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## Cost Management and Strategy

**Teaching Notes for Cases**

**1-1. Critical Success Factors**

The critical success factors for Kirsten’s business, including the proposed new publishing business are related to the needs of these customers, which probably includes, now and into the future:

* timeliness of the information in the publishing business
* reliability of the repair and consulting business
* expertise and ability to solve problems which competitors may not be able to solve
* ability to respond quickly, faster than her competitors
* since her business probably grows primarily on the basis of references and recommendations from satisfied customers, the ability to consistently satisfy her current customers is critical; she should not try to grow too fast or to move into new areas in which she cannot be immediately successful

The cost information she will need will be primarily in the management functions of (1) strategic management and (2) management and operational control. In the strategic management area, she will need cost information to understand which of her businesses is most profitable, which she can be most competitive in from a cost perspective, and to provide a basis for analysis of potential new businesses. Strategic management methods are covered in Parts One, Two and Six of the book. In management and operational control, she will need cost information to provide a fair and effective basis for identifying the most inefficient operations, and for rewarding the most effective managers. Operational control is covered in Part Five and management control is covered in Part Six.

**1-2. Contemporary Management Techniques**

Delight competes in both a low-cost/low-price market (wholesale) and in a less price-sensitive market where its innovation and product leadership are critical. The benchmarking, continuous improvement, activity-based costing, and theory of constraints techniques are likely to be used in the low-cost market. These techniques are used to assist in reducing production costs. In addition, target costing can be used for those products which have significant development costs, to focus the design effort on developing a profitable product.

Total quality management is probably used by Delight in both market segments. Quality is important to both types of customers. Also, life-cycle costing can be used in either market segment, to give Delight a basis for analyzing the profitability of each of its products over its entire life cycle. This will be especially important for products which require substantial development costs.

**1-3. Pricing; Ethics**

The staff cost analyst has the responsibility to notify immediate supervisors that the decision to cancel plans for the new cost system, without appropriately informing the U.S. Government of the implications for the contract, is unethical. Because of the accountant’s responsibility for confidentiality, the accountant should not report the matter outside the firm. The only exception to this confidentiality requirement would be a legal requirement to disclose the matter, as would be the case in a court order.

The accountant should also carefully consider whether the ethical climate in the company is sufficiently weak that it would be appropriate to leave the company. Is this an isolated incident or one of a pattern of incidents which reflect a pervasive unethical climate?

**1-4 Selected Ethics Cases**

1. The action of the COO is both unethical and illegal. If the beer was near to (but not past) its shelf life, potential customers should be advised, but if the beer is past the shelf life, the sale of the beer is illegal as well as unethical. It is also likely, depending on the degree of care taken by local authorities, that an inspection of the firm’s records will disclose the illegal act. If Jim is directly involved in the decision, then he should clearly state to immediate supervisors that the action is illegal and unwise, and refuse to take part in it. If Jim on the other hand becomes indirectly involved as an observer or becomes aware of it from others, then he should again state clearly to his immediate supervisors that the action is improper and unethical. In either case, Jim should not inform anyone outside the firm, because of his ethical responsibility to maintain the confidentiality of his employer.

2. As in part 1 above, the action of the firm appears to be in conflict with local laws. While the ethical principles are not as clear in this case, Jim is obliged to comply with local laws and ordinances, and as such should refuse to become directly involved in the act, and to report the impropriety to his immediate supervisor.

3. Since disclosure of insider information is in conflict with SEC regulations, Jim should be careful to say nothing that would provide assistance to his friends, even if it appears they may have already heard the information from another source. Jim would be subject to SEC penalties, and from an ethical standpoint, the disclosure would be unfair to the current and potential investors in the firm.

4. The salesman’s action is an unethical attempt to manipulate the financial report of the firm and to cause his or her sales commission to be received earlier than is appropriate. An evaluation of an action like this is likely to consider also the materiality of the amount. If the amount is small, then the effect on the financial report is not material, and Jim might then view the action as improper, but not requiring disclosure. On the other hand, if Jim finds that the salesperson has been doing this for some time, or if the amount involved is material, then it would be appropriate to inform the salesperson and the salesperson’s immediate supervisor.

