Solutions Manual for Cost Management 5th Hansen

CHAPTER 1
INTRODUCTION TO COST MANAGEMENT

EXERCISES

Exercise 1-1

a. FS
b. FS
c. CMS
d. CMS
e. FS
f. CMS
g. CMS
h. FS
i. CMS
j. CMS
k. FS
l. FS

Exercise 1-2

1. Customers can be internal or external. Users of the component produced by Barry's department are his internal customers. This includes the Assembly Department and the Rework Department. They are directly affected by the quality of the product produced by Barry's department. In a sense, those who buy the cell phones are his customers too—after all, the functionality of the MP3 player is affected by the quality and reliability of its components.

2. Barry's department is producing a low-quality component. One out of every 50 units is having a high defect rate and is causing a lot of rework. Being sensitive would require a dramatic reduction in the defect rate. A reduction in the defect rate would decrease cycle time, lower the rework rate, and decrease costs. These improvements in quality create the potential to increase value for external customers and make the life of internal customers much easier. In turn, these quality enhancements will likely help Hepworth please a key stakeholder (customers) more consistently, thereby increasing sales and/or decreasing quality-related costs, both of which increase Hepworth's value over the long term.

3. Cost management can provide information concerning quality—both financial and nonfinancial. Defect rates can be tracked over time. Rework costs attributable to defective components from Barry's department can be measured and tracked over time. Cycle time reductions due to improved quality can be measured and reported. Product cost reductions attributable to improved quality can be reported.

Exercise 1-3

a. Planning and control
b. Costing of service
c. Costing of product/activity
d. Planning and control
e. Planning and control
f. Decision making
g. Costing of product
h. Planning and control
i. Decision making
j. Costing of service
k. Costing of an activity
l. Planning and control
m. Decision making

Exercise 1-4

The manager is clearly considering unethical behaviors, especially the decisions associated with reducing maintenance and promotional salaries. Extending asset life for depreciation has less clear ethical implications. Reducing maintenance may not hurt much in the short run but will have long-run negative financial consequences. Furthermore, the decision for promotions has been made with a given set of financial expectations, and reducing the salary increases by 50 percent for deserving employees is obviously unfair to them. Although the manager is not a cost or management accountant, he is violating the ethical standard under integrity that requires him to "refrain from engaging in any conduct that would prejudice carrying out duties ethically" (III-2).

The reduction in promotional salary increases is particularly egregious in that he is reducing the salaries of others so that he may benefit. In effect, he is stealing from his subordinates. The reduction in maintenance budget is also a form of stealing—robbing future service potential to produce a current personal benefit.

An ethical dilemma does exist if the manager carries through with his plans. The dilemma exists because the manager wants to manipulate income to achieve personal financial gain. A company code of ethics and compliance monitoring is one recommendation. An internal audit could be used to detect and deter such questionable behavior. Furthermore, a company policy requiring managers to justify any expenditure reductions in writing to both the employees and higher management could discourage behavior like the manager's. The best control, however, is hiring managers with the integrity to do the right thing even when faced with the opportunity to cheat or steal.

Exercise 1-5

1. The controller wants a written record of spoiled material in order to more closely control it. From a behavioral perspective, the formal record keeping of spoilage will make it seem more important to individuals on the factory floor. If the company has a total quality management program in effect, keeping track of spoilage can make it easier to note trends and ensure that spoilage is being reduced over time. Additionally, the formal reporting of spoilage may make it easier to pinpoint the areas in which spoilage occurs and may enable management to improve the system to eliminate spoilage. Employees should be made aware that the purpose of tracking spoilage is to eliminate it, not to fix blame.

   It is possible that everybody doesn't know what the spoilage rate is. Some people may think it is high; others may think it is low. A written record of spoilage will prevent a certain amount of pointless arguing about this. For example, the plant manager will not be forced to rely on the production manager's assessment of spoilage. Instead, both managers can rely on the recorded spoilage to determine how much is occurring and how it can best be reduced.

2. The production manager correctly sees that keeping track of spoilage is additional work. This will cost the plant in one way or another. Even if an additional worker need not be hired, the workers who do record spoilage, by definition, will not be doing something else. The production manager should work together with the controller to see that the costs of recording spoilage do not exceed the benefits. She should also attempt to make the recording as easy as possible and concentrate on the "expensive" spoilage. Finally, her remark indicates that workers may hide spoilage to avoid responsibility. They may "steal" it and then dispose of it, or they may simply pass on a bad unit to the next process. Either approach is costly and not in harmony with the goal of improving quality. These problems can be avoided by training, education, and the installation of controls.

