Cost Management A Strategic Emphasis 9th edition Blocher Solutions Manual

SKU: 9781260814712-SOLUTIONS

Chapter 1

Cost Management and Strategy

Learning Objectives

1. Explain the use of cost management information in each of the four functions of management and in different types of organizations with emphasis on the strategic management function.
2. Explain the contemporary business environment and how it has influenced cost management.
3. Explain the contemporary management techniques and how they are used in cost management to respond to the contemporary business environment.
4. Explain the different types of competitive strategies.
5. Describe the professional environment of the management accountant, including professional organizations, professional certifications, and professional ethics.
6. Understand the principles and rules of professional ethics and explain how to apply them.

New in this Edition

- All the RWFs updated for current information.
- Update the section on economic nationalism for the current status of Brexit in the UK, and to indicate the increasing focus on tariffs in the US, Italy, China, and around the world generally. We added a new subsection on tariffs and on economic uncertainty related to economic nationalism (e.g., Brexit). We added material on the economic impacts of Brexit and economic nationalism. Also, we updated this chapter for the recent (March 2020) ratification of the USMCA to update NAFTA
- In addressing the impact of economic nationalism on uncertainty and volatility we added a reference to the IMA/ACCA publication: **Tomorrow's Finance Enterprise (2014)**. From the conclusion of that report: "Economic uncertainty, volatility, risk, and ambiguity are the critical challenges facing business today. This research is further evidence of the CFO's strategic business role and the need for greater alignment between business strategy and the role of the finance team, particularly the establishment of processes, systems or metrics for tracking success."
- Similar to the above, the focus on the customer is an idea that was consistent with globalization. We now indicate that the turn to economic nationalism has to do with protecting domestic manufacturers and, with tariffs, will hurt customers who will no longer be able to buy the best product at the best price worldwide.
- Similar to the above, under "Social, Political, and Cultural Considerations," we added a consideration of Climate Change, and added that term to the section heading.
- Added block chain and artificial intelligence to the section on business analytics
- Under benchmarking, I replaced Boeing with 3M as a company representing manufacturing excellence; also, new problem 1-59 features Boeing with its problems with the 737 Max

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- There are a lot of links and company references in this chapter which are checked and some are updated, for example Exhibit 1.5 and Exhibit 1.6 and all the RWF boxes. All the company mission statements are checked and/or replaced
- Sears is continuing to close stores; this is updated in the chapter
- The Dodd Frank act reference is updated for 2018 revision of the Act
- The reference to the CPA exam is updated for the 2017 revision
- The IMA guidance on resolving ethical issues is updated for the Sept 2019 revision
- Added a reference to the new IMA certification on Strategy and Competitive Analysis
- Economic nationalism added to summary
- Solution to CMA box is updated

Teaching Suggestions

Many instructors will choose to assign this chapter for the first one or two class meetings, but to spend little, if any, class time on it. Some instructors will choose to spend more time if a more thorough coverage of strategic positioning is desired. The main topic areas, except for strategic positioning and professional ethics, do not require class discussion and exercise. The presentation for these other topics is factual and informative, covering some of the basic concepts of management organization and of the contemporary business environment. The instructor might choose to explain each of the management techniques identified in the chapter, and to also explain that these techniques will be covered in later chapters.

The material on professional ethics is best introduced briefly at this time, with the reminder that the topic will come up in each of the subsequent chapters. Going through a few problems in Chapter 1 on ethics would provide a useful framework for them to remember in answering the ethics questions coming up in later chapters. Remind them to not forget the IMA code of ethics and the four step process for applying the code.