5. The marketing executive’s action is unethical, in effect, stealing from the company. There is also a possibility from what the executive has said that there is an outside business which might compete with the company. This would also be unethical. As in part 4 above, the materiality of the amount and the possibility of a pattern to the action would have an important effect on Jim’s evaluation of the incident.

* 1. **Strategy; Branding Beef**

1. The meatpacking industry overall is probably best described as a commodity business. The product is hard to differentiate other than by USDA grade or preparation (percent lean,…). On the other hand, some meatpackers and supermarkets are able to differentiate their product through careful selection of the meat, and focus on freshness and customer service. Husker Beef Company ([huskerbeefco.com](http://www.huskerbeefco.com)) and Kansas City Steak Company ([kcsteak.com](http://www.kcsteak.com)) are two examples of firms in the industry that differentiate.

2. The meatpackers plan to address some of the issues with preparing meat meals that are likely to be the cause of the decline in beef purchases over the last few decades. The new focus is on convenience for the customer by reducing food preparation time, and by making the food preparation process simpler so that the product is can be served with the best possible flavor and nutritional benefit.

Two of the largest meatpackers, Hormel and IBP Inc. are developing new products that improve convenience for the customer. For example, one new Hormel product, called “Always Tender” is prepared with a patented solution of salt, vinegar, and sugar to keep the meat moist, even if it is overcooked.

Also, the firms are putting more effort into marketing their product, with the goal of developing a brand image and brand loyalty. For example, IBP Inc is using the Wilson brand, and will advertise it as the centerpiece of family time, not just a meal. Together, these efforts change the nature of the competition from a commodity-based, cost leadership type to a differentiated type of competition based on customer convenience.

* 1. **Top 10 Companies**

This question is intended for class discussion in which a number of different views are likely to be expressed. I would make the observation that many of the top 10 firms in sales are cost leaders, either low cost retailers (Wal-Mart) or commodity producers (the energy companies). One might also observe that the global demand for oil products and the price increases in these products in recent years have affected the energy companies significantly, and is a reason why they are in the top 10. I would also point out that many cost leadership firms are very large because they succeed on very low margins, and therefore attain a very large size to sustain the low margins and still show strong earnings growth. Note for example that Wal-Mart is top in sales and 6th in earnings. Large manufacturers such as GM, Ford and GE are not easily identified as cost leaders or differentiators, but are established companies that have attained large size.

The list of most profitable firms includes both costs leaders and differentiators. Berkshire Hathaway and J.P Morgan Chase (financial firms), Apple, and IBM can be identified with differentiation, as innovation and customer service are key elements of their success. Alternatively, ExxonMobil and Chevron deals with a global commodity, and Microsoft and AT&Tare not easily identified as cost leaders or differentiators.

Source: [*Fortune.com*](http://www.Fortune.com)

An interesting note is that the 2001 list for Largest Revenue has 8 of the same firms from the 2008 list; also 8 of the Top Firms in profits are on both the 2008 and 2011 lists.

**Teaching Strategies for Articles**

**1-1 “Are You a Business Partner?”**

This article is based on interviews of 100 accountants who have made the transition to business partner. For firms such as McDonalds, Trane, and Boeing, they explain the transition from traditional accountant to accountant as business partner.

Discussion Questions

1. What are the key findings of the recent research of 100 accountants, now business partners?

The article begins by defining a business partner as one who works in teams with members of other disciplines to improve business processes and work for the overall success of the firm or organization.

The traditional accountant of the past was viewed as an information specialist who was valued for collecting and recording data, paying the bills, and in helping others make decisions. Accountants did not participate in decision making, and if fact, tended to work in some degree of social and physical isolation. There was no expectation that the traditional accountant would interpret or analyze the information and become part of the decision making team.

In contrast, the accountant as business partner uses a broad knowledge of the firm’s strategy and operations and competitive position to work with managers in developing the information needed to help the firm be successful, and in participating with these managers in the decision making process.

2. What are the implications of these findings for the education and training of management accountants?

The accountant as business partner needs an entirely different skill set from that of the traditional accountant. These skills include team building skills, analytical skills, and communication skills, together with a solid understanding of the firm’s operations and competitive position.

* 1. **Creating an Ethical Culture**

This article takes a look at the financial fraud at WorldCom and other companies in recent years, and examines the role of controls and the ethical culture in the frauds that occurred in these companies. In considers the following questions. How does the ethical culture effect the risk of fraud? How does a company develop an ethical culture?

