicity works on draft budgets with Tony Hall and the rest of the team. They estimate that 800 pages of advertising in the *Daily News* would be sold if they were to increase advertising rates by 4% to \$5200 per page in March 2019, amounting to advertising revenue of \$4 160 000. She decides to do this and communicates the new advertising rate schedule to the sales department.

Against the budgeted advertising revenues of \$4 160 000 for March 2019, the full budget includes budgeted circulation revenue and the production, distribution and customer service costs that would be needed to achieve sales goals, the anticipated cash flows and the potential financing needs. Managers at the *Daily News* take actions to implement the March 2019 budget. Tony Hall collects information to report performance (scorekeeping). The comparison of actual performance with budgeted performance is the *control* or *post-decision* role of information. This is different from the *pre-decision* planning information that Felicity collected in step 2 to help her to understand uncertainties better.

5. **Evaluate performance and learn.** During March 2019, the *Daily News* newspaper sold advertising, issued invoices and received payments, which were recorded in the accounting system. Table 1.2 shows the performance report of the advertising revenue earned by the *Daily News* for March 2019. This report shows that 760 pages of advertising (40 pages fewer than the budgeted 800 pages) were sold. The average rate per page is \$5080, compared with the budgeted \$5200 rate, amounting to advertising revenue of \$3 860 800, which is \$299 200 less than the budgeted \$4 160 000.

The performance report in Table 1.2 spurs investigation and learning, which involves examining past performance (the control function) and systematically exploring ways to make better-informed decisions and plans in the future. Learning can lead to changes in goals, strategies, the ways potential decisions are identified and the range of information gathered when exploring courses of action.

The performance report prompts Tony Hall to raise several questions that direct managers' attention to problems and opportunities. Is the strategy of differentiating the *Daily News* from other newspapers attracting more readers? Did the marketing and sales departments make sufficient efforts to convince advertisers that, even with the new higher rate of \$5200 per page, advertising in the *Daily News* was a good buy? Why was the actual average rate per page \$5080 instead of the budgeted rate of \$5200? Did some

**TABLE 1.2** Performance report of advertising revenue at the *Daily News* for March 2019

	Actual	Budget	Actual – budget	
	(1)	(2)	\$ Amount (3) = (1) – (2)	% of budget (4) = (3) ÷ (2)
Advertising pages sold	760	800	40 U	5.0% U
Average rate per page	\$5080	\$5200	\$120 U	2.3% U
Advertising revenue	\$3 860 800	\$4 160 000	\$299 200 U	7.2% U

U = unfavourable.

sales representatives offer discounted rates? Did economic conditions cause the decline in advertising revenue? Is revenue falling because editorial and production standards have declined? Are more readers getting their news online?

Answers to these questions could prompt management to take action, including, for example, adding more sales personnel or making changes in editorial policy, devoting more resources to expanding its presence online and on mobile devices, getting readers to pay for online content, selling digital advertising and management changes. Good implementation requires that the marketing, editorial and production departments coordinate their actions.

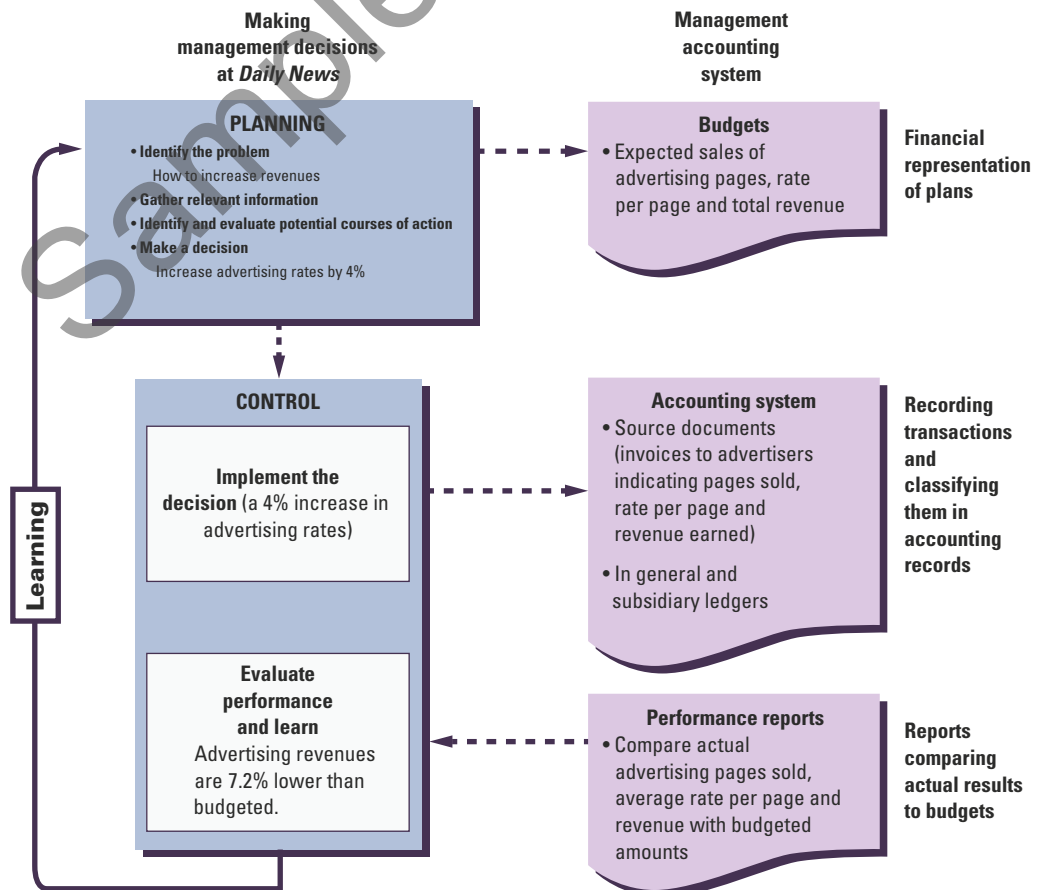
Tony Hall could go further by identifying the specific advertisers that cut back or stopped advertising after the rate increase went into effect, which would enable managers to then decide when and how sales representatives should follow up with these advertisers.