Exercise 1-6

1. *Planning*. The management accountant gains an understanding of the impact on the organization of planned transactions (i.e., analyzing strengths and weaknesses) and economic events (both strategic and tactical) and sets obtainable goals for the organization. The development of budgets is an example of planning.

   Control and evaluation. The management accountant ensures the integrity of financial information, monitors performance against budgets and goals, and provides information internally for decision making. Comparing actual performance against budgeted performance and taking corrective action where necessary is an example of control and evaluation.

Exercise 1-6 (Concluded)

***Continuous improvement*. The management accountant helps identify opportunities for improvement, measures the projected costs and benefits, and reports on the actual outcomes.**

***Decision making*. The management accountant helps in the analysis of various alternatives and in the choice of the optimal course of action.**

2. a. Planning; expected price, cost, and tax information are needed

b. Continuous improvement; cost savings from improved order entry quality and improved customer satisfaction

c. Control and evaluation; a performance report triggered the investigation that led to corrective action

d. Decision making; relevant cost information is needed to decide whether to make or buy the component.

e. Decision making; accounting must analyze cost-volume-profit effects.

f. Continuous improvement; initial quality costs by category with reports revealing their changes over time.

g. Planning; price and cost information with budgeted income statements are needed.

h. Continuous improvement; cost information for moving and waiting activities and finished goods inventories (e.g., carrying costs). Revenues for the increased market share would also be needed.

Exercise 1-7

Kaylin Hepworth is a line manager with direct responsibility for producing a major component of the plant's products. The basic objective of the plant is to produce speakers, and Kaylin plays a direct role in achieving this objective.

Joseph Nguyen is a line manager with direct responsibility for producing speakers. This is the basic objective of the plant. Thus, Joseph has direct responsibility for a basic objective and holds a line position.

Leo Tidwell is staff. He is in a support role—he prepares reports and helps explain and interpret them. His role is to help the plant manager and other line managers more effectively carry out their responsibilities.

PROBLEMS

Problem 1-8

Dear Jade,

I am pleased that you are considering taking an accounting course to complement your hotel and restaurant major. You will find that a basic knowledge of accounting will place you in good stead in dealing with the business aspects of hotel management.

Financial accounting is primarily aimed at outside parties. It involves generating financial statements that describe the assets and liabilities of a business and the periodic income earned. You will find that investors, lenders, the IRS, and other local, state, and federal regulatory and licensing agencies will appreciate a good solid financial accounting system.

Cost management is concerned with determining the costs of things like products, services, and activities. It is also concerned with using financial and nonfinancial information for planning, controlling, continuous improvement, and decision making. In your case, you will want to budget and control costs for a hotel. You may want to determine the costs and revenues of different services. For example, is it worthwhile to offer a Sunday brunch for hotel guests?

As you might guess, courses in both financial and cost management would be of value. If you cannot afford the time to take both accounting courses, a good solid background course in cost and management accounting would be best. Good luck with your goal of becoming a hotel manager!

Sincerely,

Problem 1-9

At first glance, this seems simple. Couldn't John simply mention that Patty had already accepted a position as controller in another company? Since the decision was a close one between the two, this information would likely tip the balance in favor of John. However, some ethical issues should be considered. First, the information that Patty gave was likely given in confidence, and John should not disclose this confidential information without her permission. Second, disclosing the confidential information may provide a personal benefit to John. Third, it may be that Patty will change her mind about the position she has accepted (assuming she can withdraw honorably from the acceptance) once she is officially aware of the promotion. This decision and its consequences should be Patty's and not John's. If I were John, I would leave the response to the promotion entirely in Patty's hands. Once offered the position, she may simply indicate that she cannot accept it because she is committed to another job. This may then cleanly open up the position for John.

Problem 1-10

1. Emily should not implement the suggested accounting procedures because they conflict with generally accepted accounting principles and violate Sections I and III of the Standards of Ethical Conduct for Management Accountants. It raises serious ethical questions in the areas of competence and integrity; e.g., Emily is not able to "perform professional duties in accordance with relevant laws, regulations, and technical standards" or "communicate information fairly and objectively."

2. Emily should discuss the problem with the next highest management level (if the divisional manager's mind cannot be changed). This could be, for example, the corporate controller or the CEO. She could also discuss the matter with an objective advisor to assess possible courses of action. In some firms, ethical hotlines exist that will allow the dilemma to be analyzed. If no resolution is obtained, then resignation may be called for.

