

Chapter

1

How Management Accounting Information Supports Decision Making

After completing this chapter, you will be able to:

1. Understand the major differences between financial and management accounting.
2. Appreciate the historical evolution of management accounting to its present set of practices.
3. Understand how management accounting information is used for strategic and operational decision making.
4. Understand the steps of the plan–do–check–act cycle and how each step defines a unique purpose and role for management accounting information.
5. Be sensitive to the behavioral consequences that result from the introduction of new measurement and management systems.

Research in Motion

In September 2010 Research in Motion (RIM), the producer of the BlackBerry smart phone, announced that PlayBook, its entry into the hot tablet market, would be introduced in the first quarter of 2011. This announcement caused a 3% decline in the value of RIM's shares, which analysts attributed to disappointment that the PlayBook would not be available for the December holiday season as previously expected.

RIM, once a smart phone market leader, was experiencing intense competition. Despite the extraordinary success of its BlackBerry products in the business market segment, new competitors such as Apple's iPhone, which had been developed originally for the consumer market segment, had eroded RIM's market leadership position. Apple's latest hot product, the iPad tablet, had achieved extraordinary success since its launch in March 2010 and RIM was under huge market pressure to respond with its own tablet.



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The situation RIM faced in 2010 vividly illustrates the nature of both corporate strategy (choosing the markets in which it will compete) and business unit strategy (choosing how to compete in a given market segment). The strategic decisions that RIM faced required relevant and timely information, much of which is supplied by management accounting information.

WHAT IS MANAGEMENT ACCOUNTING?

Management accounting is the process of supplying the managers and employees in an organization with relevant information, both financial and nonfinancial, for making decisions, allocating resources, and monitoring, evaluating, and rewarding performance. The reported expense of an operating department, such as the assembly department of an automobile plant or an electronics company, is one example of management accounting information. Other examples are the cost of producing a product, the cost of delivering a service, and the cost of performing an activity or business process, such as creating a customer invoice or serving a customer. Nonfinancial management accounting information includes measures related to customer satisfaction and loyalty, process quality and timeliness, innovation, and employee motivation.

Management Accounting and Financial Accounting

Most students study management accounting after taking an initial course in financial accounting. These two subjects share important similarities since both are based on financial information and other quantitative information about business operations. But they differ in important ways.

Financial accounting has the following attributes:

1. It is retrospective, reporting and summarizing in financial terms the results of past decisions and transactions.
2. It is primarily oriented to external stakeholders, such as investors, creditors, regulators, and tax authorities.
3. It must be consistent with rules formulated by standard setters such as the Financial Accounting Standards Board (FASB) in the United States and the International Accounting Standards Board (IASB) for much of the rest of the world, and local country regulatory authorities, such as the U.S. Securities and Exchange Commission (SEC). These standard setters and regulatory authorities specify the content of the reports, the rules for how the content gets developed, and how the content will be presented.

In contrast, management accounting information has the following attributes:

1. It is both retrospective, providing feedback about past operations, and also prospective, incorporating forecasts and estimates about future events. For both retrospective reporting and prospective planning, management accounting uses both financial and nonfinancial measures.
2. It is oriented to meeting the decision-making needs of employees and managers inside the organization. Ideally, a good management accounting system can become a source of competitive advantage for a company.
3. It has no prescribed form or rules about its content, how the content is to be developed, and how the content is to be presented. All of these get determined by managers' judgments and decisions about what best meets their needs for actionable information and is defined entirely by the needs of managers using the information. No standard setter or regulator specifically influences the design of management accounting information and systems.

Management accounting information must be relevant and helpful to managers, and customized to serve multiple purposes.