The important points to convey in the first class session are that the course will have four main themes: strategy, globalization of business, service firms, and ethics. Strategy is the most important theme, that is, the use of cost management methods and practices to help the firm succeed at its business strategy. Strategy can be described to the students as the umbrella concept which ties the topics of the course together—each topic is covered because it contributes in some way to the success of the firm. All four themes are covered in each chapter. The students should understand that each topic covered in the course will be strongly influenced by:

1. Cost and management accounting have changed from what was once a focus on financial record keeping to a strategic focus, one in which the management accountant becomes a business partner with management, to help the firm to succeed. To be an effective business partner, the management accountant must understand business and contemporary business issues and management techniques. He or she must go beyond an expertise in financial matters only, but also be able to integrate important factors in operations, marketing, and human resources to come up with solutions which are good for the firm, not just good accounting.
2. The strategic focus is a very important theme of the course, and is forcefully present in each of the chapters. The strategic focus is included in the text, class discussion and exercise problems. Strategic issues may even appear as a part of an exam question.

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3. The demands on management and the management accountant are increasing due to the changing business environment and to the globalization of business. Contemporary business topics are covered throughout the book, and global issues are touched on in each chapter.
4. As the demands on cost management change, so have the responsibilities of the management accountant. Each topic covered in the course will include professional and ethical issues.

Welcome to Students

(The following is in the front pages of the book, and can be used to help motivate the first day of class. Also, for a description of how the first two chapters of the text can be used in the first days of class, see the article by Edward J. Blocher, "Teaching Cost Management: A Strategic Emphasis," *Issues in Accounting Education*, February, 2009, pp 1-12.

To the student:

We have written this book to help you understand the role of cost management in helping an organization succeed. Unlike many books that aim to teach you *about* accounting, we aim to show you how an important area of accounting, cost management, *is used* by managers to help organizations achieve their goals.

An important aspect of cost management in our text is the strategic focus. By strategy we mean the long-term plan the organization has developed to compete successfully
Most organizations strive to achieve a competitive edge through the execution of a specific strategy. For some firms it is low cost, and for other it might be high quality, customer service, or some unique feature or attributes of its product or service. We know in these competitive times that an organization does not succeed by being ordinary. In contrast, it develops a strategy that will set it apart from competitors and assure its attractiveness to customers and other stakeholders into the future. The role of *cost management* is to help management of the organization attain and maintain success through strategy implementation. Thus, in every chapter, and in every problem and case in the text, there is a larger issue, which is: "How does this organization compete? What type of cost-management information does it need?" We do ***not*** cover a cost-management method simply to become proficient at it. We want you to know why, when, and how the technique is used to help the organization succeed.

A strategic understanding of cost management is so important that many senior financial managers are coming back to school to learn more about strategy, competitive analysis, and new cost-management techniques. Knowing how to do the accounting alone, no matter how well you do it, is by itself no longer sufficient. Cost management with a strategic emphasis is one way to enhance your career and to add value to your employer, whatever type of organization it might be.

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A Motivator

To help the students see the importance of cost management, the instructor can periodically use a short case with an issue the student may have some difficulty seeing initially, but which can be easily explained. The Bloomberg Business week stories which start each chapter can be used for this purpose. As an example, you can use the following question: You are a domestic appliance manufacturer and a Japanese competitor has entered the market with a product that has better quality, features, and a lower price. What do you do? How can the management accountant help? The question is a very broad but engaging question, which should have the students to begin to realize that the course is about business and being an effective competitor—we are looking to see how cost management can help. Some students will suggest one or more of the contemporary management techniques. If the discussion doesn't get there pretty quickly, ask them to think which of the contemporary management techniques might help. A variety of answers is possible. I would make sure that a discussion of target costing is covered—to explain the role of target costing in managing the firm's competitive tradeoffs between costs, features, and quality of product.

The Four Management Functions

In management and accounting, different authors describe a variety of different concepts about the functions of management. We have chosen to focus on the four functions:

1) strategic management
2) planning and decision making
3) management and operational control, and
4) preparation of financial statements.

These four functions are a useful way to view management's responsibility from a cost management perspective, and are helpful to provide an organizing structure for the book. However, sometimes a human resources perspective or alternative perspective is taken, and the functions are described differently. For example, a common listing of the functions of management would look as follows: (1) planning, (2) leading, (3) organizing, and (4) controlling.

