**Decision Making, Planning, and Control: The Five-Step Decision-Making Process**

We illustrate a five-step decision-making process using the example of the Daily News, a newspaper in Boulder, Colorado. Subsequent chapters of the book describe how managers use this five-step decision-making process to make many different types of decisions. The Daily News differentiates itself from its competitors based on in-depth analyses of news by its highly rated journalists, use of color to enhance attractiveness to readers and advertisers, and a Web site that delivers up-to-the-minute news, interviews, and analyses. It has substantial capabilities to deliver on this strategy, such as an automated, computer integrated, state-of-the-art printing facility; a Web-based information technology infrastructure; and a distribution network that is one of the best in the newspaper industry. To keep up with steadily increasing production costs, Naomi Crawford, the manager of the Daily News, needs to increase revenues. To decide what she should do, Naomi works through the five-step decision-making process.

1. Identify the problem and uncertainties. Naomi has two main choices:

a. Increase the selling price of the newspaper, or

b. increase the rate per page charged to advertisers.

The key uncertainty is the effect on demand of any increase in prices or rates. A decrease in demand could offset any increase in prices or rates and lead to lower overall revenues.

2. Obtain information. Gathering information before making a decision helps managers gain a better understanding of the uncertainties. Naomi asks her marketing manager to talk to some representative readers to gauge their reaction to an increase in the newspaper’s selling price. She asks her advertising sales manager to talk to current and potential advertisers to assess demand for advertising. She also reviews the effect that past price increases had on readership. Ramon Sandoval, the management accountant at the Daily News, presents information about the impact of past increases or decreases in advertising rates on advertising revenues. He also collects and analyzes information on advertising rates charged by competing newspapers and other media outlets.

3. Make predictions about the future. On the basis of this information, Naomi makes predictions about the future. She concludes that increasing prices would upset readers and decrease readership. She has a different view about advertising rates. She expects a market-wide increase in advertising rates and believes that increasing rates will have little effect on the number of advertising pages sold. Naomi recognizes that making predictions requires judgment. She looks for biases in her thinking. Has she correctly judged reader sentiment or is the negative publicity of a price increase overly influencing her decision making? How sure is she that competitors will increase advertising rates? Is her thinking in this respect biased by how competitors have responded in the past? Have circumstances changed? How confident is she that her sales representatives can convince advertisers to pay higher rates? Naomi retests her assumptions and reviews her thinking. She feels comfortable with her predictions and judgments.

4. Make decisions by choosing among alternatives. When making decisions, strategy is a vital guidepost; many individuals in different parts of the organization at different times make decisions. Consistency with strategy binds individuals and timelines together and provides a common purpose for disparate decisions. Aligning decisions with strategy enables an organization to implement its strategy and achieve its goals. Without this alignment, decisions will be uncoordinated, pull the organization in different directions, and produce inconsistent results. Consistent with the product differentiation strategy, Naomi decides to increase advertising rates by 4% to $5,200 per page in March 2011. She is confident that the Daily News’s distinctive style and Web presence will increase readership, creating value for advertisers. She communicates the new advertising rate schedule to the sales department. Ramon estimates advertising revenues of $4,160,000 ($5,200 per page 800 pages predicted to be sold in March 2011)

Steps 1 through 4 are collectively referred to as planning. Planning comprises selecting organization goals and strategies, predicting results under various alternative ways of achieving those goals, deciding how to attain the desired goals, and communicating the goals and how to achieve them to the entire organization. Management accountants serve as business partners in these planning activities because of their understanding of what creates value and the key success factors. The most important planning tool when implementing strategy is a budget. A budget is the quantitative expression of a proposed plan of action by management and is an aid to coordinating what needs to be done to execute that plan. For March 2011, budgeted advertising revenue equals $4,160,000. The full budget for March 2011 includes budgeted circulation revenue and the production, distribution, and customer service costs to achieve sales goals; the anticipated cash flows; and the potential financing needs. Because the process of preparing a budget crosses business functions, it forces coordination and communication throughout the company, as well as with the company’s suppliers and customers.

