CHAPTER 1
THE MANAGER AND MANAGEMENT ACCOUNTING

1-1 How does management accounting differ from financial accounting?

Management accounting measures, analyzes, and reports financial and nonfinancial information that helps managers make decisions to fulfill the goals of an organization. It focuses on internal reporting and is not restricted by generally accepted accounting principles (GAAP).

Financial accounting focuses on reporting to external parties such as investors, government agencies, and banks. It measures and records business transactions and provides financial statements that are based on generally accepted accounting principles (GAAP).

Other differences include (1) management accounting emphasizes the future (not the past), and (2) management accounting influences the behavior of managers and other employees (rather than primarily reporting economic events).

1-2 "Management accounting should not fit the straitjacket of financial accounting." Explain and give an example.

Financial accounting is constrained by generally accepted accounting principles. Management accounting is not restricted to these principles. The result is that

- management accounting allows managers to charge interest on owners' capital to help judge a division's performance, even though such a charge is not allowed under GAAP,
- management accounting can include assets or liabilities (such as "brand names" developed internally) not recognized under GAAP, and
- management accounting can use asset or liability measurement rules (such as present values or resale prices) not permitted under GAAP.

1-3 How can a management accountant help formulate strategy?

Management accountants can help to formulate strategy by providing information about the sources of competitive advantage—for example, the cost, productivity, or efficiency advantage of their company relative to competitors or the premium prices a company can charge relative to the costs of adding features that make its products or services distinctive.

1-4 Describe the business functions in the value chain.

The business functions in the value chain are

- **Research and development**—generating and experimenting with ideas related to new products, services, or processes.
- **Design of products and processes**—detailed planning, engineering, and testing of products and processes.
- **Production**—procuring, transporting, storing, coordinating and assembling resources to produce a product or deliver a service.
- **Marketing**—promoting and selling products or services to customers or prospective customers.

- **Distribution**—processing orders and shipping products or services to customers.
- **Customer service**—providing after-sales service to customers.

1-5 Explain the term *supply chain* and its importance to cost management.

Supply chain 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 one organization or in multiple organizations.

Cost management is most effective when it integrates and coordinates activities across all companies in the supply chain as well as across each business function in an individual company's value chain. Attempts are made to restructure all cost areas to be more cost-effective.

1-6 "Management accounting deals only with costs." Do you agree? Explain.

"Management accounting deals only with costs." This statement is misleading at best, and wrong at worst. Management accounting measures, analyzes, and reports financial *and nonfinancial* information that helps managers define the organization's goals and make decisions to fulfill those goals. Management accounting also analyzes revenues from products and customers in order to assess product and customer profitability. Therefore, while management accounting does use cost information, it is only a part of the organization's information recorded and analyzed by management accountants.

1-7 How can management accountants help improve quality and achieve timely product deliveries?

Management accountants can help improve quality and achieve timely product deliveries by recording and reporting an organization's current quality and timeliness levels and by analyzing and evaluating the costs and benefits—both financial and nonfinancial—of new quality initiatives, such as TQM, relieving bottleneck constraints, or providing faster customer service.

1-8 Describe the five-step decision-making process.

The five-step decision-making process is (1) identify the problem and uncertainties; (2) obtain information; (3) make predictions about the future; (4) make decisions by choosing among alternatives; and (5) implement the decision, evaluate performance, and learn.

1-9 Distinguish planning decisions from control decisions.

Planning decisions focus on selecting organization goals and strategies, predicting results under various alternative ways of achieving those goals, deciding how to attain the desired goals, and communicating the goals and how to attain them to the entire organization.

Control decisions focus on taking actions that implement the planning decisions, deciding how to evaluate performance, and providing feedback and learning to help future decision making.

1-10 What three guidelines help management accountants provide the most value to managers?

The three guidelines for management accountants are:
1. Employ a cost-benefit approach.
2. Recognize technical and behavioral considerations.
3. Apply the notion of "different costs for different purposes."

1-11 "Knowledge of technical issues such as computer technology is a necessary but not sufficient condition to becoming a successful management accountant." Do you agree? Why?

Agree. A successful management accountant requires general business skills (such as understanding the strategy of an organization) and people skills (such as motivating other team members) as well as technical skills (such as computer knowledge, calculating costs of products, and supporting planning and control decisions).

1-12 As a new controller, reply to this comment by a plant manager: "As I see it, our accountants may be needed to keep records for shareholders and Uncle Sam, but I don't want them sticking their noses in my day-to-day operations. I do the best I know how. No bean counter knows enough about my responsibilities to be of any use to me."

The new controller could reply in one or more of the following ways:

(a) Demonstrate to the plant manager how he or she could make better decisions if the plant controller was viewed as a resource rather than a deadweight. In a related way, the plant controller could show how the plant manager's time and resources could be saved by viewing the new plant controller as a team member.

(b) Demonstrate to the plant manager a good knowledge of the technical aspects of the plant. This approach may involve doing background reading. It certainly will involve spending much time on the plant floor speaking to plant personnel.

(c) Show the plant manager examples of the new plant controller's past successes in working with line managers in other plants. Examples could include
- assistance in preparing the budget,
- assistance in analyzing problem situations and evaluating financial and nonfinancial aspects of different alternatives, and
- assistance in submitting capital budget requests.

(d) Seek assistance from the corporate controller to highlight to the plant manager the importance of many tasks undertaken by the new plant controller. This approach is a last resort but may be necessary in some cases.

1-13 Where does the management accounting function fit into an organization's structure?