The left side of Figure 1.8 provides an overview of the decision-making processes at the *Daily News*. The right side highlights how the management accounting system aids in decision making.

Planning and control activities are more challenging when monitoring and managing innovation and sustainability. Think about how the *Daily News* must innovate as more of its readers migrate to the Web to get their news: in step 1, the uncertainties are much greater. Will there be demand for a newspaper? Will customers look to the *Daily News* to get their information or to other sources? In step 2, gathering information is more difficult because there is little history that managers can rely on. Instead, managers will have to make connections across disparate data, run experiments, engage with diverse experts and speculate to understand how the world might evolve. In step 3, making predictions about the future will require developing different scenarios and models. In step 4, managers will need to make decisions knowing that the world might still evolve in unanticipated ways that might require

**FIGURE 1.8**

How management accounting aids decision making, planning and control at the *Daily News*



them to be flexible and change course midstream. In step 5, the learning component is critical. How have the uncertainties evolved and what do managers need to do to respond to these changing circumstances?

Planning and control for sustainability is equally challenging. What should the *Daily News* do about energy consumption in its printing presses, the recycling of newsprint, and pollution prevention? Among the uncertainties that managers face is whether customers will reward the *Daily News* for these actions with loyalty and whether investors will react favourably to managers spending resources on sustainability. Information to gauge customer and investor sentiment is not easy to obtain. Predicting how sustainability efforts might pay off in the long run is far from certain. Even as managers make decisions, the sustainability landscape will doubtlessly change in regard to environmental regulations and societal expectations, requiring managers to learn and adapt. The challenges do not imply that planning and control systems should not be used for these initiatives. Many companies find value in using the systems to manage innovation and sustainability. We return to the themes of innovation and sustainability at various points in the book.

Two final points: first, managers use information to help implement their strategies. For example, action plans often include targets. Although budgets are primarily financial, managers use both financial and non-financial information for market share, quality, new product development and employee satisfaction. When exercising control, managers compare actual and targeted non-financial measures as well as financial measures, and take corrective action. Second, a plan must be flexible enough that managers can seize sudden opportunities unforeseen at the time the plan was formulated. Control should not lead managers to cling to a plan when unfolding events indicate that actions not encompassed by that plan would offer better results for the company. Think about this in the context of the *Daily News*. An unexpected and sensational news story, such as a major fraud in the public service, may break; if the managers wish to maximise the value of this story and beat competing newspapers to it, they need to spend more money on reporting than they had expected before the story broke. Through spending more money to cover the story, there is an opportunity to improve results for the *Daily News* by selling more newspapers.

## The influence of professional accounting organisations on management accounting

The IFAC has 175 members and associates from 130 countries, representing almost 3 million accountants. Among these are a number of professional accounting organisations that are well known in Australia, particularly those in the UK, USA, New Zealand and Australia itself. Many of these organisations have a significant international presence, such as the **Chartered Institute of Management Accountants (CIMA)**, the Association of Chartered Certified Accountants (ACCA) and CPA Australia. A relatively recent development is associations of these organisations across countries, and even closer arrangements such as that between the American Institute of CPAs (AICPA) and CIMA, which jointly awards the Chartered Global Management Accountant (CGMA) designation, and the merger of the Institute of Chartered Accountants in Australia (ICAA) and the New Zealand Institute of Chartered Accountants (NZICA) to form Chartered Accountants of Australia and New Zealand (CAANZ). All of these organisations specify entry criteria, set and administer examinations, specify continuing education requirements and apply codes of ethics.

Although professional accounting organisations have always stipulated standards of ethical professional conduct, corporate scandals over the past two decades like Enron, Arthur Andersen, Storm Financial and One.Tel have seriously eroded the public's confidence in corporations. All employees in a company, whether in line management or staff management, must comply with the society's expectations of ethical behaviour.

Accountants have special ethical obligations, given that they are responsible for the integrity of the financial information provided to internal and external parties. The Sarbanes–Oxley Act 2002 in the USA, passed in response to a series of corporate scandals,

### DECISION POINT 5

How do managers apply the five-step guide to decisions and how does it relate to management accounting?

### LEARNING OBJECTIVE 6

Explain the way in which accounting organisations influence management accountants' conduct and effectiveness and, given the context, apply the code of ethics.

focuses on improving internal control, corporate governance, the monitoring of managers and the disclosure practices of public corporations. These regulations apply tough ethical standards to managers and accountants and provide a process for employees to report violations of illegal and unethical acts. The impact of the Sarbanes–Oxley legislation extends beyond the boundaries of the USA to Australian companies that trade with US companies. In addition to the codes of ethics stipulated by professional accounting organisations, measures in Australia include the Australian Stock Exchange (ASX) Principles of Good Corporate Governance.

### Codes of ethics

CPA Australia and the ICAA established the Accounting Professional and Ethical Standards Board (APESB) in 2006 as an independent body to produce the code of ethics and professional standards, and were joined by the Institute of Public Accountants in the following year. Not only is it mandatory for all members to comply with this code, but they should also be guided by its spirit. Following the merger of the ICAA and NZICA, the APESB governs the behaviour of its Australian members, and the New Zealand Regulatory Board that of its New Zealand members. All of the above-mentioned professional accounting organisations have codes of ethics with guiding principles similar to those articulated for the CGMA designation: namely, integrity and objectivity; professional competence and due care; confidentiality; professional behaviour and conduct (see <<http://www.cgma.org/AboutCGMA/DownloadableDocuments/CGMA-code-of-ethics.v2.pdf>>).

#### DECISION POINT 6

How do professional accounting organisations influence management accountants' behaviour?

### Typical ethical challenges

Ethical issues can confront management accountants in many ways. *Try it 1.3* provides two examples.

## CONCEPTS IN ACTION

### What is material in this story? If it matters, what is to be done?

Yesterday, Wesfarmers chief executive Richard Goyder singled out the former CFO of Target for his role in the accounting scandal where Target was discovered to have used upfront payments from 31 suppliers to artificially inflate its first half earnings by \$21 million. 'If Graeme wasn't aware he should have been aware,' Mr Goyder said yesterday, as he unveiled the findings of an investigation into accounting and corporate governance practices at Target.

