#1

CASE STUDY

The Case of the Missing Check

The Millbridge Recreation Department has come under intense scrutiny. First there were concerns because revenues for the year fell short of predictions. Then town residents started complaining to the mayor that the Town had cashed their checks for use of the town pool several months after they were written, and in some cases checks were never cashed.

One irate resident, George Loudly, had complained about a payment he contended that he made for the town pool. The Recreation Department manager, Tenn Uswim, insisted that payment had never been received, and had suggested that perhaps the check was lost in the mail. Loudly countered that he dropped the check off in person. The disagreement had reached an impasse, and the resident had filed formal notice with the Town that he intended to take the floor at the public forum session during the July Town meeting. In response the mayor requested that the recreation manager attend the meeting.

Loudly provided his side of the situation at the July meeting. Then several friends that he brought to the meeting spoke, indicating that their checks were cashed but not until several months after they sent them to the Town. The recreation manager was given an opportunity to respond. Uswim indicated that his policy was to gather checks and have someone run them over to the bank for deposit from time to time. He argued that the money wasn't needed until the pool opened several months after payments were collected, so he didn't see a need to rush checks to the bank. After all, once deposited, he just kept the money in a non-interest-bearing account.

The residents countered that not only was the Town losing the opportunity to earn a return by investing the pool money, but worse, it stood to lose money if payments were misplaced. The recreation manager argued that payment checks could not possibly be lost, because he kept them all safely on top of his desk, usually under a paperweight. He contended that those who claimed their checks weren't cashed obviously never made their payments.

That remark was perhaps not well considered. Loudly felt that the recreation manager was accusing him of lying about having paid his pool fee. Uswim's contention all along was that if Loudly really had paid his fee, he should produce a cancelled check as proof. Loudly contended that he paid in person and the check was just not cashed because of government incompetence. Immediately after Uswim's remark, Loudly insisted on being allowed to immediately search the recreation department office for his check.

The mayor didn't want to give in, but he had known Loudly a long time and respected his honesty. Uswim didn't object, so the meeting moved downstairs to the Rec office. The town sheriff was asked to conduct a thorough search. Within 10 minutes, he had found five checks on the floor under desks and behind file cabinets. The dates on the checks ranged from one week to two years old. One of the checks was George Loudly's payment.

At this point several residents shouted out that they had paid in cash, and how did they know if their cash was deposited or was also lost. The mayor was at a loss for words. He quickly agreed to hire an outside consultant to evaluate the Town's cash management practices. You have just accepted that engagement.

Assignment: Why should the Town hold on to cash? In what form should it hold the cash? What practices and procedures would you suggest that the Town consider to improve their management of short-term resources in general, and cash in particular?

ISBN 1-323-02300-3

Questions for Discussion

8-1. What is a management control system? What is it compared to in the chapter?

8-2. To what extent is the role of responsibility accounting to assign the blame for poor past performance?

8-3. Do managers tend to motivate their staff by using a "carrot" or a "stick" approach?

8-4. Discuss the four main elements of the Institute of Management Accountants' code of ethics.

8-5. What is an internal control system?

8-6. What are accounting and administrative controls?

8-7. Describe the elements of an internal control system.

8-8. What are some of the principal impacts that the Sarbanes-Oxley Act is likely to have on not-for-profit organizations that decide to follow the provision of the law?

8-9. Which of the following is *not* a component of an internal control system:[19]

a. adequate documentation
b. audit trail
c. separation of duties
d. none of the above are components of internal control
e. a, b, and c are all components of an internal control system

8-10. Why are variances calculated?

8-11. How can outcomes be measured?

8-12. Distinguish between efficiency and effectiveness.

8-13. Why is it that variances are not analyzed by the finance department of the organization?

8-14. If we know that a variance is the result of an uncontrollable price increase for a supply item that we must have, do we need to investigate and make a report regarding the variance? Why or why not?

8-15. Do volume increases that lead to spending increases cause financial problems for organizations?

8-16. What is the essential issue upon which flexible budget variance analysis is based?

8-17. What are the primary variance categories under flexible budget variance analysis? Discuss each.

8-18. What are some common causes of variances?

8-19. What is the aggregation problem in variance reporting?

8-20. What is meant by exception reporting?

8-21. Will all line-items have a volume variance?

8-22. Should all variances be investigated?

8-23. Answer the following questions about variance analysis.

1. Variances are differences between ____________ and ____________ revenues or expenses.
2. The three factors involved in variance analysis are ____________, ____________, and ____________.

Problems

#3

8-24. The Rose Elementary School spent $100,000 for textbooks for the fall 2012 semester. They had expected to have a total enrollment of 450 students who would each have needed 4 books at a cost of $65 each. What is their textbook expense variance? Is it favorable or unfavorable? Why?

8-25. We-Rescue-Dogs Kennel had a labor cost budget of $100,000 for the year. It expected its staff costs related to grooming, feeding, walking, and so on to vary in direct proportion with the number of dogs, based on an hourly rate of $20 for staff, and a need for 10 hours of staff time per dog (before the dogs were adopted). In its budget for the year, it planned on rescuing 500 dogs. It turned out that it rescued 640 dogs for the year. The staff average cost turned out to be just $16 per hour. Staff were paid for a total of 6,000 hours. What is the total labor variance? Was it favorable or unfavorable? Why?

Did the number of dogs rescued result in a favorable or unfavorable volume variance? (You do not have to calculate the flexible variance.)