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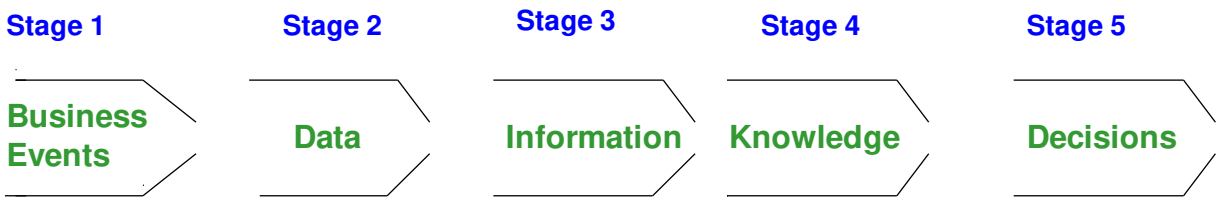
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The Definition of Management Accounting

The strategic role of the management accountant in an organization is explained in the definition of management accounting provided by the Institute of Management Accountants (IMA); relevant additional information on the definition can be found in the Statement on Management Accounting:

> **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.

Management accountants use their unique expertise (decision making, planning, performance management, and more), working with the organization's managers, to help the organization succeed in formulating and implementing its strategy. Cost management information is developed and used within the organization's information value chain, from stage 1 through stage 5 as shown below:



At lower stages of the value chain, management accountants gather and summarize data (stage 2) from business events (stage1) and then transform the data to information (stage 3) through analysis and use of the management accountant's expertise. At stage 4 the information is combined with other information about the organization's strategy and competitive environment to produce actionable knowledge. At stage 5 management accountants use this knowledge to participate with management teams in making strategic decisions that advance the organization's strategy.

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The Contemporary Business Environment

The chapter emphasizes the six forces acting on the contemporary business environment which have strongly influenced cost management:

- **The Global Business Environment**: including the importance of the World Trade Organization, other global treaties, and the integration of the European Union; note that this section has been updated for the anti-globalization trends reflected in Brexit, in the move to reduce immigration in some countries, and the move to impose tariffs on other countries goods.
- **Lean Manufacturing**: the use of the principles of production efficiency, many developed within Japanese manufacturers, especially Toyota
- **The Use of the Internet, and Enterprise Resource Management**
- **The Focus on the Customer**
- **Changes in Management Organizations**
- **Social, Political, and Cultural Changes**

Contemporary Management Techniques

The chapter describes 13 ways in which organizations, with the help of cost management, have adapted to the changing business environment:

1. The Balanced Scorecard and Strategy Map
2. The Value Chain
3. Activity Based Costing and Management
4. Business Analytics
5. Target Costing
6. Life Cycle Costing
7. Benchmarking
8. Business Process Improvement
9. Total Quality Management
10. Lean Accounting
11. The Theory of Constraints
12. Enterprise Sustainability
13. Enterprise Risk Management

Strategy and the Strategic Role of Cost Management

As a framework for the integration of strategy throughout the text, the Michael Porter model of competitive strategy is used. This model explains that an organization succeeds either by pursuing a cost leadership strategy or a differentiation strategy. The cost leader succeeds by providing the lowest cost product or service to the consumer, while the differentiated organization succeeds by providing products and services with features, quality, and innovation that draw the consumer to these products and services.

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The Five Steps for Strategic Decision Making

The five steps for decision making with a strategic emphasis are a new feature of the fifth edition. In these segments, which appear in nearly all the chapters, the material of the chapter is illustrated in a clear example to show the strategic role of cost management for that topic material. For example, listed below is a short illustration of how the steps could be used by Wal-Mart to help the company deal with the problem of rising fuel prices that affect the cost of the firm's use of trucks to deliver product from Wal-Mart's warehouses to its retail stores.