The above is an extract from a report that appeared in *The Australian* newspaper on 12 April 2016. Profit before interest and tax for the first half-year ended December 2015 was reported as \$74 million rather than the \$53 million that should have been reported. Following management changes at Target, accountants who were members of a new team

informed Wesfarmers executives of the accounting adjustments in late March. The executive formerly responsible for Target, Stuart Machin, had resigned a few days before the newspaper report appeared. He stated that while he knew nothing of the irregularities, they happened on his watch and he must take ultimate responsibility. Although it is not unusual for suppliers to offer rebates to retailers when products do not sell well, it appears that staff at Target requested the rebates before the end of the reporting period, with a promise to return them to suppliers secretly in the form of higher prices in the following half-year. While the impact on Wesfarmers' results was immaterial, the effect of the arrangement was to report Target's profits at a level 40% higher than they should have been. It was damaging to the reputation of Wesfarmers, a blue-chip organisation that is serious about its corporate culture.

Sources: Greenblat, E. 2016, 'Target scandal spreads to UK', *The Australian*, 12 April 2016, <<http://www.theaustralian.com.au/business/companies/target-scandal-spreads-to-uk/news-story/1d625302f2ce2bb6e381b626c18975e8>>, accessed 22 December 2016; Greenblat, E. & Durie, J. 2016, 'Wesfarmers' Stuart Machin resigns', *The Australian*, 8 April 2016.



1.3

**TRY IT!**

- **Case A:** Demetrius is the management accountant at Softisbetter, the software development division of a large information technology company. He notes that, for internal reporting purposes, a substantial amount of the development costs for one of their projects is currently being capitalised as an asset rather than being shown as an expense. He is concerned about the commercial potential of the software product being developed. The division manager, whose bonus is based in part on the division’s profits, argues that showing development costs as an asset is justified because the new product will generate profits, although he presents little evidence to support his argument. The last two products from this division have been unsuccessful. Demetrius wishes to make the right decision but would prefer to avoid a difficult personal confrontation with the division manager, who is his superior.
- **Case B:** A packaging supplier, bidding for a new contract, offers the management accountant of the purchasing company an all-expenses-paid weekend to the AFL grand final. The supplier does not mention the new contract when giving the invitation. The accountant is not a personal friend of the supplier. He knows that cost issues are critical in approving the new contract and is concerned that the supplier will ask for details about bids by competing packaging companies.

**Required**

1. Identify and explain the ethical issues raised by these two cases.
2. Advise the management accountant in each case as to what action he should take, if any.

**PROBLEM FOR SELF-STUDY**

Computing manufacturer Dell incurs the following costs:

- a. Electricity costs for the plant in which the Latitude computer line of products is assembled
- b. Distribution costs for shipping the Latitude line of products to a retail chain
- c. Payment to David Newbury Designs for design of the XPS 2-in-1 laptop
- d. Salary of computer scientist working on the next generation of servers
- e. Cost of visit by Dell employees to a major customer to demonstrate Dell’s ability to interconnect with other computers
- f. Purchase of competitors’ products for testing against potential Dell products
- g. Payment to business magazine for running Dell advertisements
- h. Cost of cartridges purchased from outside supplier to be used with Dell printers

**Required**

Classify each of the cost items (a–h) into one of the business functions of the value chain.

**Solution**

Cost item	Value chain business function
a	Production
b	Distribution
c	Design of products, services or processes
d	Research and development
e	Customer service; or marketing
f	Design of products, services or processes; or research and development
g	Marketing
h	Production

## DECISION POINTS

Each decision point listed below presents a key question related to a learning objective and corresponds with a decision point that appears in the text. Adjacent to each decision point is an answer guideline drawn from the content of the chapter.

### Decision

### Answer guideline

- |   |  |
|---|--|
| 1. What is management accounting and what is its role?  | Management accounting is the sourcing, analysis, communication and use of decision-relevant financial and non-financial information to generate and preserve value for organisations'. <sup>13</sup>   |
| 2. How do managers and workers add value, and what are the dimensions of performance that customers expect? | A knowledge of the value chain assists the management accountant to identify the benefits and costs of each business function to assess the value it adds. Managers and workers add value through research and development; design of products, services or processes; production; marketing; distribution; and customer service. Customers want companies to deliver performance through cost and efficiency, quality, timeliness and innovation. |
| 3. What are planning and control and how do they relate to management accounting?                           | Planning involves selecting organisational goals, predicting results under various ways of achieving those goals, deciding how to attain the desired goals, and communicating both the goals and how to attain them to the entire organisation. Control involves comparing actual performance with plans and taking appropriate action. Refer to the chapter for a full explanation.   |
| 4. What is strategy and how do management accountants influence strategic decisions?                        | Management accountants contribute to strategic decisions by providing information about the sources of competitive advantage, and to their implementation by using the five-step guide to decisions described in the chapter (complete your answer by referring to that).  |
| 5. How do managers apply the five-step guide to decisions and how does it relate to accounting?             | Refer to the chapter for a full description of the five-step guide to decisions.   |
| 6. How do professional accounting organisations influence the management accountants' behaviour?            | They put in place entry requirements, examinations and continuing education requirements to maintain technical competence, and compliance with their ethical codes of conduct is mandatory to retain membership. Ethical responsibilities relate to competence, confidentiality, integrity, objectivity and professional conduct.  |

## TERMS TO LEARN

*Each chapter will include this section. Like all technical terms, accounting terms have precise meanings. Learn the definitions of new terms when you initially encounter them. The meaning of each of the following terms is given in this chapter and in the glossary at the end of this book.*

benefit–cost analysis (p. 4)	chief financial officer (CFO) (p. 5)	design of products, services or processes (p. 9)
budget (p. 14)	control (p. 14)	distribution (p. 10)
Chartered Institute of Management Accountants (CIMA) (p. 23)	cost accounting (p. 7)	financial accounting (p. 7)
	cost leadership (p. 18)	financial director (p. 5)
	customer service (p. 10)	