A Brief History of Management Accounting

In the early 19th century, management accounting consisted of systems to measure the cost of producing individual products, such as a piece of clothing or a weapon. As enterprises grew in scale and scope, the demands for accurate costing information increased. By the middle of the 19th century, railroad managers had implemented large, complex costing systems that allowed them to compute the costs of carrying different types of freight, such as coal and steel, along multiple routes. This information supported efficiency improvements and pricing decisions. The railroads were the first modern industry to develop and use large quantities of financial statistics to assess and monitor organizational performance. Later in the century, Andrew Carnegie, in his steel company, developed detailed systems to record the cost of materials and labor used in his various mills. Carnegie intensively studied and acted on the information from his systems to continually reduce costs in his mills, and to close mills that he felt were irretrievably inefficient. Carnegie exploited his cost advantage by lowering his prices to levels that competitors could not match if they wanted to stay in business. Thus, Carnegie's excellent costing systems gave him a sustainable competitive advantage in the marketplace and promoted the growth and success of his company.

In the early 20th century, companies, such as DuPont and General Motors, expanded the focus of management accounting beyond cost accounting to management planning and control. These large companies replaced market mechanisms with

internal resource allocation to multiple lines of business. Executives needed information, such as return-on-investment by business unit, for coordination and control among these multiple businesses. They used management accounting information to empower and inform the visible hand of management to replace what Adam Smith called the invisible hand of market forces.¹

These organizations sought to improve efficiency and therefore profitability by internalizing what were previously open market transactions and eliminating the costs of transacting with external agents. The rise of these integrated companies created a demand for measuring the performance of individual organizational units to evaluate their performance through comparisons with stand-alone organizations that performed the same task. For example, an automobile company might want to compare the cost performance of a division that makes transmissions with that of an independent supplier, an application that we discuss in Chapter 3. Managers developed ways to measure the profitability and the performance of their units and continue to use them today, as discussed in Chapter 11 of the book.

After these innovations, the evolution of management accounting practice slowed as senior management interest focused on developing and preparing external financial statements that complied with the new reporting and auditing requirements imposed by regulatory authorities in the 1930s. Only in the 1970s, when American and European companies were under intense pressure from Japanese manufacturers, did interest revive in developing new management accounting tools. These tools included systems that reported on quality, service, and customer and employee performance rather than simple financial summaries of organizational unit performance. Also, major advances were made in measuring the cost of products and services to reflect the increasing importance of indirect and support costs required to design and produce a product, deliver a service, and meet a customer's demands. This text features, and in fact is organized around, many recent innovations in cost, profit, and performance measurement systems.

In summary, the history of management accounting illustrates that innovations in management accounting practice were—and continue to be—driven by the information needs of new strategies as companies became more complex, technologies changed, and new competitors appeared. When controlling and reducing costs were important, innovations in costing systems occurred. When organizations gained advantage from scale and diversification, innovative executives developed new management control systems to monitor and manage their complex enterprises. When competitive advantage shifted to how well a company deployed and managed its intangible assets—customer relationships, process quality, innovation, and, especially, employees, new systems for cost and performance management emerged.

IN PRACTICE

Definition of Management Accounting (2008), Issued by the Institute of Management Accountants

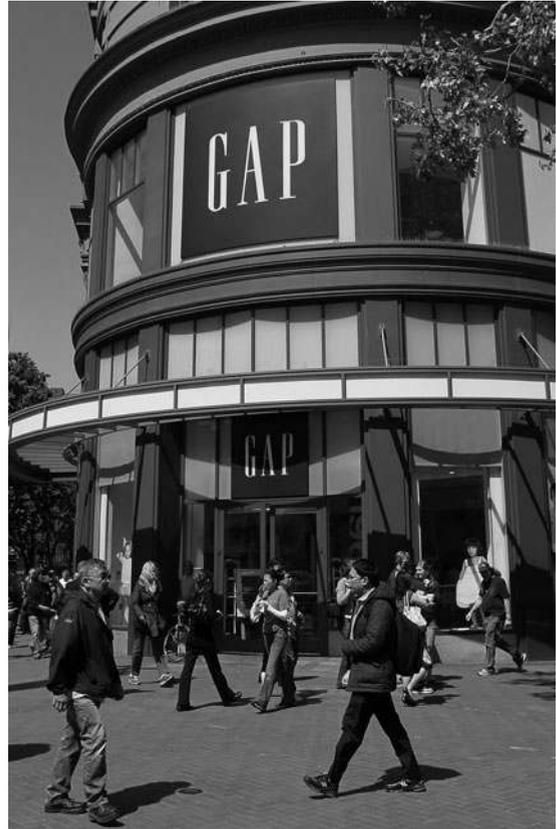
Management accounting is a profession that involves partnering in management decision making, devising planning and performance management systems, and providing expertise in financial reporting and control to assist management in the formulation and implementation of an organization's strategy.