The controller is the chief management accounting executive. The corporate controller reports to the chief financial officer, a staff function. Companies also have business unit controllers who support business unit managers or regional controllers who support regional managers in major geographic regions.

1-14 Name the four areas in which standards of ethical conduct exist for management accountants in the United States. What organization sets forth these standards?

SOLUTION

The Institute of Management Accountants (IMA) sets standards of ethical conduct for management accountants in the following four areas:

- Competence
- Confidentiality
- Integrity
- Credibility

1-15 What steps should a management accountant take if established written policies provide insufficient guidance on how to handle an ethical conflict?

Steps to take when established written policies provide insufficient guidance are as follows:

(a) Discuss the problem with the immediate superior (except when it appears that the superior is involved).
(b) Clarify relevant ethical issues by confidential discussion with an IMA Ethics Counselor or other impartial advisor.
(c) Consult your own attorney as to legal obligations and rights concerning the ethical conflicts.

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1-16 Which of the following is not a primary function of the management accountant?
a. Communicates financial results and position to external parties.
b. Uses information to develop and implement business strategy.
c. Aids in the decision making to help an organization meet its goals.
d. Provides input into an entity's production and marketing decisions.

SOLUTION

(a) Communicating financial results and position to external parties is not a primary function of the management accountant.

1-17 Value chain and classification of costs, computer company. Dell Computer incurs the following costs:
a. Utility costs for the plant assembling the Latitude computer line of products
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 Dell employees' visit 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 shown in Exhibit 1-2 (page 5).

SOLUTION

(15 min.) **Value chain and classification of costs, computer company.**

Cost Item	Value Chain Business Function
a.	Production
b.	Distribution
c.	Design of products and processes
d.	Research and development
e.	Customer service or marketing
f.	Design of products and processes (or research and development)
g.	Marketing
h.	Production

1-18 Value chain and classification of costs, pharmaceutical company. 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. Materials purchased to develop drugs yet to be approved by the government
e. Sponsorship of a professional golfer
f. Labor 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 Exhibit 1-2 (page 5).

SOLUTION

(15 min.) **Value chain and classification of costs, pharmaceutical company.**

Cost Item	Value Chain Business Function
a.	Marketing
b.	Design of products and processes
c.	Customer service
d.	Research and development
e.	Marketing
f.	Production
g.	Marketing
h.	Distribution

1-19 Value chain and classification of costs, fast-food restaurant. Burger King, a hamburger fast-food restaurant, incurs the following costs:
a. Cost of oil for the deep fryer
b. Wages of the counter help who give customers the food they order
c. Cost of the costume for the King on the Burger King television commercials
d. Cost of children's toys given away free with kids' meals
e. Cost of the posters indicating the special "two cheeseburgers for $2.50"
f. Costs of frozen onion rings and French fries
g. Salaries of the food specialists who create new sandwiches for the restaurant chain
h. Cost of "to-go" bags requested by customers who could not finish their meals in the restaurant

Required:
Classify each of the cost items (**a–h**) as one of the business functions of the value chain shown in Exhibit 1-2 (page 5).

SOLUTION

(15 min.) **Value chain and classification of costs, fast-food restaurant.**

Cost Item	Value Chain Business Function
a.	Production
b.	Distribution
c.	Marketing
d.	Marketing
e.	Marketing
f.	Production
g.	Design of products and processes (or research and development)
h.	Customer service

1-20 Key success factors. 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.

SOLUTION

(10 min.) **Key success factors.**

Change in Operations/ Management Accounting	**Key Success Factor**
a.	Innovation
b.	Cost and efficiency and quality
c.	Time
d.	Time and cost and efficiency
e.	Cost and efficiency

1-21 Key success factors. Vargas Construction Company 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 LEED 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.

SOLUTION

(10 min.) **Key success factors.**

Change in Operations/ Management Accounting	**Key Success Factor**

a.	Time and cost and efficiency
b.	Time, quality, and cost and efficiency
c.	Quality and cost and efficiency
d.	Innovation and quality
e.	Cost and efficiency

1-22 Planning and control decisions. Gregor Company 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 costs it actually incurred with 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 fiscal year.

SOLUTION

(10–15 min.) **Planning and control decisions.**

Action	**Decision**
a.	Planning
b.	Control
c.	Control
d.	Planning
e.	Planning

1-23 Planning and control decisions. Gavin Adams is the president 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.

SOLUTION

(10–15 min.) **Planning and control decisions.**

Action	**Decision**

a.	Planning
b.	Control
c.	Planning
d.	Planning
e.	Control

1-24 Five-step decision-making process, manufacturing. Madison Foods makes frozen dinners that it sells through grocery stores. Typical products include turkey, pot roast, fried chicken, and meatloaf. The managers at Madison have recently proposed a line of frozen chicken pies. They take the following actions to help decide whether to launch the line.

a. Madison's test kitchen prepares a number of possible recipes for a consumer focus group.
b. Sales managers estimate they will sell more chicken pies in their eastern sales territory than in their western sales territory.
c. Managers discuss the possibility of introducing a new chicken pie.
d. Managers compare actual labor costs of making chicken pies with their budgeted costs.
e. Profits from selling chicken pies are budgeted.
f. The company decides to introduce a new chicken pie.
g. To help decide whether to introduce a new chicken pie, the company researches the price and quality of competing chicken pies.

Required:
Classify each of the actions (**a–g**) as a step in the five-step decision-making process (identify the problem and uncertainties; obtain information; make predictions about the future; make decisions by choosing among alternatives; implement the decision, evaluate performance, and learn). The actions are not listed in the order they are performed.