<sup>13</sup> AICPA and CIMA. 2014, *Global Management Accounting Principles. Effective management accounting: Improving decisions and building successful organisations*, <[http://www.cgma.org/Resources/Reports/Pages/GlobalManagementAccountingPrinciples.aspx?utm\\_source=5cimaglobal&utm\\_medium=5principles-page&utm\\_campaign=5principles2014](http://www.cgma.org/Resources/Reports/Pages/GlobalManagementAccountingPrinciples.aspx?utm_source=5cimaglobal&utm_medium=5principles-page&utm_campaign=5principles2014)>, p. 8, accessed 17 December 2016.

key success factors (p. 11)	mission statement (p. 13)	strategic management
learning (p. 14)	planning (p. 13)	accounting (p. 19)
line management (p. 5)	production (p. 9)	strategy (p. 17)
management accountant (p. 19)	product differentiation (p. 18)	supply chain (p. 8)
management accounting (p. 2)	research and development (p. 9)	sustainability (p. 14)
manufacturing (p. 10)	staff management (p. 5)	value chain (p. 9)
marketing (including sales) (p. 10)	statement of values (p. 13)	vision statement (p. 13)

## ASSIGNMENT MATERIAL

### Questions

- 1.1 Explain the way in which cost accounting, management accounting, activity management and financial reporting are inter-related.
- 1.2 'Management accounting should not fit the straitjacket of financial reporting.' Explain your response to this statement and give an example.
- 1.3 Explain the way in which a management accountant is able to help to form strategy.
- 1.4 Describe the business functions in the value chain.
- 1.5 Explain the term 'supply chain' and its importance to the management of activities.
- 1.6 'Management accounting deals only with costs.' Do you agree? Explain your answer.
- 1.7 Explain the way in which management accountants help to improve quality and to ensure that products are delivered on time.
- 1.8 Describe the five-step guide to making decisions.
- 1.9 Distinguish between planning decisions and control decisions.
- 1.10 Describe the three guidelines that help management accountants provide the most value to managers.
- 1.11 'Knowledge of technical issues such as computer technology is a necessary but not a sufficient condition to becoming a successful management accountant.' Do you agree? Explain your answer.
- 1.12 As a new management accountant, reply to this comment by a production manager: 'No bean counter knows enough about my responsibilities to be of any use to me. As I see it, our accountants may be needed to keep records for shareholders and the Australian Tax Office, but I don't want them sticking their noses in my day-to-day operations.'
- 1.13 Describe the professional occupation of members of CPA Australia, Chartered Accountants of Australia and New Zealand (CAANZ) and the Chartered Institute of Management Accountants (CIMA).
- 1.14 Name the five areas in which there are standards of ethical conduct for management accountants in Australia. Name the organisations that set these standards.
- 1.15 If a management accountant is faced with an ethical conflict, state and explain the steps that s/he should take if established written policies provide insufficient guidance on how to handle it.

### Exercises

One or more stars following each problem number indicate the suggested level of difficulty:

- \* basic
- \*\* intermediate
- \*\*\* difficult.

#### 1.16 \* Value chain and classification of costs

#### OBJECTIVE 2

Johnson & Johnson, a health-care company, incurs the following costs:

- a. Payment of booth registration fee at a medical conference to promote new products to physicians
- b. Cost of redesigning an artificial knee to make it easier to implant in patients
- c. Cost of a toll-free telephone line used for customer inquiries about drug usage, side effects of drugs and so on
- d. Equipment purchased to develop drugs yet to be approved by the government
- e. Sponsorship of a professional golfer
- f. Labour costs of workers in the tableting area of a production facility
- g. Bonus paid to a salesperson for exceeding a monthly sales quota
- h. Cost of FedEx courier service to deliver drugs to hospitals

#### REQUIRED

Classify each of the cost items (a–h) as one of the business functions of the value chain shown in Figure 1.5 (p. 9).

**1.17 \* Key success factors****OBJECTIVE 2**

Dominion Consulting has issued a report recommending changes for its newest manufacturing client, Gibson Engine Works. Gibson currently manufactures a single product, which is sold and distributed nationally. The report contains the following suggestions for enhancing business performance:

- a. Develop a rechargeable electric engine to stay ahead of competitors
- b. Adopt a TQM philosophy to reduce waste and defects to near zero
- c. Reduce lead times (time from customer order of product to customer receipt of product) by 20% in order to increase customer retention
- d. Negotiate faster response times with direct material suppliers to allow for lower material inventory levels
- e. Benchmark the company's gross margin percentages against its major competitors

**REQUIRED**

Link each of these changes to the key success factors that are important to managers.

**1.18 \* Key success factors****OBJECTIVE 2**

Vargas Construction Ltd provides construction services for major projects. Managers at the company believe that construction is a people-management business, and they list the following as factors critical to their success:

- a. Increase spending on employee development to streamline processes
- b. Foster cooperative relationships with suppliers that allow for more frequent deliveries as and when products are needed
- c. Integrate tools and techniques that reduce errors in construction projects
- d. Train employees in green construction techniques to appeal to companies seeking certification
- e. Benchmark the company's gross margin percentages against its major competitors

**REQUIRED**

Match each of the above factors to the key success factors that are important to managers.

**1.19 \* Planning and control decisions****OBJECTIVE 3**

Gregor Ltd makes and sells brooms and mops. It takes the following actions, not necessarily in the order given. For each action (a–e), state whether it is a planning decision or a control decision.

- a. Gregor asks its advertising team to develop fresh advertisements to market its newest product.
- b. Gregor calculates customer satisfaction scores after introducing its newest product.
- c. Gregor compares the costs it actually incurred with the costs it expected to incur for the production of the new product.
- d. Gregor's design team proposes a new product to compete directly with the Swiffer.
- e. Gregor estimates the costs it will incur to distribute 30 000 units of the new product in the first quarter of next financial year.

**1.20 \* Planning and control decisions****OBJECTIVE 3**

Gavin Adams is the CEO of Trusted Pool Service. He takes the following actions, not necessarily in the order given. For each action (a–e), state whether it is a planning decision or a control decision.

- a. Adams decides to expand service offerings into an adjacent market.
- b. Adams calculates material costs of a project that was recently completed.
- c. Adams weighs the purchase of an expensive new excavation machine proposed by field managers.
- d. Adams estimates the weekly cost of providing maintenance services next year to the city recreation department.
- e. Adams compares payroll costs of the past quarter to budgeted costs.