Source: "Definition of Management Accounting," one of a series of Statements on Management Accounting, published by the Institute of Management Accountants, 2008, accessed from http://www.imanet.org/PDFs/Secure/Member/SMA/SMA_DefinManAcct_0408_2.pdf, which may be limited to IMA members.)

¹ Alfred DuPont Chandler, *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, Mass.: Belknap Press, 1977).

The Gap operates retail outlets, such as Banana Republic, Gap, and Old Navy, that target different market segments. Each market segment addresses different customers so the managers in each of the Gap's operating units need different management accounting information to evaluate their performance.

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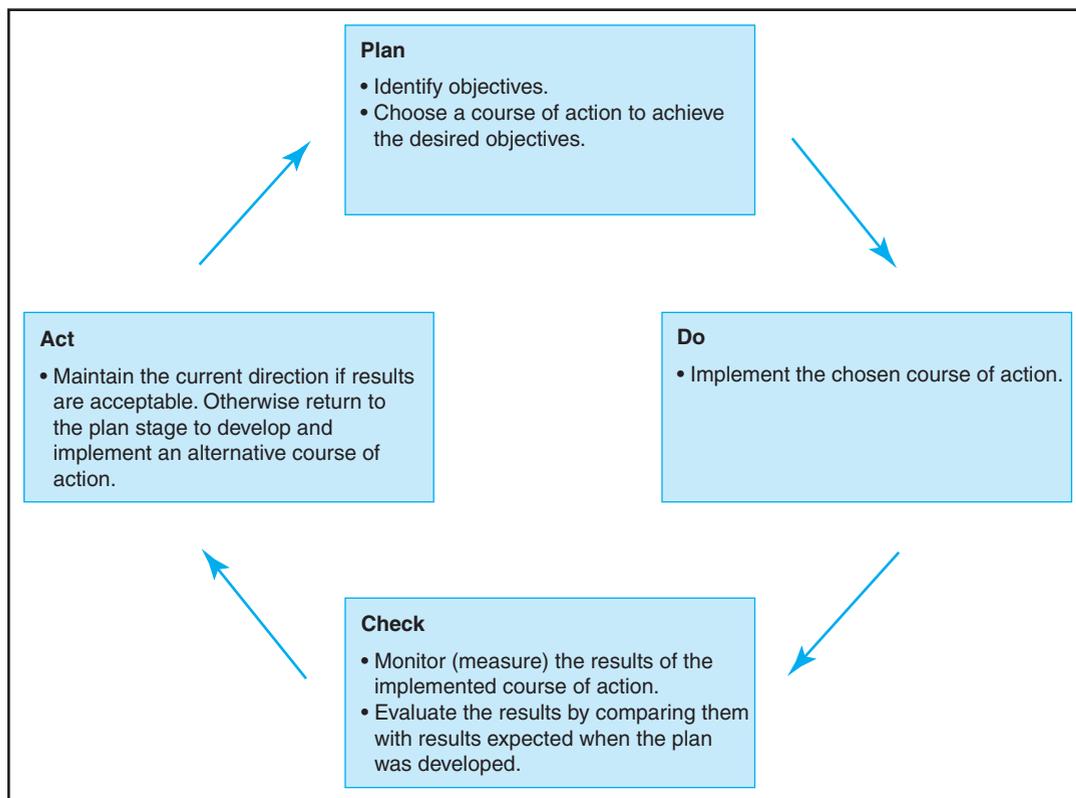
STRATEGY

This book frames management accounting as a discipline that helps an enterprise to develop and implement its strategy. Of course, this also requires that strategic objectives be linked to reporting on and improving operations.