**Discussion Questions**:

1. According to the article, did World Com lack internal controls to detect fraud? Why was the fraud not detected earlier, or prevented all together?

The article suggests that internal controls were adequately in place at World Com, but the fraud that occurred there was enabled by the culture that permitted unethical conduct. The point is that to reduce the risk of fraud, the company must focus as much on developing an ethical culture within the company as it does on compliance with internal accounting controls, as required under section 404 of the Sarbanes-Oxley Act of 2002. The reason the fraud was not detected earlier is that the culture within the company supported the unethical environment there.

2. According to the Culture Risk Assessment model, what are the levels of values of an organization and what are the objectives of each?

The levels and objectives of each are identified in Figure 1 in the article:



3. What are some of the ways a company can help to develop an ethical culture?

* The criteria for success of an ethics program must be outcomes based.
* Each organization must identify the key indicators of its culture.
* The organization must gauge how all levels of employees perceive adherence to values by others within the company.
* Formal programs are guides to shape the culture, not vice versa.
  1. **POGS at the Park, POGS at home: C-ing Business Expansion Opportunities**

This article explains the competitive environment for a minor league baseball team. An innovative manager of the team uses strategic cost management concepts for achieving greater profitability.

**Discussion Questions**

1. Explain whether Greg uses a cost leadership or a differentiation strategy, and why. How does his plan for the POG oven initiative fit with this strategy?

The Pikesville Lightning team is best described as a differentiator. The special elements Greg uses to promote the team, as illustrated in Table 1, are a good example of how the team differentiates itself not only as a minor league baseball team, but also as a competitor for other types of family entertainment. The POGS oven initiative fits very well into the differentiation strategy since in reinforces one of the key differentiators of the team, the “out of the park” hot dog sold at Waterfall Stadium. Also, it provides a way for Lightning to have in place in the homes of the team’s fans a reminder of the fun of game days. So during the off-season, the fans can enjoy a POG and look forward to the start of the next season.

2. Use the C-Framework in Figure 1 to outline your advice to Greg for improving the strategic financial management function. Be sure to discuss how your advice will assist the organization in achieving Greg’s goals.

The CFO Framework in Figure 1 is a useful summary of the many ways in which the accounting function, as represented here by the CFO (Chief Financial Officer), supports the success of the firm. The CFO levers and Company levers can be compared to the 13 contemporary management techniques described in the chapter. Each of these “levers” helps the team achieve success by helping the team to identify and implement a strategy for success. In this case, Greg uses Game Day Events and Special Game Day Experiences (Table 1) and strategic initiatives such as the POGS oven to achieve success. The role of the management accountant is at the center of the C-Framework, providing the management accounting expertise and the knowledge of the team’s business and competitive environment to make the decisions and introduce the initiatives that will help the team succeed.

**1-4 Leading with Your Soul**

This article focuses on ethical leadership. Today’s business environment is not often conducive to ethical practices. The author points out that everyday ethics do not differ from business ethics, although the hindrances to ethical practices in the business world are many. An in-depth examination of the Comprehensive Ethical Leadership ModelTM explains the six ethical leadership traits. These traits are given in the article and then a discussion of applying the traits follows.

**Discussion Questions**:

1. What are some of the main reasons, according to the article, that professionals struggle with ethics in the professional world today?

Some of the reasons include: not having the emotional strength to stand up for what is right, not willing to confront issues, and not willing to sacrifice the impending personal material gain

1. In looking at the example of a CFO who overworks his or her employees due to financial and performance pressures, what are the main deterrents for this CFO to act ethically?

The hindrances to ethical actions can be summarized as:

**1.** Professional and social pressures,

**2.** Pursuit of pleasure,

**3.** Desire for power,

**4.** Pride and the need to be a winner at any cost, and

**5.** Conflicting priorities.

1. How do the four-dimensions of a person contribute to ethical behavior?

“The fundamental reality is human beings are not things needing to be motivated and controlled; they are four-dimensional—body, mind, heart, and spirit.” Stephen Covey (renowned author of time management books and the book on “Seven Habits”), writing in the Summer 2006 issue of *Leader to Leader*, conveyed the message of respect for individuals as complete human beings, recognizing their need for survival (body), relationships (heart), continued learning (mind), and social contribution (spirit). This endeavor, if not followed through with utmost commitment, has the potential to cripple individuals and society because sustaining individuals is at the heart of sustaining the global society. Covey also said, “A new era is for greatness. It’s for fulfillment, passionate execution, and significant contribution….Leadership in the knowledge worker age will be characterized by those who find their own voice and who, regardless of formal position, inspire others to find theirs.”