**1.21 \* Planning and control decisions****OBJECTIVE 3**

Leisure Hotels (LH) is a hotel chain in Australia that provides superior accommodation. It takes the following actions, not necessarily in the order given below. For each action (a–e), state whether it is a planning decision or a control decision.

- a. LH compares the cost of food ingredients in its top restaurants with the expected costs.
- b. LH calculates its share of the accommodation market after introducing its off-season special offers.
- c. LH asks its marketing and management accounting teams to conduct a feasibility study of offering special rates in the off-season.
- d. LH estimates the costs it will incur to sell 500 additional room-nights in the off-season next year.
- e. LH compares the sales of room-nights in the first off-season of offering reduced rates with the estimate in the feasibility study.

**1.22 \* Five-step guide to decisions, service firm****OBJECTIVE 5**

Dewhirst Painters is a firm that provides house-painting services. Harry Dewhirst, the owner, is trying to find new ways to increase revenues. Dewhirst performs the following actions, not in the order listed.

- a. Dewhirst calls Johnson's Hardware to ask the price of paint sprayers.
- b. Dewhirst discusses with his employees the possibility of growing the revenues of the firm.
- c. One of Dewhirst's project managers suggests that using paint sprayers instead of hand painting will increase productivity and thus revenues.
- d. The workers who are not familiar with paint sprayers take more time to finish a job than they did when painting by hand.
- e. Dewhirst compares the expected cost of buying sprayers to the expected cost of hiring more workers who paint by hand, and estimates profits from both alternatives.
- f. The project scheduling manager confirms that demand for house painting services has increased.
- g. Dewhirst decides to buy the paint sprayers rather than hire additional painters.

**REQUIRED**

Classify each action (a–g) according to its step in the five-step guide to decisions (identify the problem and uncertainties; obtain relevant information; make predictions about the future; make decisions by choosing among alternatives; implement the decision, evaluate performance, and learn).

**1.23 \* Five-step guide to decisions****OBJECTIVE 5**

Sizemore Landscaping is a firm that provides commercial landscaping and grounds maintenance services. Derek Sizemore, the owner, is trying to find new ways to increase revenues. Mr Sizemore performs the following actions, not in the order listed.

- a. Mr Sizemore decides to buy power tilling equipment rather than hire additional landscape workers.
- b. Mr Sizemore discusses with his employees the possibility of using power equipment instead of manual processes to increase productivity and thus profits.
- c. Mr Sizemore learns of a large potential job that is about to go out for bids.
- d. Mr Sizemore compares the expected cost of buying power equipment to the expected cost of hiring more workers and estimates profits from both alternatives.
- e. Mr Sizemore estimates that using power equipment will reduce tilling time by 20%.
- f. Mr Sizemore researches the price of power tillers online.

**REQUIRED**

Classify each of the actions (a–f) according to its step in the five-step decision-making process (identify the problem and uncertainties; obtain relevant information; make predictions about the future; make decisions by choosing among alternatives; implement the decision, evaluate performance, and learn).

**1.24 \*\* Professional ethics****OBJECTIVE 6**

Heather Scott is division management accountant and Martin Andrews is division manager of the Walk Smart Shoe Company. Scott has line responsibility to Andrews, but she also has staff responsibility to the company management accountant.

Andrews is under severe pressure to achieve the budgeted division profit for the year. He has asked Scott to book \$200 000 of revenues on 30 June. The customers' orders are firm but the shoes are still in the production process. They will be shipped on or around 4 July. Andrews says to Scott: 'The key event is getting the sales order, not shipping the shoes. You should support me, not obstruct me in reaching my division goals.'

**REQUIRED**

1. Describe Scott's ethical responsibilities.
2. What should Scott do if Andrews gives her a direct order to book the sales?

**1.25 \*\* Professional ethics****OBJECTIVE 6**

Hannah Gilpin is the management accountant of Blakemore Auto Glass, a division of Eastern Glass and Window. Blakemore replaces and installs broken windshields. Her division has been under pressure to improve its divisional operating income. Currently, divisions of Eastern Glass are allocated corporate overhead based on cost of goods sold. Jake Myers, the president of the division, has asked Gilpin to reclassify \$50 000 of installation labour, which is included in cost of goods sold, as administrative labour, which is not. Doing so will save the division \$20 000 in allocated corporate overhead. The labour costs in question involve installation labour provided by trainee employees. Myers argues, 'The trainees are not as efficient as regular employees, so this is unfairly inflating our cost of goods sold. This is really a cost of training (administrative labour) not part of cost of goods sold.' Gilpin does not see a reason for reclassification of the costs, other than to avoid overhead allocation costs.

**REQUIRED**

1. Describe Gilpin's ethical dilemma.
2. What should Gilpin do if Myers gives her a direct order to reclassify the costs?

**1.26 \* Planning and control decisions****OBJECTIVE 3**

Intheknow.com.au offers its subscribers several services, such as an annotated television guide and local area information on weather, restaurants and movie theatres, music festivals and art workshops. Its main revenue sources are fees for banner advertisements and fees from subscribers. Recent data are:

Month/year	Advertising revenues	Actual number of subscribers	Monthly fee per subscriber
June 2017	\$4 000 988	28 642	\$14.95
December 2017	833 158	54 813	19.95
June 2018	861 034	58 178	19.95
December 2018	1 478 072	86 437	19.95
June 2019	2 916 962	146 581	19.95

The following decisions were made from June to October 2019:

- a. June 2019: Raised subscription fee to \$24.95 per month from July 2019 onwards. The budgeted number of subscribers for this monthly fee is shown in the following table.
- b. June 2019: Informed existing subscribers that from July onwards the monthly fee would be \$24.95.
- c. July 2019: Offered email service to subscribers and upgraded other online services.
- d. October 2019: Dismissed the director of marketing after significant slowdown in subscribers and subscription revenues, based on July to September 2019 data in the table below.
- e. October 2019: Reduced subscription fee to \$21.95 per month from November 2019 onwards.

Results for July–September 2019 are:

Month/year	Budgeted number of subscribers	Actual number of subscribers	Monthly fee per subscriber
July 2019	140 000	128 933	\$24.95
August 2019	150 000	139 419	24.95
September 2019	160 000	143 131	24.95

**REQUIRED**

1. Classify each of the decisions (a–e) as a planning or a control decision.
2. Give two examples of other planning decisions and two examples of other control decisions that may be made at Intheknow.com.au.