Strategy is about an organization making choices about what it will do and, equally important, about what it will not do. At the highest level strategic planning involves choosing a strategy that provides the best fit between the organization's environment and its internal resources in order to achieve the organization's objectives. Selecting a strategy forces managers to make choices about what markets the organization should target and how the organization will compete in those markets. The details about how to do strategic planning and the type of information and analysis that strategists use to select a particular strategy are covered in strategy courses. But once a strategy has been selected, the organization needs management accounting information to help implement the strategy, allocate resources for the strategy, communicate the strategy, and link employees and operational processes to achieve the strategy. As the strategy gets executed, management accounting information provides feedback about where it is working and where it is not, and guides actions to improve the performance from the strategy. We can view the iterative strategy execution process through the lens of the **plan–do–check–act cycle**, originally developed for improving the quality of products and processes (see Exhibit 1-1).

Exhibit 1-1

The Plan–Do–Check–Act (PDCA) Cycle



The Plan–Do–Check–Act (PDCA) Cycle

Quality expert W. Edwards Deming helped develop and disseminate the plan–do–check–act (PDCA) cycle, and it is often called the *Deming cycle*. Deming proposed it as a systematic and recursive way to develop, implement, monitor, evaluate, and, when necessary, change a course of action. Although Deming’s focus was on improving product and process quality, his idea can be applied to any decision-making activity. We will illustrate how the PDCA cycle can frame the strategic and operational roles for management accounting information.

Plan

The first PDCA step defines the organization’s purpose and selects the focus and scope of its strategy. Many organizations start the planning stage by reaffirming or updating their mission statement, which should be a powerful message to people inside and outside the organization about the organization’s purpose and the value it intends to create in society. The enterprise’s planners then accumulate information about the organization’s external environment (political, economic, social, technological, environmental, and legal), its industry situation, and its internal strengths and weaknesses, relative to competitors. Executives use this information to decide on a strategy (a course of action) to achieve the organization’s objectives. The planning step uses management accounting information in several ways.

IN PRACTICE

A Mission Statement

Virtually every company has a mission statement that expresses its fundamental purpose and how it intends to add value to society through its relationships with customers, shareholders, employees, suppliers, and communities. You can find the mission statements for all Fortune 500 companies at the

website http://www.missionstatements.com/fortune_500_mission_statements.html. As one example, FedEx, a Fortune 500 company, provides its mission statement and other aspects of its system of corporate governance at <http://ir.fedex.com/governance.cfm>



FedEx has crafted a strong mission statement to express its fundamental purpose to shareholders, employees, customers, and suppliers.

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Chapter 2 introduces the strategy map and Balanced Scorecard, two important management accounting tools for planning, deploying, and communicating the strategy. The strategy map and Balanced Scorecard capture management's beliefs about the drivers or causes of success in achieving an organization's objectives. They also provide a systematic way of identifying the management accounting information needed to communicate, monitor, and evaluate the chosen strategy.

Another essential component for the strategy planning stage is to estimate the cost and profit consequences from a course of action. Managers use cost-volume-profit (CVP) analysis, a widely used financial management tool that is introduced in Chapter 3, for profit planning and financial modeling. The chapter starts with the fundamental cost concepts and cost behavior that are the foundation for CVP analysis. Chapter 3 also discusses relevant cost analysis, which is used to help managers make ongoing business decisions such as whether to make or buy a product component, drop or add a product or department, and add or subtract resource capacity. Chapter 3 provides insight into the critical role management accounting information plays in the support of many of the important planning decisions that arise regularly in organizations.

The financial consequences of a strategy are often translated into a budget, perhaps the most widely used short-term financial planning and control tool. To develop

a budget, the organization's financial planners develop a forecast that summarizes the revenue, cost, and profit consequences from the organization's planned activities. Chapter 10 discusses the scope and components of budgeting—an activity you will inevitably confront no matter where your professional career takes you.

Organizations also need to plan for the development of entirely new products and services. Chapter 8 discusses the role of management accounting for designing new products, monitoring the efficiency of the product development process, and assessing the total life-cycle cost consequences from using and disposing of products. End-of-cycle salvage and reclamation costs can be enormous, and information about these future costs for any project are now considered part of any new product development process.