The first step is to determine the strategic issues surrounding the problem, because the solution of any problem must fit the organization's strategy. A good decision is one that makes the organization more competitive and successful. By starting with the strategic issues, we ensure that the decision fits the organization's strategic goals.

1. **Determine the Strategic Issues Surrounding the Problem.**
   Fuel costs are critical to Wal-Mart because it competes on low cost and low prices. So this problem will get close management attention. In contrast, the effect of a rise in fuel prices will likely not be as critical for a differentiated company, such as a high-end retailer like Nordstrom.

2. **Identify the Alternative Actions:**
   In one alternative, Wal-Mart considers the use of smaller and more fuel-efficient trucks together with a relocation of its warehouses, to reduce travel time and fuel usage. Another option would be to outsource all of Wal-Mart's delivery needs to other trucking firms.

3. **Obtain Information and Conduct Analyses of the Alternatives**
   Wal-Mart collects relevant cost information and calculates the expected cost of each alternative and finds that the use of other truckers would provide significantly lower total fuel cost. Considering the problem strategically, Wal-Mart projects on the one hand that it can more effectively compete with Target by providing more rapid delivery of fast-moving items to its stores, and that this could be accomplished with the use of smaller trucks. On the other hand, Wal-Mart also knows that it competes on cost and that lower cost is critical to its success.

4. **Based on Strategy and Analysis, Choose and Implement the Desired Alternative**
   After considering the options, Wal-Mart chooses to outsource the delivery function to other trucking firms, in order to maintain or perhaps improve its low cost position. In contrast, a high-end retailer such as Nordstrom might have chosen the option with more rapid delivery and higher cost, because its strategy is based on quality of product and customer satisfaction. Knowing the strategic context for the decision can make a big difference!

5. **Provide an On-going Evaluation of the Effectiveness of implementation in Step 4.**
   To provide an on-going review of delivery costs, Wal-Mart top management instructs operational managers in the firm to present an updated review of the decision to top management once every quarter. In this way, changes in costs or strategic objectives will be reviewed on a regular basis.

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Assignment Matrix Chapter 1 Exercises and Problems				Learning Objectives						Text Features				
9e	Changes for the 9e	Time	Connect	1. Cost management information	2. Contemporary business environment	3. Contemporary management techniques	4. Types of competitive strategies	5. Professional environment	6. Professional ethics	Strategy	Service	International	Ethics	Sustainability
Brief Exercises														
1-15		5 min.					X			X				
1-16		5 min.							X				X	
1-17		5 min.							X				X	
1-18		5 min.					X			X				
1-19		5 min.					X			X				
1-20		5 min.					X			X				
1-21		5 min.					X			X				
1-22		5 min.					X			X				
1-23		5 min.					X			X				
1-24		5 min.	X	X										
1-25		5 min.	X	X			X							
1-26		5 min.	X	X										
1-27		5 min.	X	X										
1-28		5 min.	X				X			X				
1-29		5 min.	X		X					X				
1-30		5 min.	X			X								
1-31		5 min..	X					X						
1-32		5 min.	X						X					
1-33		5 min.	X		X		X			X				
1-34		5 min.	X			X				X				
1-35		5 min.	X						X					
Exercises														
1-36		15 min.		X					X	X	X		X	
1-37		15 min		X			X			X				
1-38	Updated	15 min.				X								X
1-39		30 min.				X								
1-40		15 min.				X								
1-41		20 min.				X		X		X	X		X	
1-42		20 min.				X		X			X			
1-43		20 min.						X						
1-44		15 min.						X						