**1.27 \* Strategic decisions and management accounting****OBJECTIVE 4**

A series of independent situations in which a firm is about to make a strategic decision follow.

**Decisions**

- a. Prestige Computers is trying to decide whether to produce and sell a new home computer software package that includes the ability to interface with a thermostat and a refrigerator. There is no such software currently on the market.
- b. Mayberry Pharmaceuticals has been asked to provide a 'store brand' facial cream that will be sold at discount retail stores.
- c. Hellophones is about to decide whether to launch the production and sale of a mobile phone with standard features.
- d. Georges Delicatessen is entertaining the idea of developing a special line of gourmet pasta sauce made with sun-dried tomatoes, mushrooms and truffle oil.

**REQUIRED**

1. For each decision, state whether the company is following a cost-leadership or a differentiated-product strategy.
2. For each decision, discuss what information the management accountant can provide about the source of competitive advantage for these firms.

**1.28 \* Management accounting guidelines****OBJECTIVE 1**

For each of the following items, identify which of the management accounting guidelines applies: benefit–cost approach, behavioural and technical considerations, or different costs for different purposes.

1. Analysing whether to keep the billing function within an organisation or outsource it
2. Deciding to give bonuses for superior performance to the employees in an Indian subsidiary and extra holiday time to the employees in a New Zealand subsidiary
3. Including costs of all the value-chain functions before deciding to launch a new product, but including only its manufacturing costs in determining its inventory valuation
4. Considering the desirability of hiring one more salesperson
5. Giving each salesperson the compensation option of choosing either a low salary and a high-percentage sales commission or a high salary and a low-percentage sales commission
6. Selecting the more costly computer system after considering two systems
7. Installing a participatory budgeting system in which managers set their own performance targets, instead of top management imposing performance targets on managers
8. Recording research costs as an expense for financial reporting purposes (as required by Australian Accounting Standards) but capitalising and expensing them over a longer period for management performance evaluation purposes
9. Introducing a profit-sharing plan for employees

**1.29 \* Management accounting guidelines**

**OBJECTIVE 1**

For each of the following items, identify which of the management accounting guidelines applies: benefit-cost approach, behavioural and technical considerations, or different costs for different purposes.

1. Analysing whether to produce a component needed for an end product or to outsource it
2. Deciding whether to compensate the sales force by straight commission or by salary
3. Adding the cost of store operations to merchandise cost when deciding on product pricing, but only including the cost of freight and the merchandise itself when calculating cost of goods sold on the income statement
4. Considering the desirability of purchasing new technology
5. Weighing the cost of increased inspection against the costs associated with customer returns of defective goods
6. Deciding whether to buy or lease an existing production facility to increase capacity
7. Estimating the loss of future business resulting from bad publicity related to an environmental disaster caused by a company's factory in the Philippines, but estimating clean-up costs for calculating the liability on the balance sheet

**1.30 \* Role of management accountant, role of chief financial officer**

**OBJECTIVE 1**

Martin Saunders is the management accountant at Future Ltd, a manufacturer of devices for the computer industry. He is being considered for a promotion to chief financial officer.

**REQUIRED**

1. In this table, indicate which executive is *primarily* responsible for each activity.

Activity	Management accountant	CFO
Managing accounts payable		
Communicating with investors		
Strategic review of different lines of business		
Budgeting funds for a plant upgrade		
Managing the company's short-term investments		
Negotiating fees with auditors		
Assessing profitability of various products		
Evaluating the costs and benefits of a new product design		

2. Based on this table and your understanding of the two roles, what types of training or experiences will Saunders find most useful for the CFO position?

**1.31 \* Role of management accountant, role of chief financial officer**

**OBJECTIVE 1**

George Jimenez is the management accountant at Balkin Electronics, a manufacturer of devices for the computer industry. The company may promote him to chief financial officer (CFO).

**REQUIRED**

1. In this table, indicate which executive is primarily responsible for each activity.

Activity	Management accountant	CFO
Managing the company's long-term investments		
Presenting the financial statements to the board of directors		
Strategic review of different lines of businesses		
Budgeting funds for a plant upgrade		
Managing accounts receivable		
Negotiating fees with auditors		
Assessing profitability of various products		
Evaluating the costs and benefits of a new product design		

2. Based on this table and your understanding of the two roles, what types of training or experience will George find most useful for the CFO position?

### 1.32 \*\* Ethics

### OBJECTIVE 6

Jocinta Marks is the Melbourne-based management accountant of Prakash & Sons, a rapidly growing manufacturer and marketer of Indian food products. Marks is currently considering the purchase of a new cost management package for use by each of the company's six manufacturing plants and its many marketing personnel. Four major competing products are being considered by Marks.

Pinnacle is an aggressive software developer. It views Prakash & Sons as a target of opportunity. Every six months, Pinnacle has a three-day users' conference in a Chinese location. Each conference has substantial time allowed for 'rest and recreation'. Pinnacle offers Marks an all-expenses-paid visit to the upcoming conference in Hong Kong. Marks accepts the offer, believing it will be very useful to talk to other users of Pinnacle software. She is especially looking forward to the visit because she has friends living in Hong Kong.

Prior to leaving, Marks receives a visit from the chief executive of Prakash & Sons. Marks shows him an anonymous letter sent to her. It argues that Pinnacle is receiving unfair favourable treatment in Prakash & Sons' software decision-making process. The letter specifically mentions Marks's upcoming 'all-expenses-paid package to Hong Kong'. Marks is deeply offended. She says she has made no decision, and she believes she is very capable of making a software choice on the merits of each product. Prakash & Sons currently does not have a formal, written code of ethics.

### REQUIRED

1. Do you think Marks faces an ethical problem in regard to her forthcoming visit to the Pinnacle users' group meeting? Refer to the CGMA Code of Ethics (<<http://www.cgma.org/AboutCGMA/DownloadableDocuments/CGMA-code-of-ethics.v2.pdf>>). Explain.
2. Should Prakash & Sons allow executives to attend user meetings while negotiating with other vendors about a purchase decision? Explain. If yes, what conditions on attending should apply?
3. Would you recommend that Prakash & Sons develop its own code of ethics to handle situations such as this? What are the pros and cons of having such a written code?