SOLUTION

(15 min.) **Five-step decision-making process, manufacturing.**

Action	Step in Decision-Making Process
a.	Obtain information.
b.	Make predictions about the future.
c.	Identify the problem and uncertainties.
d.	Implement the decision, evaluate performance, and learn.
e.	Make predictions about the future.
f.	Make decisions by choosing among alternatives.
g.	Obtain information.

1-25 Five-step decision-making process, service firm. 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 details about 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 information; make predictions about the future; make decisions by choosing among alternatives; implement the decision, evaluate performance, and learn).

SOLUTION

(15 min.) **Five-step decision-making process, service firm.**

Action	Step in Decision-Making Process
a.	Make decisions by choosing among alternatives.
b.	Identify the problem and uncertainties.
c.	Obtain information and/or make predictions about the future.
d.	Obtain information and/or make predictions about the future.
e.	Make predictions about the future.
f.	Obtain information.

1-26 Professional ethics and reporting division performance. Maria Mendez is division controller and James Dalton is division manager of the Hestor Shoe Company. Mendez has line responsibility to Dalton, but she also has staff responsibility to the company controller.

Dalton is under severe pressure to achieve the budgeted division income for the year. He has asked Mendez to book $200,000 of revenues on December 31. The customers' orders are firm, but the shoes are still in the production process. They will be shipped on or around January 4. Dalton says to Mendez, "The key event is getting the sales order, not shipping the shoes. You should support me, not obstruct my reaching division goals."

Required:
1. Describe Mendez's ethical responsibilities.
2. What should Mendez do if Dalton gives her a direct order to book the sales?

SOLUTION

(10–15 min.) **Professional ethics and reporting division performance.**

1. Mendez's ethical responsibilities are well summarized in the IMA's "Standards of Ethical Behavior for Practitioners of Management Accounting and Financial Management" (Exhibit 1-7 of text). Areas of ethical responsibility include the following:

- Competence
- Confidentiality
- Integrity
- Credibility

The ethical standards related to Mendez's current dilemma are integrity, competence, and credibility. Using the integrity standard, Mendez should carry out duties ethically and communicate unfavorable as well as favorable information and professional judgments or opinions. Competence demands that Mendez perform her professional duties in accordance with relevant laws, regulations, and technical standards and provide decision support information that is accurate. Credibility requires that Mendez report information fairly and objectively and disclose deficiencies in internal controls in conformance with organizational policy and/or applicable law. Mendez should refuse to book the $200,000 of sales until the goods are shipped. Both financial accounting and management accounting principles maintain that sales are not complete until the title is transferred to the buyer.

2. Mendez should refuse to follow Dalton's orders. If Dalton persists, the incident should be reported to the corporate controller. Support for line management should be wholehearted, but it should not require unethical conduct.

1-27 Professional ethics and reporting division performance. Hannah Gilpin is the controller of Blakemore Auto Glass, a division of Eastern Glass and Window. Blakemore replaces and installs 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 labor, which is included in cost of goods sold, as administrative labor, which is not. Doing so will save the division $20,000 in allocated corporate overhead. The labor costs in question involve installation labor 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 labor) 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?

SOLUTION

(10–15 min.) **Professional ethics and reporting division performance.**

1. Gilpin's ethical responsibilities are well summarized in the IMA's "Standards of Ethical Behavior for Practitioners of Management Accounting and Financial Management" (Exhibit 1-7 of text). Areas of ethical responsibility include the following:

- Competence
- Confidentiality
- Integrity
- Credibility

The ethical standards related to Gilpin's current dilemma are integrity, competence, and credibility. Using the integrity standard, Gilpin should carry out duties ethically and communicate unfavorable as well as favorable information and professional judgments or opinions. Competence demands that Gilpin perform her professional duties in accordance with relevant laws, regulations, and technical standards and provide decision support information that is accurate. Credibility requires that Gilpin report information fairly and objectively and disclose deficiencies in internal controls in conformance with organizational policy and/or applicable law. Gilpin should use her professional judgment to decide if reclassifying labor costs from cost of goods sold to administrative labor is appropriate. This cost should be classified as cost of goods sold and she should refuse to classify the $50,000 of costs as administrative costs only to avoid allocation of overhead costs.

2. Gilpin should refuse to follow Myers' orders but should discuss her concerns with Myers. If Myers persists, the incident should be reported to the corporate controller of Blakemore Auto Glass. Gilpin may also want to consider consulting the IMA for ethical guidance. Support for line management should be wholehearted, but it should not require unethical conduct.

1-28 Planning and control decisions, Internet company. PostNews.com offers its subscribers several services, such as an annotated TV guide and local-area information on weather, restaurants, and movie theaters. Its main revenue sources are fees for banner advertisements and fees from subscribers. Recent data are as follows:

Month/Year	Advertising Revenues	Actual Number of Subscribers	Monthly Fee per Subscriber
June 2015	$ 415,972	29,745	$15.50
December 2015	867,246	55,223	20.50
June 2016	892,134	59,641	20.50
December 2016	1,517,950	87,674	20.50
June 2017	2,976,538	147,921	20.50

The following decisions were made from June through October 2017:

a. June 2017: Raised subscription fee to $25.50 per month from July 2017 onward. The budgeted number of subscribers for this monthly fee is shown in the following table.

b. June 2017: Informed existing subscribers that from July onward, monthly fee would be $25.50.

c. July 2017: Offered e-mail service to subscribers and upgraded other online services.

d. October 2017: Dismissed the vice president of marketing after significant slowdown in subscribers and subscription revenues, based on July through September 2017 data in the following table.

e. October 2017: Reduced subscription fee to $22.50 per month from November 2017 onward.