Continued on next page…

Assignment Matrix Chapter 1 **Learning Objectives** **Text Features**

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(continued)														
9e	Changes for the 9e	Time	Connect	1. Cost management information	2. Contemporary business environment	3. Contemporary management techniques	4. Types of competitive strategies	5. Professional environment	6. Professional ethics	Strategy	Service	International	Ethics	Sustainability
Problems														
1-45		15 min.		X			X			X				
1-46		30 min.			X									
1-47		30 min.			X		X			X				
1-48	Revised	20 min.				X								
1-49		20 min.					X			X	X			
1-50	Revised	15 min.					X			X				
1-51	Revised	15 min.					X			X				
1-52	Revised	15 min.					X			X				
1-53	Revised	15 min.						X						
1-54		40 min.						X						
1-55		15 min.							X				X	
1-56		20 min.							X				X	
1-57	Revised	15 min.							X				X	
1-58		10 min.							X				X	
1-59	New in 9e	20 min.							X	X			X	
1-60	Revised	15 min			X		X			X		X		
1-61	Revised	20 min			X		X			X		X		
1-62	New in 9e	15 min					X			X		X		
1-63	New in 9e	20 min			X							X		

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Lecture Notes

A. The Uses of Cost Management Information. Cost management information is the information managers need to effectively manage the firm or not-for-profit organization. By combining traditional financial information with nonfinancial information, cost management seeks to avoid using only a short-term focus; rather, it provides the manager with a strategic outlook on the firm's competitive position. The firm's controller, who operates under the chief financial officer (CFO), is largely responsible for obtaining cost management information for internal use. In addition, the controller is also in charge of preparing the firm's financial statements, primarily for external users. These dual roles can pose a problem for the controller, since cost management information focuses on usefulness and timeliness, while financial reporting is more concerned with accuracy and compliance. Underneath the controller are management accountants, who have four different functions.

1. The Four Functions of Management. The cost accountant fills several different roles, as well as provides a wealth of knowledge to the CFO and other company managers.

a. Strategic Management. Strategic Management is the development if a sustainable competitive position in which the firm's competitive advantage provides continued success. In order to accomplish this goal, the management account must implement a strategy, or a set of goals and specific actions plans that provide the desired competitive advantage.

b. Planning and Decision Making. The management accountant is also responsible for budgeting and profit planning, cash flow management, and decisions relating to the firm's operations.

c. Management and Operational Control. These responsibilities included managing and monitoring the actions of employees. Specifically, management control refers to upper-level employees evaluating mid-level employees, while operational control is used when operating-level employees are monitored by mid-level employees.

d. Preparation of Financial Statements. The management accountant must also prepare financial statements, which must comply with reporting requirements of different external groups and agencies. Because of their relevant information, financial statements can also be used in any of the other management functions.

2. Strategic Management and Strategic Cost Management. Overall, cost management's traditional role has changed to encompass a much more strategic emphasis. Changes is the business environment have made cost management much more critical to the firm's success, as well as more dynamic. Therefore, this book focuses on the strategic aspects of cost management, such as anticipating change, being more flexible, and thinking creatively. Along with this strategic focus has come a greater emphasis on cross-functional teams and cooperation among different members of an organization.

3. Types of Organizations. Cost management information is useful in a wide range of organizations: business firms, governmental units, and not-for-profit organizations. Business units are usually categorized as a manufacturer (uses raw materials to produce goods), a wholesaler (a merchandising firm that sells to other merchandisers), a retailer (a merchandiser that sells to final consumers), or a service firm (a firm that appeals to consumers' needs for speed and convenience by offering a service).

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Governmental and not-for-profit organizations also provide services; however, they usually provide public services and goods outside of established markets. These different organizations all use cost management information, although in different ways. Specifically, while a manufacturer may use it to manage production costs, a service firm could use cost management information to identify the firm's more profitable service lines. Its important to note that the firm's strategy will often be the determining factor in deciding how the information is used.

B. The Contemporary Business Environment. Many of the changes in the role of cost management have been the result of changes in the current business environment.

1. **The Global Business Environment.** A key factor that drives the changes in the contemporary business environment is the growth of international markets and trade. The increasing competitiveness of the global business environment means that cost management information will continue to be an important tool in the struggle to remain competitive.