### 1.33 \*\* Budgeting, ethics, pharmaceutical company

### OBJECTIVE 6

Chris Jackson was recently promoted to management accountant of Research and Development (R&D) for BrisCor, a Fortune 500 pharmaceutical company that manufactures prescription drugs and nutritional supplements. The company's total R&D cost for 2018 was expected (budgeted) to be \$5 billion. During the company's mid-year budget review, Chris realised that current R&D expenditures were already at \$3.5 billion, nearly 40% above the mid-year target. At this current rate of expenditure, the R&D division was on track to exceed its total year-end budget by \$2 billion!

In a meeting with CFO Ronald Meece later that day, Jackson delivered the bad news. Meece was both shocked and outraged that the R&D spending had got out of control. Meece wasn't any more understanding when Jackson revealed that the excess cost was entirely related to research and development of a new drug, Vyacon, which was expected to go to market next year. The new drug would result in large profits for BrisCor, if the product could be approved by year-end.

Meece had already announced his expectations of third-quarter earnings to Wall Street analysts. If the R&D expenditures weren't reduced by the end of the third quarter, Meece was certain that the targets he had announced publicly would be missed and the company's stock price would tumble. Meece instructed Jackson to make up the budget shortfall by the end of the third quarter using 'whatever means necessary'.

Jackson was new to the controller's position and wanted to make sure that Meece's orders were followed. Jackson came up with the following ideas for making the third-quarter budgeted targets:

- a. Stop all research and development efforts on the drug Vyacon until after year-end. This change would delay the drug going to market by at least six months. It is possible that in the meantime a BrisCor competitor could make it to market with a similar drug.



- b. Sell off rights to the drug Martek. The company had not planned on doing this because, under current market conditions, it would get less than fair value. It would, however, result in a one-time gain that could offset the budget shortfall. Of course, all future profits from Martek would be lost.
- c. Capitalise some of the company's R&D expenditures, reducing R&D expense on the income statement. This transaction would not be in accordance with accounting standards, but Jackson thought it was justifiable because the Vyacon drug was going to market early next year. Jackson would argue that capitalising R&D costs this year and treating them as expenses next year would better match revenues and expenses.

### REQUIRED

1. Referring to ethical principles, comment on the acceptability of items a–c above.
2. Recommend an appropriate course of action to Jackson.

#### 1.34 \*\* Professional ethics

#### OBJECTIVE 6

Marie Sommers is the new division management accountant of the snack foods division of Superior Foods. Superior Foods has reported a minimum 15% growth in annual earnings for each of the past five years. The snack foods division has reported annual earnings growth of more than 20% each year in this same period. During the current year, the economy went into a recession. The corporate management accountant estimates a 10% annual earnings growth rate for Superior Foods this year. One month before the 30 June financial year-end of the current year, Sommers estimates that the snack foods division will report an annual earnings growth of only 8%. Zac Haast, the snack foods division manager, is not happy, but he notes that 'the end-of-financial-year actions' still need to be taken.

Sommers makes some enquiries and is able to compile the following list of end-of-financial-year actions that were more or less accepted by the previous division management accountant:

- a. deferring June's routine monthly maintenance on packaging equipment by an independent contractor to July
- b. extending the close of the current financial year beyond 30 June so that some sales of next year are included in the current year
- c. altering dates of shipping documents of next July's sales to record them as sales in June of the current financial year
- d. giving salespeople a double bonus to exceed June sales targets
- e. deferring the current period's advertising by reducing the number of television spots run in June and running more than planned in July
- f. deferring the current period's reported advertising costs by having Superior Foods' outside advertising agency delay the billing of June advertisements until July or by having the agency alter invoices to conceal the June date
- g. persuading carriers to accept merchandise for shipment in June of the current financial year although they normally would not have done so

### REQUIRED

1. Why might the snack foods division director want to take these end-of-financial-year actions?
2. The division management accountant is deeply troubled and reads the CIMA Code of Ethics for Professional Accountants. Classify each of the end-of-financial-year actions (a–g) as *acceptable* or *unacceptable* according to that document.
3. What should Sommers do if Haast suggests that these end-of-financial-year actions are taken in every division of Superior Foods and that she will greatly harm the snack foods division if she does not cooperate and paint the rosiest picture possible of the division's results?

#### 1.35 \*\* Professional ethics

#### OBJECTIVE 6

Trade Issue Pty Ltd is a publishing company that produces trade magazines. The company's shareholders are awaiting the announcement of Trade Issue's earnings for the financial year, which ends on 30 June. Market analysts have predicted earnings to be around \$1.34 per share. The CEO of Trade Issue expects earnings to be only \$1.20 per share, and knows this will cause the price of the shares to drop. The CEO suggests the following ideas to various managers to try to increase reported earnings by the end of the financial year:

- a. delaying the recording of cancelled subscriptions for June until July
- b. waiting until the new financial year to update the software on office computers
- c. recognising unearned subscription revenue (cash received in advance for magazines that will be sent in the future) as revenue when received in the current month (just before financial year-end) instead of booking it as a liability
- d. delaying the recording of purchases of office supplies on account until after financial year-end
- e. recording advertising revenues that relate to July in June

- f. waiting until after financial year-end to do building repairs
- g. switching from declining-balance to straight-line depreciation to reduce depreciation expenses in the current year

**REQUIRED**

1. Why would Trade Issue's CEO want to 'manage' earnings?
2. From the point of view of the CIMA Code of Ethics for Professional Accountants, which of items a–g above are acceptable to Trade Issue's management accountant? Which are unacceptable?
3. What should the management accountant do about the CEO's suggestions? What should the management accountant do if the CEO refuses to change the suggestions?