Results for July–September 2017 are as follows:

Month/Year	Budgeted Number of Subscribers	Actual Number of Subscribers	Monthly Fee per Subscriber
July 2017	145,000	129,250	$25.50
August 2017	155,000	142,726	25.50
September 2017	165,000	145,643	25.50

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 PostNews.com.

SOLUTION

(15 min.) **Planning and control decisions, Internet company.**

1. **Planning decisions**
   - a. Decision to raise monthly subscription fee from July
   - c. Decision to offer e-mail service to subscribers and upgrade content of online services (later decision to inform subscribers and upgrade online services is an implementation part of control)
   - e. Decision to decrease monthly subscription fee starting in November.

   Control decisions
   - b. Decision to inform existing subscribers about the rate of increase—an implementation part of control decisions
   - d. Dismissal of VP of Marketing—performance evaluation and feedback aspect of control decisions

2. Other planning decisions that may be made at PostNews.com: decision to raise or lower advertising fees; decision to charge a fee from on-line retailers when customers click-through from PostNews.com to the retailers' websites.

Other control decisions that may be made at PostNews.com: evaluating how customers like the new format for the weather information, working with an outside vendor to redesign the website, and evaluating whether the waiting time for customers to access the website has been reduced.

1-29 Strategic decisions and management accounting. Consider the following series of independent situations in which a firm is about to make a strategic decision.

Decisions

a. Julian Phones is about to decide whether to launch production and sale of a cell phone with standard features.

b. Flint 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.

c. Maria Cosmetics has been asked to provide a "store brand" facial cream that will be sold at discount retail stores.

d. Jansen Computers is considering developing a special line of computers that can be both a tablet and a computer.

Required:

1. For each decision, state whether the company is following a cost leadership or a product differentiation strategy.

2. For each decision, discuss what information the management accountant can provide about the source of competitive advantage for these firms.

SOLUTION

(20 min.) **Strategic decisions and management accounting.**

1. The strategies the companies are following in each case are:
   a. Cost leadership or low price strategy
   b. Product differentiation strategy
   c. Cost leadership or low price strategy
   d. Product differentiation strategy

2. Examples of information the management accountant can provide for each strategic decision about the source of competitive advantage follow.

   a. Cost to manufacture and sell the cell phone
   Productivity, efficiency, and cost advantages relative to competition
   Prices of competitive cell phones
   Sensitivity of target customers to price and quality
   The production capacity of Julian Phones and its competitors
   How the market for cell phones with standard features is growing

   b. Cost to develop, produce, and sell new home computer software package
   Premium price that customers would be willing to pay due to product uniqueness
   Price of basic software
   Price of closest competitive software
   Cash needed to develop, produce, and sell new software

   c. Cost of producing the "store-brand" facial cream
   Productivity, efficiency, and cost advantages relative to competition
   Prices of competitive products
   Sensitivity of target customers to price and quality
   The production capacity of Maria Cosmetics and its competitors
   How the market for facial cream is growing

d. Cost to produce and sell new line of tablet computers
Premium price that customers would be willing to pay due to product uniqueness
Price of basic computer
Price of closest competitive product
Cash available to develop, produce, and sell special line of tablet computers

1-30 Strategic decisions and management accounting. Consider the following series of independent situations in which a firm is about to make a strategic decision.

Decisions

a. A running shoe manufacturer is weighing whether to purchase leather from a cheaper supplier in order to compete with lower priced competitors.
b. An office supply store is considering adding a delivery service that its competitors do not have.
c. A regional retailer is deciding whether to install self-check-out counters. This technology will reduce the number of check-out clerks required in the store.
d. A local florist is considering hiring a horticulture specialist to help customers with gardening questions.

Required:

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

SOLUTION

(20 min.) **Strategic decisions and management accounting.**

1. The strategies the companies are following in each case are
   a. Cost leadership or low-price strategy
   b. Product differentiation strategy
   c. Cost leadership or low-price strategy
   d. Product differentiation strategy

2. Examples of information the management accountant can provide for each strategic decision follow.

a. Cost related to purchase leather from a cheaper supplier
Productivity and efficiency advantages relative to competition
Sensitivity of target customers to price and quality
Materials and labor usage costs when working with cheaper leather

b. Cost of delivery service
Premium price that customers would be willing to pay for the service
Price of closest competitive product

c. Cost to develop new software to check in customers
Efficiency and cost advantages relative to competition
Sensitivity of target customers to change in service

d. Cost to hire horticultural specialist
Premium price that customers would be willing to pay for expert advice
Price of closest competitive product

1-31 Management accounting guidelines. For each of the following items, identify which of the management accounting guidelines applies: cost–benefit approach, behavioral and technical considerations, or different costs for different purposes.

1. Analyzing whether to keep the billing function within an organization or outsource it.
2. Deciding to give bonuses for superior performance to the employees in a Japanese subsidiary and extra vacation time to the employees in a Swedish 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 an additional 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 costlier 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 U.S. GAAP) but capitalizing and expensing them over a longer period for management performance-evaluation purposes.
9. Introducing a profit-sharing plan for employees.