5. Implement the decision, evaluate performance, and learn. Managers at the Daily News take actions to implement the March 2011 budget. Management accountants collect information to follow through on how actual performance compares to planned or budgeted performance (also referred to as scorekeeping). Information on actual results is different from the pre-decision planning information Naomi collected in Step 2, which enabled her to better understand uncertainties, to make predictions, and to make a decision. The comparison of actual performance to budgeted performance is the control or post-decision role of information. Control comprises taking actions that implement the planning decisions, deciding how to evaluate performance, and providing feedback and learning to help future decision making. Measuring actual performance informs managers how well they and their subunits are doing. Linking rewards to performance helps motivate managers. These rewards are both intrinsic (recognition for a job well-done) and extrinsic (salary, bonuses, and promotions linked to performance). A budget serves as much as a control tool as a planning tool. Why? Because a budget is a benchmark against which actual performance can be compared. Consider performance evaluation at the Daily News. During March 2011, the newspaper sold advertising, issued invoices, and received payments. These invoices and receipts were recorded in the accounting system. Exhibit 1-4 shows the Daily News’s performance report of advertising revenues for March 2011. This report indicates that 760 pages of advertising (40 pages fewer than the budgeted 800 pages) were sold. The average rate per page was $5,080, compared with the budgeted $5,200 rate, yielding actual advertising revenues of $3,860,800. The actual advertising revenues were $299,200 less than the budgeted $4,160,000. Observe how managers use both financial and nonfinancial information, such as pages of advertising, to evaluate performance. The performance report in Exhibit 1-4 spurs investigation and learning. Learning is examining past performance (the control function) and systematically exploring alternative ways to make better-informed decisions and plans in the future. Learning can lead to changes in goals, changes in strategies, changes in the ways decision alternatives are identified,





changes in the range of information collected when making predictions, and sometimes changes in managers. The performance report in Exhibit 1-4 would prompt the management accountant to raise several questions directing the attention of managers to problems and opportunities. Is the strategy of differentiating the Daily News from other newspapers attracting more readers? In implementing the new advertising rates, did the marketing and sales department make sufficient efforts to convince advertisers that, even with the higher rate of $5,200 per page, advertising in the Daily News was a good buy? Why was the actual average rate per page $5,080 instead of the budgeted rate of $5,200? Did some sales representatives offer discounted rates? Did economic conditions cause the decline in advertising revenues? Are revenues falling because editorial and production standards have declined? Answers to these questions could prompt the newspaper’s publisher to take subsequent actions, including, for example, adding more sales personnel or making changes in editorial policy. Good implementation requires the marketing, editorial, and production departments to work together and coordinate their actions. The management accountant could go further by identifying the specific advertisers that cut back or stopped advertising after the rate increase went into effect. Managers could then decide when and how sales representatives should follow-up with these advertisers. The left side of Exhibit 1-5 provides an overview of the decision-making processes at the Daily News. The right side of the exhibit highlights how the management accounting system aids in decision making.

**Key Management Accounting Guidelines**

Three guidelines help management accountants provide the most value to their companies in strategic and operational decision making: Employ a cost-benefit approach, give full recognition to behavioral and technical considerations, and use different costs for different purposes.

**Cost-Benefit Approach**

Managers continually face resource-allocation decisions, such as whether to purchase a new software package or hire a new employee. They use a cost-benefit approach when making these decisions: Resources should be spent if the expected benefits to the company exceed the expected costs. Managers rely on management accounting information to quantify expected benefits and expected costs although all benefits and costs are not easy to quantify. Nevertheless, the cost-benefit approach is a useful guide for making resource-allocation decisions. Consider the installation of a company’s first budgeting system. Previously, the company used historical recordkeeping and little formal planning. A major benefit of installing a budgeting system is that it compels managers to plan ahead, compare actual to budgeted information, learn, and take corrective action. These actions lead to different decisions that improve performance relative to decisions that would have been made using the historical system, but the benefits are not easy to measure. On the cost side, some costs, such as investments in software and training are easier to quantify. Others, such as the time spent by managers on the budgeting process, are harder to quantify. Regardless, senior managers compare expected benefits and expected costs, exercise judgment, and reach a decision, in this case to install the budgeting system.

**Behavioral and Technical Considerations**

The cost-benefit approach is the criterion that assists managers in deciding whether, say, to install a proposed budgeting system instead of continuing to use an existing historical system. In making this decision senior managers consider two simultaneous missions: one technical and one behavioral. The technical considerations help managers make wise economic decisions by providing them with the desired information (for example, costs in various valuechain categories) in an appropriate format (such as actual results versus budgeted amounts) and at the preferred frequency. Now consider the human (the behavioral) side of why budgeting is used. Budgets induce a different set of decisions within an organization because of better collaboration, planning, and motivation. The behavioral considerations encourage managers and other employees to strive for achieving the goals of the organization. Both managers and management accountants should always remember that management is not confined exclusively to technical matters. Management is primarily a human activity that should focus on how to help individuals do their jobs better—for example, by helping them to understand which of their activities adds value and which does not. Moreover, when workers underperform, behavioral considerations suggest that management systems and processes should cause managers to personally discuss with workers ways to improve performance rather than just sending them a report highlighting their underperformance.