**The four dimensions: body, heart, mind, and spirit**

4. What are the six ethical leadership traits?

1. Purpose driven
2. Courage of conviction
3. Whole person approach
4. Empowerment
5. Succession planning
6. Emotional intelligence

**1-5 Seven Habits**

This article points out that the role of CFOs today is multi-faceted and not as specialized as it used to be. CFOs play an especially important role in forming the strategies of companies. This excerpt walks the reader through seven critical steps: setting clear expectations for each business line, using synergies across portfolios, the tradeoff between cost-savings and customer loyalty, what to do in downturn business cycle and honing in on key growth opportunities.

**Discussion Questions**:

1. Describe how CFOs today are different from CFOs in the past.

In this charged environment, many CFOs have had to evolve from specialists in accounting to generalists in growth. Chief financial officers were once specialists in accounting and maybe taxes and treasury as well. We were, in essence, high-level bean counters assigned to track and report revenues and profits. Traditional CFOs were also gatekeepers, ensuring that company initiatives didn’t go forward unless they promised to generate acceptable rates of return.

1. What does it mean to grow a business organically and how does that contribute to managing to the portfolio?

In addition to managing diverse business lines, another dimension of managing to the portfolio involves growing the company organically, from the inside out, by extending and adding capabilities to the core business. Leveraging your existing capabilities to expand into adjacent, complementary lines of business can help your company meet the growth expectations of investors without the distractions often caused by acquisitions.

3. What are the seven habits of strategic CEOs?

1. Take a seat at the strategy table
2. Define and manage return expectations
3. Manage to the portfolio
4. Help nurture a customer-driven growth culture
5. Don’t be afraid to prune
6. Fertilize in the winter
7. Know when to buy and when to build

**1-6 Test Your Ethical Judgment**

This reading provides you with the opportunity to use scenarios from the WorldCom accounting standards in 2001 to test your own response to ethical issues. It also provides recommended solutions to each instance presented.

**Discussion Questions**:

**1 Recommended solutions for 14 cases:**

All 14 scenarios are taken directly from WorldCom activities occurring during 2001.While the WorldCom scandal has many more facets to it than can be presented in a few short scenarios, these scenarios are indicative of both the work environment at WorldCom and the types of accounting fraud that occurred.

While 2001 is quickly becoming a distant memory, we must never forget the lessons learned. Fraud at WorldCom—along with Enron and others—brought our stock market prices down, tarnished the reputations of all accountants, felled a global accounting firm that was once known as the “gold standard” of accounting firms, revealed gaping flaws in U.S. Generally Accepted Accounting Principles (GAAP), and eventually brought about the rise in International Financial Reporting Standards (IFRS). In short, it changed our world.

The information in the scenarios and in some of the suggested solutions comes from published information listed in the References sidebar. Each answer below is keyed to the corresponding reference number so you can look up further information if you want. The references are to the reference list at the end of the article.

**ANSWER to 1: C.** A certain amount of stock market

pressure is to be expected, but the additional pressure

from a CEO whose financial security is *precariously*

dependent on keeping the stock price stable is very troubling. Clearly, ethical tension is both evident here and improper. Intense pressure can distort people’s objectivity and erode their integrity. **Ref. 1, 4**

**ANSWER to 2: C.** Employees shouldn’t be paid significantly more than they are worth in the marketplace for a variety of reasons. First, overpaying employees is an inefficient use of corporate funds. Second, and most important,

this practice may make employees beholden to their

superiors and distort their objectivity. This may create an environment where ethical problems could ferment as they did at WorldCom. **Ref. 5**

**ANSWER to 3: D.** This scenario goes well beyond an issue of confidentiality. Employees need full access to the information necessary to make competent decisions related to their positions. Denial of proper access appears to indicate that something is being hidden. **Ref. 1**

**ANSWER to 4: B.**While it is certainly good business

practice to manage your most important ratio, reporting a steady ratio during extreme volatility may lack credibility. The suspicion is that the ratio may not fairly represent the operations of the business.