SOLUTION

(15 min.) **Management accounting guidelines.**

1. Cost-benefit approach
2. Behavioral and technical considerations
3. Different costs for different purposes
4. Cost-benefit approach
5. Behavioral and technical considerations
6. Cost-benefit approach
7. Behavioral and technical considerations
8. Different costs for different purposes
9. Behavioral and technical considerations

1-32 Management accounting guidelines. For each of the following items, identify which of the management accounting guidelines applies: cost–benefit approach, behavioral and technical considerations, or different costs for different purposes.

1. Analyzing whether to produce a component needed for the 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 cleanup costs for calculating the liability on the balance sheet.

SOLUTION

(15 min.) **Management accounting guidelines.**

1. Cost-benefit approach
2. Behavioral and technical considerations and cost-benefit approach
3. Different costs for different purposes
4. Cost-benefit approach or behavioral and technical considerations, for example, how employees will react to the new technology
5. Cost-benefit approach
6. Cost-benefit approach
7. Different costs for different purposes.

1-33 Role of controller, role of chief financial officer. George Jimenez is the controller at Balkin Electronics, a manufacturer of devices for the computer industry. The company may promote him to chief financial officer.

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

Activity	Controller	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?

SOLUTION

(15 min.) **Role of controller, role of chief financial officer.**

1.

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

2. As CFO, Jimenez will be interacting much more with the senior management of the company, the board of directors, auditors, and the external financial community. Any experience he can get with these aspects will help him in his new role as CFO. George Jimenez can be better positioned for his new role as CFO by participating in strategy discussions with senior management, by preparing the external investor communications and press releases under the guidance of the current CFO, by attending courses that focus on the interaction and negotiations between the various business functions and outside parties such as auditors and, either formally or on the job, getting training in issues related to investments and corporate finance.

1-34 Budgeting, ethics, pharmaceutical company. Chris Jackson was recently promoted to Controller 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 2017 was expected (budgeted) to be $5 billion. During the company's midyear budget review, Chris realized that current R&D expenditures were already at $3.5 billion, nearly 40% above the midyear 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 gotten 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 6 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. Capitalize some of the company's R&D expenditures, reducing R&D expense on the income statement. This transaction would not be in accordance with GAAP, but Jackson thought it was justifiable because the Vyacon drug was going to market early next year. Jackson would argue that capitalizing R&D costs this year and expensing them next year would better match revenues and expenses.

Required:

1. Referring to the "Standards of Ethical Behavior for Practitioners of Management Accounting and Financial Management," Exhibit 1-7 (page 17), which of the preceding items (**a–c**) are acceptable to use? Which are unacceptable?

2. What would you recommend Jackson do?

SOLUTION

(30 min.) **Pharmaceutical company, budgeting, ethics.**

1. The overarching principles of the IMA Statement of Ethical Professional Practice are Honesty, Fairness, Objectivity and Responsibility. The statement's corresponding "Standards for Ethical Behavior…" require management accountants to

- Perform professional duties in accordance with relevant laws, regulations, and technical standards.
- Refrain from engaging in any conduct that would prejudice carrying out duties ethically.
- Communicate information fairly and objectively.
- Disclose all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, analyses, or recommendations.

The idea of capitalizing some of the company's R&D expenditures is a direct violation of the IMA's ethical standards above. This transaction would not be "in accordance with relevant laws, regulations, and technical standards." GAAP requires research and development costs to be expensed as incurred. Even if Jackson believes his transaction is justifiable, it violates the profession's technical standards and would be unethical.

The other "year-end" actions occur in many organizations and fall into the "gray" to "acceptable" area. Much depends on the circumstances surrounding each one, however, such as the following:

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 also possible that in the meantime a BrisCor competitor could make it to market with a similar drug.* While this solution may solve the budget shortfall in this year, it could result in a significant loss of future profits for BrisCor in the long run, especially if a competitor is able to obtain a patent on a similar drug before BrisCor.

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 onetime gain that could offset the budget shortfall. Of course, all future profits from Martek would be lost.* Again, this solution may solve the company's short-term budget crisis, but could result in the loss of future profits for BrisCor in the long run.

2. While it is not uncommon for companies to sacrifice long-term profits for short-term gains, it may not be in the best interest of the company's shareholders. In the case of BrisCor, the CFO is primarily concerned with "maximizing shareholder wealth" in the immediate future (third quarter only) but not in the long term. Because this executive's incentive pay and even employment may be based on his ability to meet short-term targets, he may not be acting in the best interest of the shareholders in the long run.

Jackson definitely faces an ethical dilemma. It is not unethical on Jackson's part to want to please his new boss, nor is it unethical that Jackson wants to make a good impression on his first days at his new job; however, Jackson must still act within the ethical standards required by his profession. Taking illegal or unethical action by capitalizing R&D to satisfy the demands of his new supervisor, Ronald Meece, is unacceptable. Although not strictly unethical, I would recommend that Jackson not agree to slow down the R&D efforts on Vyacon or sell off the rights to Martek. Each of these appears to sacrifice the overall economic interests of BrisCor for short-run gain. Jackson should argue against doing this but not resign if Meece insists that these actions be taken. If, however, Meece asks Jackson to capitalize R&D, he should raise this issue with the chair of the audit committee after informing Meece that he is doing so. If the CFO still insists on Jackson capitalizing R&D, he should resign rather than engage in unethical behavior.