Do

The “do” step of the PDCA cycle involves the implementation of a chosen course of action. In this setting, management accounting information is communicated to front-line and support employees to inform their daily decisions and work activities. Employees use cost, profit, and nonfinancial information to operate and improve processes; market, sell, and deliver products and services to customers; and respond to customer requests. Management accounting information is often used by internal auditing to ensure that the planned strategy and decisions are being faithfully executed. This enforcement role, which is an element of the wider role of corporate governance, has become an important component of the contribution that management accounting information makes in organizations.

Check

The check step in the PDCA cycle includes two components: measuring and monitoring ongoing performance and taking short-term actions based on the measured performance. Management accounting's traditional focus has been on measuring, evaluating, and reporting the costs of ongoing operations. Chapters 4 and 5 develop the nature and elements of systems designed to calculate the cost and profitability of products. Chapter 6 introduces an expanded role for management accounting information by measuring the cost of serving customers and customer profitability. Understanding the profit or loss of a company's multiple products and customers is essential feedback on how well the company's product-line and market strategy is working. Chapter 7 contributes to the check step in the PDCA cycle with its coverage of analyzing and improving operational processes. Chapter 10 describes the traditional financial control tool of variance analysis and Chapter 11 illustrates how management accounting information is used to evaluate overall departmental and business unit performance.

One of this book's innovations is to complement the normal financial focus of management accounting information with extensive treatment of the role of nonfinancial measures of performance. Chapter 2's introduction of the Balanced Scorecard frames the importance and role for nonfinancial information in managers' planning and control decisions. **Nonfinancial information** reports on the critical drivers of long-term financial performance: customers, processes, innovation, employees, systems, and culture. The particular nonfinancial measures most useful for an organization will vary based on its industry and strategy, but generally will include measures of customer loyalty, process quality, and employee capabilities and motivation.

Act

In the final PDCA step, managers take actions to lower costs, change resource allocations, improve the quality, cycle time, and flexibility of processes, modify the product mix, change customer relationships, and redesign and introduce new products. They reward (and occasionally punish) employees based on performance. Rather than a

separate chapter or two on the act step of the PDCA cycle, we have embedded such decision making throughout the book. This emphasizes the fact that management accounting should always be informative and actionable for helping the organization implement its plan. As these new actions get implemented, the management team will eventually return to the planning step to assess whether its previous plan is still valid and worth continuing, or whether it has become time to adapt the plan or perhaps introduce a new strategic plan. This launches the enterprise on another trip around its PDCA cycle.

BEHAVIORAL IMPLICATIONS OF MANAGEMENT ACCOUNTING INFORMATION

Thus far we have emphasized the analytic role played by management accounting information for planning, resource allocation, decision making, acting, monitoring, and improving. Although the role of management accounting information is essential for supporting decisions and solving problems, information is never neutral. The mere act of measuring and informing affects the individuals involved. A famous study conducted in the 1920s at the Hawthorne Plant of the Western Electric Company concluded that individuals and groups alter their behavior when they know they are being studied and their performance is being measured. People react when they are being measured. They focus on the variables and behavior being measured and pay less attention to those not being measured. Some people have overstated this effect by declaring, “What gets measured gets done.” More accurately, the expression should be “If you don’t measure it, you can’t manage and improve it,” which can be taken as one of the fundamental rationales for studying and implementing management accounting systems.

It is normal, however, as managers introduce or redesign cost and performance measurement systems, for people familiar and comfortable with the previous systems to resist change. These people have acquired expertise in the use (and occasional misuse) of the old system and are concerned about whether their experience and expertise will be transferable to the new system. People also may feel committed to the decisions and actions taken on the basis of information an old system has produced. These actions may no longer seem valid based on the information produced by a newly installed management accounting system. Thus, a new management system can lead to embarrassment and threat, a trigger for reactions against change. The design and introduction of new measurements and systems must be accompanied by an analysis of the behavioral and organizational reactions to the measurements, a topic we discuss extensively in Chapter 9. Even more important, when the measurements are used not only for information, planning, and decision making but also for control, evaluation, and reward, employees and managers place great emphasis on the measurements themselves. Managers and employees may take unexpected and undesirable actions to influence their score on the performance measure. For example, managers seeking to improve current bonuses based on reported profits may skip discretionary expenditures such as preventive maintenance, research and development, and advertising that may improve performance in future periods.