**Different Costs for Different Purposes**

This book emphasizes that managers use alternative ways to compute costs in different decision-making situations, because there are different costs for different purposes. A cost concept used for the external-reporting purpose of accounting may not be an appropriate concept for internal, routine reporting to managers. Consider the advertising costs associated with Microsoft Corporation’s launch of a major product with a useful life of several years. For external reporting to shareholders, television advertising costs for this product are fully expensed in the income statement in the year they are incurred. GAAP requires this immediate expensing for external reporting. For internal purposes of evaluating management performance, however, the television advertising costs could be capitalized and then amortized or written off as expenses over several years. Microsoft could capitalize these advertising costs if it believes doing so results in a more accurate and fairer measure of the performance of the managers that

launched the new product. We now discuss the relationships and reporting responsibilities among managers and management accountants within a company’s organization structure.

**Organization Structure and the Management Accountant**

We focus first on broad management functions and then look at how the management accounting and finance functions support managers.

**Line and Staff Relationships**

Organizations distinguish between line management and staff management. Line management, such as production, marketing, and distribution management, is directly responsible for attaining the goals of the organization. For example, managers of manufacturing divisions may target particular levels of budgeted operating income, certain levels of product quality and safety, and compliance with environmental laws. Similarly, the pediatrics department in a hospital is responsible for quality of service, costs, and patient billings. Staff management, such as management accountants and information technology and human-resources management, provides advice, support, and assistance to line management. A plant manager (a line function) may be responsible for investing in new equipment. A management accountant (a staff function) works as a business partner of the plant manager by preparing detailed operating cost comparisons of alternative pieces of equipment. Increasingly, organizations such as Honda and Dell are using teams to achieve their objectives. These teams include both line and staff management so that all inputs into a decision are available simultaneously.

**The Chief Financial Officer and the Controller**

The chief financial officer (CFO)—also called the finance director in many countries—is the executive responsible for overseeing the financial operations of an organization. The responsibilities of the CFO vary among organizations, but they usually include the following areas:

* Controllership—includes providing financial information for reports to managers and shareholders, and overseeing the overall operations of the accounting system
* Treasury—includes banking and short- and long-term financing, investments, and cash management
* Risk management—includes managing the financial risk of interest-rate and exchange-rate changes and derivatives management
* Taxation—includes income taxes, sales taxes, and international tax planning
* Investor relations—includes communicating with, responding to, and interacting with shareholders
* Internal audit—includes reviewing and analyzing financial and other records to attest to the integrity of the organization’s financial reports and to adherence to its policies and procedures

 The controller (also called the chief accounting officer) is the financial executive primarily responsible for management accounting and financial accounting. This book focuses on the controller as the chief management accounting executive. Modern controllers do not do any controlling in terms of line authority except over their own departments. Yet the modern concept of controllership maintains that the controller exercises control in a special sense. By reporting and interpreting relevant data, the controller influences the behavior of all employees and exerts a force that impels line managers toward making better-informed decisions as they implement their strategies. Exhibit 1-6 is an organization chart of the CFO and the corporate controller at Nike, the leading footwear and apparel company. The CFO is a staff manager who reports to and supports the chief executive officer (CEO). As in most organizations, the corporate controller at Nike reports to the CFO. Nike also has regional controllers who support regional managers in the major geographic regions in which the company operates, such



as the United States, Asia Pacific, Latin America, and Europe. Individual countries sometimes have a country controller. Organization charts such as the one in Exhibit 1-6 show formal reporting relationships. In most organizations, there also are informal relationships that must be understood when managers attempt to implement their decisions. Examples of informal relationships are friendships among managers (friendships of a professional or personal kind) and the personal preferences of top management about the managers they rely on in decision making. Ponder what managers do to design and implement strategies and the organization structures within which they operate. Then think about the management accountants’ and controllers’ roles. It should be clear that the successful management accountant must have technical and analytical competence as well as behavioral and interpersonal skills. The Concepts in Action box on page 37 describes some desirable values and behaviors and why they are so critical to the partnership between management accountants and managers. We will refer to these values and behaviors as we discuss different topics in subsequent chapters of this book.