1-35 Professional ethics and end-of-year actions. Linda Butler is the new division controller of the snack-foods division of Daniel Foods. Daniel Foods has reported a minimum 15% growth in annual earnings for each of the past 5 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 controller estimates a 10% annual earnings growth rate for Daniel Foods this year. One month before the December 31 fiscal year-end of the current year, Butler estimates the snack-foods division will report an annual earnings growth of only 8%. Rex Ray, the snack-foods division president, is not happy, but he notes that the "end-of-year actions" still need to be taken.

Butler makes some inquiries and is able to compile the following list of end-of-year actions that were more or less accepted by the previous division controller:

a. Deferring December's routine monthly maintenance on packaging equipment by an independent contractor until January of next year.
b. Extending the close of the current fiscal year beyond December 31 so that some sales of next year are included in the current year.
c. Altering dates of shipping documents of next January's sales to record them as sales in December of the current year.
d. Giving salespeople a double bonus to exceed December sales targets.
e. Deferring the current period's advertising by reducing the number of television spots run in December and running more than planned in January of next year.
f. Deferring the current period's reported advertising costs by having Daniel Foods' outside advertising agency delay billing December advertisements until January of next year or by having the agency alter invoices to conceal the December date.
g. Persuading carriers to accept merchandise for shipment in December of the current year even though they normally would not have done so.

Required:
1. Why might the snack-foods division president want to take these end-of-year actions?
2. Butler is deeply troubled and reads the "Standards of Ethical Behavior for Practitioners of Management Accounting and Financial Management" in Exhibit 1-7 (page 17). Classify each of the end-of-year actions (**a–g**) as acceptable or unacceptable according to that document.
3. What should Butler do if Ray suggests that these end-of-year actions are taken in every division of Daniel 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?

SOLUTION

(30–40 min.) **Professional ethics and end-of-year actions.**

1. The possible motivations for the snack foods division wanting to take end-of-year actions include:

(a) Management incentives. Daniel Foods may have a division bonus scheme based on one-year reported division earnings. Efforts to front-end revenue into the current year or transfer costs into the next year can increase this bonus.
(b) Promotion opportunities and job security. Top management of Daniel Foods likely will view those division managers who deliver high reported earnings growth rates as being the best prospects for promotion. Division managers who deliver "unwelcome surprises" may be viewed as less capable.
(c) Retain division autonomy. If top management of Daniel Foods adopts a "management by exception" approach, divisions that report sharp reductions in their earnings growth rates may attract a sizable increase in top management supervision.

2. The "Standards of Ethical Conduct . . . " require management accountants to

- Perform professional duties in accordance with relevant laws, regulations, and technical standards.
- Refrain from engaging in any conduct that would prejudice carrying out duties ethically.

- Communicate information fairly and objectively.

Several of the "end-of-year actions" clearly are in conflict with these requirements and should be viewed as unacceptable by Butler.

(b) The fiscal year-end should be closed on midnight of December 31. "Extending" the close falsely reports next year's sales as this year's sales.
(c) Altering shipping dates is falsification of the accounting reports.
(f) Advertisements run in December should be charged to the current year. The advertising agency is facilitating falsification of the accounting records.

The other "end-of-year actions" occur in many organizations and fall into the "gray" to "acceptable" area. However, much depends on the circumstances surrounding each one, such as the following:

(a) If the independent contractor does not do maintenance work in December, there is no transaction regarding maintenance to record. The responsibility for ensuring that packaging equipment is well maintained is that of the plant manager. The division controller probably can do little more than observe the absence of a December maintenance charge.
(d) In many organizations, sales are heavily concentrated in the final weeks of the fiscal year-end. If the double bonus is approved by the division marketing manager, the division controller can do little more than observe the extra bonus paid in December.
(e) If TV spots are reduced in December, the advertising cost in December will be reduced. There is no record falsification here.
(g) Much depends on the means of "persuading" carriers to accept the merchandise. For example, if an under-the-table payment is involved, or if carriers are pressured to accept merchandise, it is clearly unethical. If, however, the carrier receives no extra consideration and willingly agrees to accept the assignment because it sees potential sales opportunities in December, the transaction appears ethical.

Each of the (a), (d), (e), and (g) "end-of-year actions" may well disadvantage Daniel Foods in the long run. For example, lack of routine maintenance may lead to subsequent equipment failure. The divisional controller is well advised to raise such issues in meetings with the division president. However, if Daniel Foods has a rigid set of line/staff distinctions, the division president is the one who bears primary responsibility for justifying division actions to senior corporate officers.

3. If Butler believes that Ray wants her to engage in unethical behavior, she should first directly raise her concerns with Ray. If Ray is unwilling to change his request, Butler should discuss her concerns with the Corporate Controller of Daniel Foods. She could also initiate a confidential discussion with an IMA Ethics Counselor, other impartial adviser, or her own attorney. Butler also may well ask for a transfer from the snack foods division if she perceives Ray is unwilling to listen to pressure brought by the Corporate Controller, CFO, or even President of Daniel Foods. In the extreme, she may want to resign if the corporate culture of Daniel Foods is to reward division managers who take "end-of-year actions" that Butler views as unethical and possibly illegal. It was precisely actions along the lines of (b), (c), and (f) that

caused Betty Vinson, an accountant at WorldCom, to be indicted for falsifying WorldCom's books and misleading investors.