   Also, in recent years, we are seeing anti-globalization trends reflected in Brexit, in the move to reduce immigration in some countries, and the move to impose tariffs in some countries.

2. Manufacturing and Information Technologies. As a result of the new global focus, several new manufacturing and information technologies have been created (just-in-time, quality teams, statistical cost control, and speed-to-market). Another recent change has been the gradual increase in facilities costs relative to materials and labor costs; firms are now placing a greater emphasis of controlling large facilities costs than they have in the past.

3. The New Economy: Use of Information Technology, the Internet, and E-Commerce. These technologies have fostered the growing strategic focus of cost management by reducing the time required for record keeping and expanding the individual manager's access to information within the firm, the industry, and the international business environment.

4, Focus on the Customer. As a result of an increased focus on consumer expectations regarding product use and quality, product life cycles have begun to shorten. This shortened life cycle forces companies to think in more strategic terms, as they begin to find their prior competitive advantages slipping away. Today many firms' critical success factors are all customer related. Cost management information has also adapted by starting to provide more nonfinancial information regarding customer satisfaction and preferences.

Because of the global trend to economic nationalism in recent years, and since economic nationalism has to do with protecting domestic manufacturers, it will hurt customers who will no longer be able to buy the best product at the best price worldwide.

5. Management Organization. In order to address this changing business environment more quickly and effectively, many firms have moved away from the traditional hierarchy of organization structure. Many firms are now promoting a more flexible structure and more cross-functional interaction, in order to meet consumers changing demands.

6. Social, Political, and Cultural Considerations. While changes in culture and politics vary between countries, there have been some distinguishable trends. Specifically, they include a more diverse workforce, a greater sense of ethical responsibility, and an increased deregulation. Overall, the changing business environment has forced companies to think in broader terms, focusing beyond the production of its product or service, and more on the global consumer and society as a whole.

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C. The Strategic Focus of Cost Management. Realizing, anticipating, and reacting to changes in the business environment, the modern cost manager is now more concerned with strategic thinking, rather than simply measuring a company's financial information. Also, cost management has started to have a greater focus on identifying costs and measures that a critical to the firm's success. Generally speaking, the role of management accounting can be seen as having traveled through different phases, from a simple measurement and transaction-recording role, to more of a strategic business partner that helps identify and monitor a firm's critical success factors (aspects of a firm's performance that are essential to its competitive advantage and success).

D. Contemporary Management Techniques. Along with the changing business environment, there are several new management styles and techniques that are designed to help firms remain competitive.

1. **The Balanced Scorecard and Strategy Map.** Keeping with the renewed focus on both financial and nonfinancial measurements, the balanced scorecard (BSC) is an accounting report that includes the firm's critical success factors in four areas: financial performance, customer satisfaction, internal business processes, and innovation and training. The balanced scorecard provides a more well-rounded assessment of the firm's performance than just using financial measurements alone. The Strategy Map is a method based on the BSC which links the BSC perspectives in a causal framework.

2. **The Value Chain.** The value chain is an analysis tool which identifies the specific steps required to provide a product or service to the customer.

3. **Activity Based Costing and Management.** Activity-based costing (ABC) is used to improve the accuracy of cost analysis by improving the tracing of costs to products and individual consumers. By using an activity analysis, managers are able to gain a better understanding regarding the firm's cost structure, operations and management control.

4. **Business Analytics.** Business analytics is an approach to strategy implementation in which the management accountant uses data to understand and analyze business performance. Business Intelligence (BI) often uses statistical methods such as regression or correlation analysis to predict consumer behavior, to measure customer satisfaction, or to develop models for setting prices, among other uses. BI is best suited for companies that have a distinctive capability which can be derived from measurable critical success factors. BI is similar to the BSC because it focuses on critical success factors; the difference is that BI uses analytical tools to develop predictive models of core business processes.