Thus we must be ever vigilant to not only see the analytic, or left-brain, properties of management accounting information but also appreciate the emotional, or right-brain, reactions by individuals to the information used to monitor and evaluate their performance.

SUMMARY

This chapter introduced the role and nature of management accounting within the PDCA planning and control cycle. Management accounting must inform the actions and decisions made by managers and employees. This is why the generation and use of management accounting information must be driven by the organization's strategic choices. Management accounting information also monitors and evaluates the results from implemented decisions. It leads to

new actions to improve the implementation of the intended strategy through operational enhancements, decisions about products, processes, and customers, new product introductions, and, perhaps most important, better motivated and empowered managers and employees. But all new measurement and management systems must be introduced with sensitivity to the reactions of employees and managers to the act of measurement.

KEY TERMS

financial accounting, 3
management accounting, 2

nonfinancial information, 8
plan–do–check–act cycle, 5

strategy, 5

ASSIGNMENT MATERIALS

Questions

- 1-1 What is management accounting? (LO 1)
- 1-2 Why do a company's operators/workers, managers, and executives have different informational needs than shareholders and external suppliers of capital? (LO 1, 3)
- 1-3 Why may financial information alone be insufficient for the ongoing informational needs of operators/workers, managers, and executives? (LO 1, 3)
- 1-4 Why might senior executives need measures besides financial ones to assess how well their business performed in the most recent period? (LO 1, 3)

- 1-5 Provide examples of how management accounting systems have changed in response to information needs as companies have become more complex, technologies have changed, or new competitors have appeared. (LO 1, 2)
- 1-6 Given a selected strategy, how do organizations use management accounting information to implement the strategy? (LO 3)
- 1-7 Briefly explain each of the four steps of the plan–do–check–act cycle. (LO 4)
- 1-8 How can management accounting information produce behavioral and organizational reactions? (LO 5)

Exercises

- LO 1, 3, 4, 5 1-9 *The role of management accounting* Consider the descriptions of management accounting provided in the chapter. Discuss why the associated responsibilities are viewed as “accounting” and how people handling those responsibilities interface with other functional areas in fulfilling the stated responsibilities. What skills and knowledge does one need to fulfill the responsibilities?
- LO 1, 3 1-10 *The plan–do–check–act cycle* For each of the four steps of the plan–do–check–act cycle, describe examples of possible uses of management accounting information.
- LO 1, 3 1-11 *Different information needs* Consider the operation of a fast-food company with hundreds of retail outlets scattered about the country. Consider the descriptions of management accounting provided in the chapter to identify management accounting information needs for the following:
 - a. The manager of a local fast-food outlet that prepares food and serves it to customers who walk in or pick it up at a drive-through window
 - b. The regional manager who supervises the operations of all the retail outlets in a three-state region

- c. Senior management located at the company's corporate headquarters. Consider specifically the information needs of the president and the vice presidents of operations and marketing.
Be sure to address the content, frequency, and level of aggregation of information needed by these different managers.
- LO 1, 3** **1-12 *Different information needs*** Consider the descriptions of management accounting provided in the chapter to identify management accounting information needs for the following:
- The managers of (1) a patient unit, where patients stay while being treated for illness or while recuperating from an operation, and (2) the radiology department, where patients obtain X-rays and receive radiological treatment
 - The manager of a nursing service who hires and assigns nurses to all patient units and to specialty services, such as the operating room, emergency room, recovery room, and radiology room
 - The chief executive officer of the hospital.
- Be sure to address the content, frequency, and level of aggregation of information needed by these different managers.
- LO 3** **1-13 *The elements of quality*** For each of the following products, suggest three measures of quality:
- Television set
 - University course
 - Meal in an exclusive restaurant
 - Carryout meal from a restaurant
 - Container of milk
 - Visit to the doctor
 - Trip on an airplane
 - Pair of jeans
 - Novel
 - University textbook.