1-36 Professional ethics and end-of-year actions. Phoenix Press produces consumer magazines. The house and home division, which sells home-improvement and home-decorating magazines, has seen a 20% reduction in operating income over the past 9 months, primarily due to an economic recession and a depressed consumer housing market. The division's controller, Sophie Gellar, has felt pressure from the CFO to improve her division's operating results by the end of the year. Gellar is considering the following options for improving the division's performance by year-end:

a. Cancelling two of the division's least profitable magazines, resulting in the layoff of 25 employees.
b. Selling the new printing equipment that was purchased in January and replacing it with discarded equipment from one of the company's other divisions. The previously discarded equipment no longer meets current safety standards.
c. Recognizing unearned subscription revenue (cash received in advance for magazines that will be delivered in the future) as revenue when cash is received in the current month (just before fiscal year-end) instead of showing it as a liability.
d. Reducing the liability and related expense related to employee pensions. This would increase the division's operating income by 3%.
e. Recognizing advertising revenues that relate to January in December.
f. Switching from declining balance to straight-line depreciation to reduce depreciation expense in the current year.

Required:

1. What are the motivations for Gellar to improve the division's year-end operating earnings?
2. From the point of view of the "Standards of Ethical Behavior for Practitioners of Management Accounting and Financial Management," Exhibit 1-7 (page 17), which of the preceding items (**a–f**) are acceptable? Which are unacceptable?
3. What should Gellar do about the pressure to improve performance?

SOLUTION

(30 min.) **Professional ethics and end-of-year actions.**

1. The possible motivations for Controller Sophie Gellar to modify the division's year-end earnings are

(i) Job security and promotion. The company's CFO will likely reward her for meeting the company's performance expectations. Alternately, Gellar may be penalized, perhaps even by losing her job if the performance expectations are not met.

(ii) Management incentives. Gellar's bonus may be based on the division's ability to meet certain profit targets. If the House and Home division is able to meet its profit target for the year, the Controller may personally benefit if new printing equipment is sold off and replaced with the discarded equipment that no longer meets current safety standards, or if operating income is manipulated by questionable revenue and/or expense recognition.

2. The overarching principles of the IMA Statement of Ethical Professional Practice are Honesty, Fairness, Objectivity and Responsibility. The statement's corresponding "Standards for Ethical Conduct…" require management accountants to

- Perform professional duties in accordance with relevant laws, regulations, and technical standards.
- Refrain from engaging in any conduct that would prejudice carrying out duties ethically.
- Communicate information fairly and objectively.
- Disclose all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, analyses, or recommendations.

Several of the "year-end" actions are clearly in conflict with the statement's principles and required standards and should be viewed as unacceptable.

(c) Subscription revenue received in December in advance for magazines that will be sent out in January is a liability. Showing it as revenue falsely reports next year's revenue as this year's revenue.

(d) Reducing the liability and related expenses for employee pensions would violate Generally Accepted Accounting Principles unless the pension expense and liability are currently overstated. Recording this transaction would result in an overstatement of income and could potentially mislead investors.

(e) Booking advertising revenues that relate to January in December falsely reports next year's revenue as this year's revenue.

The other "year-end" actions occur in many organizations and fall into the "gray" to "acceptable" area. Much depends on the circumstances surrounding each one, however, such as the following:

(a) *Cancelling two of the division's least profitable magazines, resulting in the layoff of twenty-five employees.* While employee layoffs may be necessary for the business to survive, the layoff decision could result in economic hardship for those employees who lose their jobs, as well as result in employee morale problems for the rest of the division. Many companies would prefer to avoid causing hardship for their existing employees due to layoffs unless absolutely necessary for the survival of the business as a whole.

(b) *Selling the new printing equipment that was purchased in January and replacing it with discarded equipment from one of the company's other divisions. The previously discarded equipment no longer meets current safety standards.* Again, while this method may result in a short-term solution for the Controller and the Production Manager personally, this decision may actually harm the corporation financially as a whole, not to mention the potential resulting injuries to production workers from hazardous equipment. This method would be also be ethically questionable and would likely violate the IMA's ethical standards of integrity and credibility.

(f) *Switching from declining balance to straight line depreciation to reduce depreciation expense in the current year.* Many companies switch their depreciation policy from one method to another. Phoenix Press could argue that straight-line depreciation better represents the decrease in the economic value of the asset compared to the declining balance method. Straight-line depreciation may also be more in line with what its competitors do. If, however, the company changes to straight-line depreciation with the sole purpose of reducing expenses to meet its profit goals, such behavior would be unacceptable. The Standards of Ethical Behavior require management accountants to communicate information fairly and objectively and to carry out duties ethically.

3. Gellar should directly raise her concerns first with the CFO, especially if the pressure from the CFO is so great that the only course of action on the part of the controller is to otherwise behave unethically. If the CFO refuses to change his direction, then the controller should raise these issues with the CEO, and next to the Audit Committee and the Board of Directors, after informing the CFO that she is doing so. The Controller could also initiate a confidential discussion with an IMA Ethics Counselor, other impartial adviser, or his/her own attorney. In the extreme, the Controller may want to resign if the corporate culture of Phoenix Press is to reward executives who take year-end actions that the Controller views as unethical and possibly illegal. It was precisely actions along the lines of (c), (d) and (e) that caused Betty Vinson, an accountant at WorldCom, to be indicted for falsifying WorldCom's books and misleading investors.