5. **Target Costing.** Target costing determines the desired cost for a product on the basis of a given competitive price so that the product will earn a desired profit.

6. **Life Cycle Costing.** Life-cycle costing is a management technique used to identify and monitor the costs of a product throughout its life cycle. Management accountants now manage the product's full life cycle of costs, including upstream and downstream costs, as well as manufacturing costs. Particularly close attention is paid to product design, since design decisions affect most subsequent life-cycle costs

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7. **Benchmarking.** Benchmarking is a process by which a firm identifies its critical success factors, studies the best practices of other firms for achieving these factors, and then implements improvements in the firm's process to match or beat the performance of those competitors. Cooperative networks of noncompeting firms that exchange benchmark information facilitate benchmarking efforts.

8. **Business Process Improvement.** Based on the Japanese concept of kaizen, business process improvement is a management technique in which managers and workers commit to a program of continuous improvement in quality and other critical success factors. Continuous improvement is often associated with benchmarking and TQM.

9. **Total Quality Management (TQM).** TQM is a technique by which management develops policies and practices to ensure that the firm's products and services exceed customers' expectations. This approach focuses on increased product functionality, reliability, durability, and serviceability. Cost management is used when analyzing the cost consequences of a particular decision.

10. **Lean Accounting**. Lean accounting uses value streams to measure the financial benefits of a firm's progress in implementing lean manufacturing. Lean accounting places the firm's product and services into value streams, each of which is a group of related products or services. For example, a company manufacturing consumer electronics might have two groups of products (and two value stream) –digital cameras and video cameras – with several models in each group. Accounting for value streams can help the firm to better understand the profitability of its process improvements and product groups.

11. **The Theory of Constraints (TOC).** TOC is a strategic technique to help firms effectively improve their cycle time (the rate at which raw materials are converted to finished goods). Specifically, TOC helps identify and eliminate bottlenecks in the production process. Due to the increased importance of speed-to-market, TOC has grown in popularity as an important new cost management technique.

12. **Sustainability.** Sustainability means the balancing of the organization's short and long term goals in all three dimensions of performance – social, environmental, and financial.

13. **Enterprise Risk Management.** Enterprise Risk Management is a framework and process that organizations use to manage the risks that could negatively or positively affect the company's competitiveness and success. Risk is considered broadly, to include (1) hazards such as fire or flood, (2) financial risks due to foreign currency fluctuations, commodity price fluctuations, and changes in interest rates, (3) operating risk related to customers, products, or employees, and (4) strategic risk related to top management decisions about the firm's strategy and implementation thereof.

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E. Developing a Competitive Strategy: Strategic Positioning. The concept of competitive strategy developed by Michael Porter identifies two main types of competitive strategies: cost leadership and differentiation. In developing a sustainable competitive position, each firm purposefully or as a result of market forces arrives at one the two strategies.

1. Cost Leadership. Cost leadership is a strategy in which a firm outperforms competitors in producing products or services at the lowest cost. The cost leader makes sustainable profits a lower price, thereby limiting the growth of competition in the industry. The cost leader normally has a relatively large market share and tends to market segments by using the price advantage to attract a large portion of the broad market. Cost advantages usually result from productivity in the manufacturing process, in distribution, or in overall administration. A potential weakness of the cost leadership strategy is the tendency to cut costs in a way that undermines demand for the product or service. The cost leader remains competitive only so long as the consumer sees that the product or service is nearly equivalent to competing products that cost more.

2. Differentiation. The differentiation strategy is implemented by creating a perception among consumers that the product or service is unique in some important way, usually by being higher quality. This perception allows firms to charge higher prices and outperform the competition in profits without reducing costs significantly. The appeal of differentiation is especially strong for product lines for which to perception of quality and image is important. A weakness of the differentiation strategy is the firm's tendency to undermine its strength by attempting to lower cost or by ignoring the necessity to have a continual and aggressive marketing plan to reinforce the perceived difference.