Problems

- LO 1, 3** **1-14 *Differences between financial and managerial accounting*** Many German companies have their management accounting department as part of the manufacturing operations group rather than as part of the corporate finance department. These German companies operate two separate accounting departments. One performs financial accounting functions for shareholders and tax authorities, and the other maintains and operates the costing system for manufacturing operations.

Required

What are the advantages and disadvantages of having separate departments for financial accounting and management accounting?

- LO 1** **1-15 *Differences between financial and managerial accounting*** The controller of a German machine tool company believed that historical cost depreciation was inadequate for assigning the cost of using expensive machinery to individual parts and products. Each year, he estimated the replacement cost of each machine and included depreciation based on the machine's replacement cost in the machine-hour rate used to assign machine expenses to the parts produced on that machine. Additionally, the controller included an interest charge, based on 50% of the machine's replacement value, into the machine-hour rate. The interest rate was an average of the three- to five-year interest rate on government and high-grade corporate securities.

As a consequence of these two decisions (charging replacement cost rather than historical cost and imputing a capital charge for the use of capital equipment), the product cost figures used internally by company managers were inconsistent with the numbers that were needed for inventory valuation for financial and tax reporting. The accounting staff had to perform a tedious reconciliation process at the end of each year to back out the interest and replacement value costs from the cost of goods sold and inventory values before they could prepare the financial statements.

Required

- (a) Why would the controller introduce additional complications into the company's costing system by assigning replacement value depreciation costs and imputed interest costs to the company's parts and products?
- (b) Why should management accountants create extra work for the organization by deliberately adopting policies for internal costing that violate the generally accepted accounting principles that must be used for external reporting?

LO 1, 3, 4 **1-16** *Role of financial information for continuous improvement* Consider an organization that has empowered its employees, asking them to improve the quality, productivity, and responsiveness of their processes that involve repetitive work. This work could arise in a manufacturing setting, such as assembling cars or producing chemicals, or in a service setting, such as processing invoices or responding to customer orders and requests. Clearly the workers would benefit from feedback on the quality (defects, yields) and process times of the work they were doing to suggest where they could make improvements. Identify the role, if any, for sharing financial information with these employees to help them in their efforts to improve quality, productivity, and process times. Be specific about the types of financial information that would be helpful and the specific decisions or actions that could be made better by supplementing physical and operational information with financial information.

Cases

LO 1, 3, 4 **1-17** *Different information needs* Julie Martinez, manager of the new retail outlet of Super Printing, is pondering the management challenges in her new position. Super Printing is a long-established printing company in a major metropolitan area. The new Super outlet, located at the edge of the parking lot for Western Business School, represents Super's attempt to break into the rapidly growing business for retail digital imaging.

The Super retail store provides a range of copying and digital imaging services for the business school's students, faculty, and administrators, plus other retail customers. Super's primary products are black-and-white copies of documents. Variation exists even in this basic product, however, as consumers can choose from a variety of paper colors, sizes, and quality. Super recently purchased a machine that prints color copies from digital input. Color copies also can be produced in a variety of sizes, paper quality, and paper types, including transparencies for overhead projection and photographic-quality reproductions. Other printing products include business cards, laminated luggage tags, and name badges for conferences, executive programs, and students.

In addition to physical printing, the Super center provides fax services by which individuals can both receive and transmit documents. When incoming faxes are received, a store employee calls the recipient, who stops at the outlet to pick up the document. The center also has several personal computers, both Windows-based and Macintosh, that students rent by the hour for basic computer processing, Internet access, e-mail, and preparing presentations and résumés. Each computer is

connected to Super's black-and-white and color printers, enabling students to produce paper copies of their presentations and résumés.

Super has other machines that assemble printed pages into bound documents. Two different binding types are available. The store also sells a limited selection of office supplies, including paper, envelopes, paper clips, glue, binders, tabs, pens, pencils, and marking pens.

Currently, about five employees (including Julie) work at the retail outlet during prime hours (8:00 A.M. to 5:00 P.M.) with two to four people working the evening shift (5:00 P.M. to midnight) when walk-in business is much slower. The number of people working during the evening hours is determined by the anticipated backlog of reproduction work that will be performed during these hours.