**ANSWER to 5: C.** The Audit Committee’s proper role involves much more than merely listening to the final report for the year completed and the plan for the current year. The Bankruptcy Court finds that they “have not identified any effective participation by the Audit Committee in setting the internal audit plan. Under such circumstances, the ability of senior management to influence the focus of the Internal Audit Department away from sensitive areas may be left without the control check which the Audit Committee is expected to provide.” (The quote comes from Ref. 4, pp. 55-56.) Without proper oversight, objectivity may become compromised.

**Ref. 2**

**ANSWER to 6: D.** Such an extended delay of scheduled audits without the Board of Directors’ explicit approval leads one to wonder why Internal Audit is being distracted from their proper role. The responsibility of the Internal Audit function is compromised. **Ref. 5**

**ANSWER to 7: A.** Estimates are involved with many adjusting entries.

**ANSWER to 8: E.** No journal entry should be prepared without proper support. Journal entries are never to be booked in order to meet the budget but must always be booked to reflect actual business activity only. In this scenario at WorldCom, the costs in question were line costs (the cost of essentially renting the use of telephone communication lines that customers use to connect conversing parties; the lines aren’t owned by WorldCom). Supporting documentation ensures objectivity; fairness requires

the financials to reflect actual operations and not just

budgeted targets. **Ref. 1**

**ANSWER to 9: E.** Periodic rent provides current period benefits but no future economic benefits owned or controlled by the company despite the fact that its payment may be fixed for an extended future period of time. Honesty is at issue here given the assumption that lack of competency isn’t the cause. Again, the WorldCom counterpart to this scenario deals with line costs. **Ref. 1**

**ANSWER to 10: E.** Unfortunately, not everything at

WorldCom turned out okay. Accountant Troy Normand faced this particular situation while failing all four principles of ethical conduct. He had good reason to be uncomfortable with this fraud. Speaking to the CFO about his concerns was indeed appropriate, but nothing else he did was proper. As a consequence of his actions and inactions at WorldCom, Troy Normand pleaded guilty to conspiracy and securities fraud. He wasn’t alone.

The CFO, Scott Sullivan, pleaded guilty to three counts of securities fraud and is spending five years in jail. **Ref. 3, 5**

**ANSWER to 11: E.** So now we know that the fraud at WorldCom occurred, was then allowed to continue unreported, and was actually encouraged. This controller, David Myers, spent one year and one day in jail after pleading guilty to securities fraud, conspiracy to commit securities fraud, and false filings. His competence was never questioned. He clearly knew right from wrong, yet he still chose the fraudulent path. **Ref. 1**

**ANSWER to 12: E.** The CEO always has an obligation to present fairly, in all material respects, the true financial condition of the corporation and never to mislead the public by disguising actual performance. Bernie Ebbers, then CEO of WorldCom, was convicted of fraud for knowingly misleading the public in its SEC filings and was sentenced to 25 years in jail. **Ref. 1**

**ANSWER to 13: E.** It is clearly fraudulent to book a

gain contingency. **Ref. 1**

**ANSWER to 14: D.** While simple filing errors occur

even in well-run organizations, a filing room in complete disarray indicates a serious problem with record keeping. When this situation continues, the accounting records become virtually unauditable, and the integrity of the accounting system is in question.

1. When do accountants usually face ethical dilemmas and what is the best way to deal with these issues?

As accountants, we typically don’t face ethical dilemmas on a daily basis. Instead, the dilemmas tend to surface during the quarter-end and year-end closing activities. Thus, we must be attentive to recognize ethical conflicts when they occur and then act appropriately in the presence of tension

1. What effect did the WorldCom incident in 2001 have on our world?

Fraud at WorldCom—along with Enron and others—brought our stock market prices down, tarnished the reputations of all accountants, felled a global accounting firm that was once known as the “gold standard” of accounting firms, revealed gaping flaws in U.S. Generally Accepted Accounting Principles (GAAP), and eventually brought about the rise in International Financial Reporting Standards (IFRS).