3. Other Strategic Issues. While most firms will have a dominant strategy, recognize that many firms are likely to employee both of the strategies at the same time. However, a firm following both strategies is likely to succeed only if it achieves one of them significantly; otherwise, it could face the problem of "getting stuck in the middle." A firm stuck in the middle is not able to sustain a competitive advantage. A common way for a firm to get stuck in the middle arises from its normal progression from one type of strategy to another.

F. The Professional Environment of Cost Management. Management accountants must continually improve their technical skills and maintain a constant high level of professionalism, integrity, and objectivity about their work. Many professional organizations encourage their members to earn relevant professional certifications, participate in professional development programs, and continually reflect on the professional ethics they bring to their work.

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1. Professional Organizations. The professional environment of the management accountant is influenced by two types of organizations: one that sets guidelines and regulations regarding management accounting practices and one that promotes the professionalism and competence of management accountants.

a. Federal Agencies. The first group or organizations include several federal agencies, such as the Internal Revenue Service (IRS), which sets product costing guidelines for tax purposes, and the Federal Trade Commission (FTC), which restricts pricing practices and requires that prices be justified on the basis of cost. Also, the Securities and Exchange Commission (SEC) provides guidance, rules, and regulations regarding financial reporting. The Cost Accounting Standards Board's (CASB) objective is to reduce fraud in government contracts through continual efforts at consistent documentation.

b. Private Agencies. The Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA) supply additional guidance regarding financial reporting. The AICPA also provides educational opportunities, such as newsletters, magazines, seminars, and technical meetings. The Institute of Management Accountants (IMA) supports the growth and professionalism of management accountants. The IMA also provides magazines, newsletters, research reports, and seminars. Several different countries, including U.K., Spain, and India, also have separate accounting organizations.

2. Professional Certifications. The role of professional certifications is to provide a distinct measure of experience, training, and performance capability. There are three types of certifications relevant to the management accountant.

a. The Certified Management Accountant (CMA). The CMA is administered by the IMA, and requires passing an exam and satisfying other experience requirements. The test covers four areas of knowledge: economic, financial, and management; financial accounting and reporting; management analysis and reporting; and decision analysis and information systems.

b. The Certified Public Accountant (CPA). The certification, prepared by the AICPA, is only administered in the United States. Although it is necessary for those accountants who intend to practice auditing, the CMA is widely viewed as the most relevant certification when dealing with cost management issues.

c. The Chartered Global Management Accountant (CGMA), offered by a partnership of the American Institute of CPAs and the Chartered Institute of Management Accountants (CIMA) in the United Kingdom.

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3. Professional Ethics. Professional ethics can be summed up as the commitment of the management accountant to provide a useful service for management. This commitment means that the management accountant has the competence, integrity, confidentiality, and objectivity to serve effectively.

The IMA Code of Ethics. The IMA Code of Ethics specifies minimum standards of behavior that are intended to guide the management accountant and to inspire professionalism. The IMA Code has four sections: competence, confidentiality, integrity, and credibility.

The Sarbanes-Oxley Act. Passed in July 2002, this Act of the U.S. Congress created a new oversight board for the accounting profession – the Public Company Accounting Oversight Board (PCAOB). The PCAOB is now the source of auditing standards for the accounting profession, in contrast to the American Institute of CPAs, as was the case prior to July 2002.

How to Apply the Statement of Ethical Professional Practice.

When faced with an ethical issue, the management accountant should follow the organization's established policies on the resolution of such conflict. If these policies do not resolve the ethical conflict, consider the following courses of action:

1. Discuss the issue with your immediate supervisor except when it appears that the supervisor is involved. In that case, present the issue to the next level of management.
2. Clarify relevant ethical issues by initiating a confidential discussion with the IMA helpline.
3. Consult an attorney as to legal obligations and rights and risks concerning the issue.

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