Problem 1-11

The proposed changes violate the following ethical standards:

***Competence*. Top management's request for Kala Smith to account for the company's information in a manner that is not in accordance with generally accepted accounting principles violates the standard to "perform professional duties in accordance with relevant laws, regulations, and technical standards." (I-2)**

***Confidentiality*. Top management has violated the ethical standard of "refrain[ing] from using confidential information for unethical or illegal advantage." (II-3)**

***Integrity*. Top management has violated the standard to "avoid actual or apparent conflicts of interest and advise all appropriate parties [other shareholders] of any potential conflict." (III-1)**

The motivation for top management in this circumstance may be reinforced by the favorable bonus situation, which is in violation of the standard to "refuse any gift, favor [bonus], or hospitality that would influence their actions."

***Credibility*. Top management's restriction and distortion of Silverado's financial information violates the standard to "communicate information fairly and objectively." (IV-1)**

By telling Kala to restrict the disclosure of the changes, top management is clearly in violation of the standard to "communicate unfavorable as well as favorable information."

To resolve the ethical dilemma, Kala should first determine if the company has an established policy. If so, he should follow the prescribed policies in resolving the ethical conflict. If there is no policy, then the specific steps are as follows:

a. **To confront top management about the unethical behavior unless Kala feels that they are involved, in which case the problem should be presented to the next higher level, the chairman of the board of directors. If this fails, then the issue can be taken to the audit committee and the board of directors.**

b. **To clarify relevant concepts by confidential discussion with an objective advisor to obtain possible courses of action.**

c. **To resign and submit an informative memorandum to the chairman of the board of directors, if all levels of internal review have been exhausted and the conflict still exists.**

Problem 1-12

By discussing the possible sale of Emery's common stock with members of the troubleshooting team, Gus Swanson has violated the following standards of ethical conduct:

***Competence (I)*. Gus has an obligation to perform his duties in accordance with relevant laws and regulations. By discussing the information he overheard, he may have violated laws regulating the use of inside information.**

***Confidentiality (II)*. Gus has disclosed confidential information acquired in the course of his work that he has not been authorized to share with peers and others within the organization. In addition, he has not informed subordinates of the confidential nature of the information nor has he attempted to prevent the further distribution of this information.**

***Integrity (III)*. By discussing this information, Gus has engaged in an activity that would discredit his profession and prejudice his ability to carry out his duties ethically.**

***Credibility (IV)*. Gus has violated the requirement to communicate all information fairly and objectively.**

Problem 1-13

1. **Assuming the controller did not inform the CEO and CFO of the situation, the ethical considerations of the controller's apparent lack of action, as covered in the Standards of Ethical Conduct for Management Accountants, are as follows:**

   ***Competence (I)*. Management accountants have a responsibility to perform their professional duties in accordance with the relevant laws, regulations, and technical standards. The controller's apparent lack of action regarding the overstatement of inventory and lack of provision for potential purchase commitment losses do not comply with generally accepted accounting principles.**

   ***Integrity (III)*. Management accountants have a responsibility to avoid conflicts of interest, refrain from engaging in any activity that would prejudice their ability to carry out their duties ethically, and refrain from engaging in any activity that would discredit their profession.**

   ***Credibility (IV).* Management accountants have a responsibility to communicate information fairly and objectively and to fully disclose information that could influence an intended user's understanding of the reports.**

Problem 1-13 (Concluded)

2. The recommended course of action that you should take, as described in the Standards of Ethical Conduct for Management Accountants, is as follows:

   Consult company policies and procedures regarding ethical conflict. If the company does not have adequate procedures in place to resolve the conflict, then you should discuss the problem with her immediate superior, the controller. However, as the controller is apparently involved in the matter and she has already spoken to him, it would not be necessary to inform him that she is taking the situation to the CFO.

   Since the issue is still not resolved, she should consult the next higher level of management, the CFO, particularly since he or she will be one of the signers of the representation letter.

   During this process, you could clarify relevant concepts by confidential discussion with an objective advisor to obtain an understanding of possible courses of action. (The IMA maintains a toll-free ethics hotline for members experiencing ethical conflicts.)

   If the issue remains unresolved, you should continue to take the problem to the next higher levels of authority, which may include the audit committee, executive committee, and/or the board of directors.

   If the ethical conflict still exists, after exhausting all levels of internal review, you should resign and submit an informative memorandum to an appropriate representative of the organization.

   Except where legally prescribed, communication of these issues to outsiders (the media, regulatory bodies, etc.) by you is not considered appropriate.

3. The actions that Heart Health Procedures can take to improve the ethical situation within the company include:

   Setting the tone at the top for control consciousness of the people in the organization.

   Establishing an audit committee within the board of directors and providing an avenue for communication free of reprisals within the company.

   Adopting performance-based, long-term financial incentive plans.