Prices for the various products and services have been set based on those of competitors, such as FedEx Kinko's and Staples. Julie receives a daily report on total sales, broken down by cash sales, credit card sales, and credit sales to various programs at the business school; however, she currently does not have a report on expenses such as labor, materials, and equipment for each line of business (black-and-white and color printing, computer services, document preparation, fax services, and sales of office supplies). Thus, Julie is unsure whether each line of business is profitable. Julie is also unsure how efficiently the business is run.

Further, the different business lines require different quantities and types of capital: equipment such as copying and printing machines, computers, and facsimile machines; physical capital such as office space; and the different inventories of paper types, colors, grades and sizes, and office supplies.

If the pilot store that Julie is operating is successful, then the parent company will likely try to open many similar outlets near schools and universities throughout the metropolitan area. For this purpose, the parent company wants to know which business lines are the most profitable, including the cost of capital and space required, so that these lines can be featured at each retail outlet. If some business lines are not profitable, then Super probably will not offer those services at newly opened stores unless they are necessary to build retail traffic.

Required

Identify the management accounting information needs for the following:

- (a) An employee desiring to help serve customers more efficiently and effectively
- (b) Julie Martinez, the manager of the pilot retail outlet
- (c) The president of Super Printing

Be sure to address the content, frequency, and level of aggregation of information needed by these different individuals.

LO 1,3 1-18 Information for employee empowerment A U.S. automobile components plant had recently been reorganized so that quality and employee teamwork were to be the guiding principles for all managers and workers. One production worker described the difference:

In the old production environment, we were not paid to think. The foreman told us what to do, and we did it even if we knew he was wrong. Now, the team decides what to do. Our voices are heard. All middle management has been cut out, including foremen and superintendents. Management relies on us, the team members, to make decisions. Salary people help us make these decisions; the production and manufacturing engineers work for us. They are always saying, "We work for you. What do you need?" And they listen to us.

The plant controller commented as follows:

In traditional factories, the financial system viewed people as variable costs. If you had a production problem, you sent people home to reduce your variable costs. Here, we do not send people home. Our production people are viewed as problem solvers, not as variable costs.

Required

- (a) What information needs did the production workers have in the old environment?
- (b) What information do you recommend be supplied to the production workers in the new environment that emphasizes quality, defect reduction, problem solving, and teamwork?

LO 1, 3, 4 1-19 *Financial information for continuous improvement* The manager of a large semiconductor production department expressed his disdain for the cost information he was presently given:

Cost variances are useless to me.² I don't want to ever have to look at a cost variance, monthly or weekly. Daily, I look at sales dollars, bookings, and on-time delivery (OTD)—the percent of orders on time. Weekly, I look at a variety of quality reports including the outgoing quality control report on items passing the final test before shipment to the customer, in-process quality, and yields. Yield is a good surrogate for cost and quality. Monthly, I do look at the financial reports. I look closely at my fixed expenses and compare these to the budgets, especially on discretionary items like travel and maintenance. I also watch headcount.

But the financial systems still don't tell me where I am wasting money. I expect that if I make operating improvements, costs should go down, but I don't worry about the linkage too much. The organizational dynamics make it difficult to link cause and effect precisely.

Required

Comment on this production manager's assessment of his limited use for financial and cost summaries of performance. For what purposes, if any, are cost and financial information helpful to operating people? How should the management accountant determine the appropriate blend between financial and nonfinancial information for operating people?

LO 1, 2, 3, 4, 5 1-20 *Comprehensive performance measurement in public and nonprofit organizations* Organizations in the public and nonprofit sector, such as government agencies and charitable social service entities, have financial systems that budget expenses and monitor and control actual spending. Explain why these organizations should consider developing a comprehensive set of performance measurements (including nonfinancial measures) to monitor and report on their performance. Provide examples of financial and nonfinancial measures that should be included in such a comprehensive set of measurements.

² We will study cost variances in later chapters. For the purposes of this case, it is sufficient to recognize that a cost variance represents the difference between the cost actually assigned to a production department and the cost that was expected or budgeted for that department.