## COLLABORATIVE LEARNING PROBLEMS

**1.36 \*\*\* Ethical challenges****OBJECTIVE 6**

In June 2017, the government of Sandos invited bids for the construction of a mobile telephone network. Pure Tone, an experienced communications company, was eager to enter the growing field of mobile telephone networks in countries with poor infrastructure for land-lines. If Pure Tone won a few of these early contracts, it would be sought after for its field experience and expertise. After careful analysis, the company prepared a detailed bid for the Communications Ministry of Sandos, building in only half of its usual profit margin and providing a contractual guarantee that the project would be completed in two years or less. The multimillion-dollar bid was submitted before the deadline, and Pure Tone received notification that it had reached the Sandos government. Then, despite repeated faxes, emails and telephone calls to the ministry, there was no news on the bids or the project from the Sandos government.

Richard Burns, Director of Global Operations for Pure Tone, contacted the Australian commercial attaché in Sandos, who told him that his best chance was to go to Sandos and try to meet the deputy minister of communications in person. Burns prepared thoroughly for the trip, rereading the proposal and making sure that he understood the details.

At the commercial attaché's office in Sandos's capital, Burns waited nervously for the deputy minister and his assistant. Burns had come to Sandos with a clear negotiating strategy to try to win the bid. Soon the deputy minister and his staff arrived, introductions were made and pleasantries exchanged. The deputy minister asked a few questions about Pure Tone and the bid and then excused himself, leaving his assistant to talk to Burns. After clearly indicating that many other compelling bids had been made by firms from around the world, the assistant said: 'Mr Burns, I guarantee that Pure Tone's bid will be accepted if you pay a \$1 million commission. Of course, your excellent proposal doesn't have to be altered in any way.' It was clear to Burns that the 'commission' was, in fact, a bribe. Tactfully, he pointed out that Australian laws and Pure Tone's corporate policy prohibited such a payment. The assistant wished him a good day and a pleasant flight home and left.

**REQUIRED**

1. As a shareholder in Pure Tone, would you prefer that Pure Tone executives agree to the payment of the 'commission'?
2. When Burns described his experience to his friend Anthony Corder, who managed international business development for another company, Corder said that his own 'personal philosophy' was to make such payments if they were typical in the local culture. Do you agree with Corder's point of view? Explain.
3. Why would Pure Tone have a corporate policy against such payments?
4. What should Richard Burns do next?

**1.37 \*\*\* Ethical challenges, environmental concerns****OBJECTIVE 6**

Furniquial Ltd produces high-quality furniture in Australia for sale to top Australian retailers. In 1995, Furniquial purchased a timber operation in Indonesia, and shifted from using Australian hardwoods to using Indonesian ramin in its products. The ramin proved to be a cheaper alternative, and it was widely accepted by Furniquial's customers. Furniquial's management credits the early adoption of Indonesian wood for its ability to keep its Australian factory open when so many competitors had closed their doors. Recently, however, consumers have become increasingly concerned about the sustainability of tropical woods, including ramin. Furniquial has seen sales begin to fall, and the company was even singled out by an environmental group for boycott. It appears that a shift to more sustainable woods before year-end will be necessary, and more costly.

In response to the looming increase in material costs, CEO Stuart Fisher calls a meeting of senior management. The group generates the following ideas to address customer concerns and/or salvage company profits for the current year:

- a. Pay local officials in Indonesia to 'certify' that the ramin used by Furniquial is sustainable. It is not certain whether the ramin would indeed be sustainable. Put highly visible tags on each piece of furniture to inform consumers of the change.
- b. Make deep cuts in pricing through the end of the year to generate additional revenue.
- c. Record executive year-end bonus compensation accrued for the current year when it is paid in the next year, after the December fiscal year-end.
- d. Reject the change in materials. Counter the bad publicity with an aggressive ad campaign showing the consumer products as 'made in Australia', since production takes place in Australia.
- e. Redesign upholstered furniture to replace ramin contained inside with less expensive recycled plastic. The change in materials would not affect the appearance or durability of the furniture. The company would market the furniture as 'sustainable'.
- f. Pressure current customers to take early delivery of goods before the end of the year so that more revenue can be reported in this year's financial statements.
- g. Begin purchasing sustainable Australian hardwoods and sell the Indonesian subsidiary. Initiate a 'plant a tree' marketing program, in which the company would plant a tree for every piece of furniture sold. Material costs would increase 25%, and prices would be passed along to customers.
- h. Sell off production equipment before year-end. The sale would result in one-time gains that could offset the company's lagging profits. The owned equipment could be replaced with leased equipment at a lower cost in the current year.
- i. Recognise sales revenues on orders received but not shipped as of year-end.

### REQUIRED

1. As the management accountant for Furniquial, prepare a report to the CEO in which you evaluate each of the preceding items (a–i) in the context of the professional accountants' code of ethics.
2. Prepare a formal written note as to the action you would take with regard to those items that are in violation of the ethical standards for management accountants.

## ▶ TRY IT SOLUTIONS

### TRY IT 1.1 solution

- a production
- b design of products, services or processes
- c marketing
- d research and development
- e marketing
- f customer service
- g production
- h distribution

### TRY IT 1.2 solution

To respond to the challenges posed in MCL's environment, as highlighted by the five-forces analysis, MCL must choose between two basic strategies: differentiating its product or achieving cost leadership. Strong competition and the bargaining powers of customers and suppliers put significant pressure on MCL's selling prices, service and quality performance. While these conditions demand high-quality materials and labour inputs, new entrants are deterred by low prices and MCL has the capability to continuously improve quality and contain prices. Under these conditions, MCL should pursue a cost-leadership strategy.

### TRY IT 1.3 solution

In both cases, the management accountant is faced with an ethical dilemma. Ethical issues are not always clear-cut. Case A involves competence, objectivity and integrity. The management accountant should request that the division manager provide credible evidence that the new product is commercially viable. If the manager does not provide such evidence, it is appropriate that the development costs be treated as an expense in the current period. Case B involves confidentiality, integrity and objectivity. The supplier in case B may have no intention of raising issues associated with the bid. However, the appearance of a conflict of interest in case B is sufficient for many companies to prohibit employees from accepting 'favours'

from suppliers. The management accountant in case B should discuss the invitation with his immediate supervisor. If the visit is approved, the supplier should be informed that the invitation has been officially approved subject to his following corporate policy, which includes not disclosing confidential information.

If the divisional management accountant in case A is not satisfied with the division manager's response regarding the commercial viability of the product, s/he should discuss the issue with the CFO.

Sample pages