Did the number of hours of labor actually consumed for each dog cause a favorable or unfavorable variance? (You do not have to calculate the flexible variance.)

8-26. Justice Township tries to keep tight control over the costs of the municipal court system. Since the town is small, its courts only operate a few days a week, and they get by largely with part-time workers. Last month it was expected that court stenographers would cost $25,000, but they actually cost $30,000, which is 20 percent more than the budgeted amount. The municipal judge has argued that the bench heard many more cases than expected, and this caused the increase. The director of the town's budget office feels that a 20 percent variance is unreasonable. As an analyst for the budget office, you have been asked to explain the variance. Your investigation shows that it was expected that there would be 125 trials, stenographers would be paid $20 per hour, and each trial would take an average of 10 hours. Actually, there were 150 trials, lasting 8 hours each, on average, and

[19]This question was written by Dwight Denison.

ISBN 1-323-02300-3

stenographers earned $25 per hour. Calculate the volume, quantity, and rate variances, and provide some possible explanations for each.

8-27. The fire department expected to spend $100,000 in April. Actually, it spent $108,680. The department thought it would pay each member of its team of firefighters $25 per hour. However, it paid them each $26 per hour on average. The department expected that the team of firefighters would work a total of 4,000 hours and fight 100 fires. Of course, many hours the firefighters are on duty in the station house between fires. Those hours are considered to be worked and the firefighters are paid for those hours. The actual results were 4,180 hours worked by the team of firefighters and 110 fires fought by the department. What was the total variance? What were the rate (or price), quantity, and volume variances? Which variances were favorable and which were unfavorable?

8-28. Donate Your Vehicle (DYV) is a charity that receives donations of old cars and converts them into cash to be used for various charitable purposes. DYV budgeted receipt of 300 cars, but actually received one-third more than expected. They sold the cars for $2,700 each, which was 10 percent below the budgeted price. What was the total revenue variance? Was it favorable or unfavorable? What are the two types of subvariances that caused the total variance?

8-29. Assume that you are the nursing administrator for a medical group that expects a severe outbreak of flu this winter. You hire additional staff to treat patients and administer shots. Your special project budget was for 1,000 hours of part-time nurses' services at $40 per hour, for a total cost of $40,000. It was expected that these nurses would treat 2,000 patients. After the flu season was over, it turned out that the total spent on part-time nurses was $50,000. The nurses worked 1,200 hours and 2,600 patients were treated. Calculate the variances. Was the overall result favorable or unfavorable?

8-30. Using the information from Problem 8-29, assume that the nursing administrator expected 400 patients for flu shots and 1,600 for flu treatment. The medical group typically charges $50 for a flu shot and $80 for treating a flu patient. Actually, the group had 1,200 patients who received flu shots and 1,400 who had the flu and received treatment. On average, it was able to collect $55 per flu shot and $70 per flu patient. Compute the volume, mix, and price revenue variances. How did things turn out for the group considering just revenues? How did they turn out from a profit perspective?

8-31. Dr. Eger is a physician who operates on two different types of patients. He has been pressing the Hospital for Ordinary Surgery (HOS) for more operating-room time. HOS is busy and would have to turn away other surgeons if it complies. Eger claims that he has become so efficient lately that the HOS cannot afford to refuse him. As evidence of his improved efficiency, he points out that in August he operated on 18 patients. The total cost of treating the patients was $129,100. In September also, he operated on 18 patients. The total cost of treating the patients was only $127,000. According to Dr. Eger, he has generated a total savings of $2,100.

Your investigation determines that in August, he treated 7 type X patients with an average cost of $4,300 and 11 type Y patients with an average cost of $9,000. In September, he treated 8 type X patients and 10 type Y patients. Costs in September for his patients were $5,000 for type X and $8,700 for type Y. Although the August cost for type X patients had risen, Eger points out that costs for the higher-volume, higher-cost type Y patients had fallen.

Develop a case-mix variance and a cost variance so we can better understand the impact on HOS of the changes in Dr. Eger's practice from August to September. What other information would be of interest in this particular case?

#4

8-32. Joy Becket is the director of Eyeglasses for the Poor (EP). EP receives donations of eyeglasses and recycles them for use by the nearsighted needy around the world. Sometimes the eyeglass frames are expensive designer frames that can be sold to raise operating funds for the organization. Joy is concerned that EP's resources are not adequately safeguarded. This problem is compounded by the fact that there are relatively few employees, so separation of duties is difficult. She does know that if anything goes wrong (e.g., waste of resources, embezzlement), she will be held responsible. Therefore, she has called you in as an expert consultant in the area of accountability and control. She has asked you to recommend specific procedures and policies for enhancing the internal controls for the organization. Write a one-page memo identifying policies and procedures that she should consider adopting.

8-33. (Control Systems) Pam Crawford is the vice president of the HMO of Millbridge. The organization bills and collects premiums from employers for their employees who are enrolled as members of the HMO. In turn, it receives bills from hospitals and physicians for care they have given to its members. Pam is in charge of optimizing the use of resources and safeguarding the resources of the HMO. She knows that if anything goes wrong (e.g., waste of resources, embezzlement), she will be held responsible.

Therefore, she has called you in as an expert consultant in the area of accountability and control. Pam has asked you to recommend specific procedures and policies for enhancing the internal controls for the organization. Write a one-page memo to Pam Crawford identifying policies and procedures that she should consider adopting at the HMO of Millbridge.

ISBN 1-323-02300-3