1-37 Ethical challenges, global company environmental concerns. Contemporary Interiors (CI) manufactures high-quality furniture in factories in North Carolina for sale to top American retailers. In 1995, CI purchased a lumber operation in Indonesia, and shifted from using American hardwoods to Indonesian ramin in its products. The ramin proved to be a cheaper alternative, and it was widely accepted by American consumers. CI management credits the early adoption of Indonesian wood for its ability to keep its North Carolina factories open when so many competitors closed their doors. Recently, however, consumers have become increasingly concerned about the sustainability of tropical woods, including ramin. CI 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 Geoff Armstrong calls a meeting of upper 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" the ramin used by CI as sustainable. It is not certain whether the ramin would be sustainable or not. 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 the USA," since manufacturing takes place in North Carolina.
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 North American hardwoods and sell the Indonesian lumber subsidiary. Initiate a "plant a tree" marketing program, by which the company will 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 prior to 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. Recognize sales revenues on orders received but not shipped as of the end of the year.

Required:
1. As the management accountant for Contemporary Interiors, evaluate each of the preceding items (**a–i**) in the context of the "Standards of Ethical Behavior for Practitioners of Management Accounting and Financial Management," Exhibit 1-7 (page 17). Which of the items are in violation of these ethics standards and which are acceptable?
2. What should the management accountant do with regard to those items that are in violation of the ethical standards for management accountants?

SOLUTION

(40 min.) **Ethical challenges, global company.**

1. The overarching principles of the IMA Statement of Ethical Professional Practice are Honesty, Fairness, Objectivity, and Responsibility. The statement's corresponding "Standards for Ethical Conduct…" require management accountants to

- Perform professional duties in accordance with relevant laws, regulations, and technical standards.
- Refrain from engaging in any conduct that would prejudice carrying out duties ethically.
- Communicate information fairly and objectively.
- Disclose all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, analyses, or recommendations.

Several of the suggestions made by Armstrong's staff are clearly in conflict with the statement's principles and required standards and should be viewed as unacceptable.

a. *Pay local officials to "certify" the ramin used by CI as sustainable. It is not certain whether the ramin would indeed be sustainable or not.* If the payment could be considered a bribe, the company would be in violation of the Foreign Corrupt Practices Act. Knowledge of such a violation of law would be considered a violation of professional ethics.

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.* GAAP requires expenses to be recorded (accrued) when incurred, not when paid (cash basis accounting). Therefore, failure to record the executives' year-end bonus would violate the IMA's standards of credibility and integrity.

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.* This tactic, commonly known as channel stuffing, merely results in shifting future period revenues into the current period. The overstatement of revenue in the current period may mislead investor's to believe that the company's financial well-being is better than the actual results achieved. This practice would violate the IMA's standards of credibility and integrity. Channel stuffing is frequently considered a fraudulent practice.

i. *Recognize sales revenues on orders received but not shipped as of the end of the year.* GAAP requires income to be recorded (accrued) when the four criteria of revenue recognition have been met:

1. The company has completed a significant portion of the production and sales effort.
2. The amount of revenue can by objectively measured.
3. The major portion of the costs has been incurred, and the remaining costs can be reasonably estimated.
4. The eventual collection of the cash is reasonably assured.

Because criteria 1 and 3 have not been met at the time the order is placed, the revenue should not be recognized until after year-end. Therefore, recording next year's revenue in the current year would be a violation of GAAP and would be falsifying revenue. This would be a violation of the IMA's standards of credibility and integrity and may be considered fraudulent.

Three of the suggestions appear to be acceptable:

d. *Reject the change in materials. Counter the bad publicity with an aggressive ad campaign showing the consumer products as "made in the USA," since manufacturing takes place in North Carolina.* This is an acceptable strategy. Consumers could then weigh the employment benefits against the negative environmental effects of the company's actions.

e. *Redesign upholstered furniture to replace ramin contained inside with less expensive recycled plastic.* Creative changes in product design using recycled materials will allow CI to address sustainability concerns as well as protect company profits.

g. *Begin purchasing sustainable North American hardwoods and sell the Indonesian lumber subsidiary. Initiate a "plant a tree" marketing program, by which the company will plant a tree for every piece of furniture sold.* While this solution would increase cost of materials and the price CI must charge for its product, sales and profits may not decline if consumers perceive the value of sustainability and corporate social responsibility.

The other "year-end" actions occur in many organizations and fall into the "gray" to "acceptable" area. Much depends on the circumstances surrounding each one, however, such as the following:

b. *Make deep cuts in pricing through the end of the year to generate additional revenue.* Again, this is only a short-term tactic to improve this year's financial results. Investors may be content in the short run, but in the long run, the new shipping company will see reduced margins from these actions.

h. *Sell-off production equipment prior to 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.* While this course of action does not necessarily violate the IMA's code of ethical standards, it may be only a short-term tactic to improve this year's financial results. Armstrong will need to weigh his options in the long term to make the most cost effective decision for his company.

2. It is possible that any of the "year-end" actions that fall into the "gray" area may be good for investors, depending on the credible evidence that supports the management decision. For example, replacing owned equipment with leased equipment may result in both short-term gains for the company and long-term cost reduction. If so, this decision would be in the best interest of the investors. If the decision only results in short-term gains, but higher costs in the long-run, then the decision may not be in the best long-term interest of the company's investors and should not be implemented solely to prop up short-term earnings.

Those decisions that clearly violate the IMA code of ethical standards (a, c, f, and i) would never be in the best interest of the investor. These options would result in misleading financial statements and could result in the demise of the company or even in criminal charges, as was the case with companies such as Enron and WorldCom. If Armstrong asks the management accountant to take any of the actions that are clearly unethical, he should raise this issue with the chair of the Audit Committee after informing Armstrong that he is doing so. If Armstrong still insists on the management accountant taking these actions, he should resign rather than engage in unethical behavior.