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Course code: BE 417
Course name: Management Control Systems

Date: December 9, 2014
Duration: 3 hours

Number of pages incl. front page: 15

Resources allowed: English Dictionary

Notes: There are 3 (three) suggested answers to each question, but **only 1 (one) is correct**. The other two answers are completely wrong. If you do not know the correct answer, you should therefore be able to deduct the two which are wrong. You do not need a calculator to know the answer for the mathematical questions.

Please fill out your student ID at the top of the response sheet **enclosed** at the end of this exam (page 15).

The questions from the exam must be submitted along with the response sheet. Failure to do so will result in a failed test. Any question regarding a specific question can be asked after class by emailing the instructor.

Question 1

Management control can be described as:

- A. The process by which management is controlled by the judicial system
- B. The process by which management is making use of accounting systems to generate reports such as income statements, balance sheets and cash flow statements
- C. The process by which management encourages, enables, or, sometimes “forces” employees to act in the organization’s best interests

Question 2

Ensuring employees perform (or do not perform) certain actions known to be beneficial (or harmful) to the organization is known as:

- A. Action Controls
- B. Results Controls
- C. Personnel Controls

Question 3

The concept of redundancy in management control is generally defined as:

- A. Holding employees accountable for the actions they take
- B. Scrutinizing of action plans, investment proposals and budgets
- C. Assigning more people (or machines) to a task than necessary

Question 4

A benefit of Results control is that:

- A. Behavior can be influenced while allowing significant autonomy
- B. It tends to lead to documentation of the accumulation of knowledge as to what works best
- C. It is an efficient way of coordination, i.e. they increase the predictability of actions and reduce the amount of inter-organizational information flows to achieve a coordinated effort

Question 5

The case of Bellagio Casino Resort discussed in class involved a Blackjack dealer. We identified controls such as licensing, hiring, supervision, and mystery shoppers? What are these controls examples of:

- A. Results and personnel controls
- B. Personnel and action controls
- C. Results and action controls

Question 6

From the case discussion on Lincoln Electric in class, what key elements of Lincoln Electric's management system has made them successful?

- A. Because almost all aspects of the company's practices reinforce the shared goals of cost reduction and high profits, shared values such as your status and reward in proportion to your contribution, and serve to improve communication and reduce unnecessary barriers to communications and efficiency.
- B. Because the company continually strives to hire the best business students, from leading international business schools, thereby providing for an organizational culture which consistently has created many premium products and services.
- C. Because by using primarily many result controls, the company manages to achieve the targets its sets out: what is measured get's done.

Question 7

What best describes why tight control can be considered "good control"?

- A. Because it provides a high degree of certainty that people will act as the organization wishes (assuming away harmful side-effects)
- B. Because it decreases the predictability of actions and reduces the amount of inter-organizational information flows to achieve a coordinated effort
- C. Because it involves rewarding individuals for generating good results (or punishing them for poor results)?

Question 8

What are examples harmful side effects (costs of control) of a control system?

- A. Behavioral displacement, gamesmanship and negative attitudes
- B. Cost of cash bonuses, internal audit staff
- C. Time spent on planning and budgeting activities, on pre-action re-views etc.

Question 9

What is an example of gamesmanship?

- A. Creation of slack resources
- B. Lengthy review processes
- C. Negative attitudes

Question 10

Regarding action accountability and results control, which statement is true?

- A. As firms grow, their controls evolve usually towards decreased formalization of procedures
- B. As firms grow, their controls evolve usually towards less elaborate information (“accounting”) systems
- C. As firms grow, their controls evolve usually towards increased formalization of procedures

Question 11

What is the difference between a so called engineered expense center (EEC) and a discretionary expense center (DEC)?

- A. An engineered expense center have outputs that are difficult to measure with inputs that cannot be measured by monetary terms.
- B. A engineered expense center, such as a manufacturing department, has a direct causal relationship between inputs and outputs
- C. A discretionary expense center, such as an R&D center, only makes custom made products.

Question 12

Lack of goal congruence occur in organizations when

- A. self-interested behavior is manifested in laziness.
- B. individual goals do not coincide with organizational goals.
- C. organizational strategies are not linked to organizational objectives.

Question 13

Examples of controls which do not focus on measured performance are:

- A. return on investment, return on equity and revenue generation
- B. results control, action control and personnel control
- C. direct supervision, employee hiring standards and codes of conduct

Question 14

In the article “Practice Developments in Budgeting: An Overview and Research Perspective” by Hansen et al (2003), discussed in class, we learn about two different views on budgeting:

- A. One approach advocates improving the budgeting process, and another advocates abandoning the budget and primarily focus on the performance evaluation with budgeting.
- B. One approach advocates the use of “Cash Flow Return on Investment” (CFROI) and another the use of “Economic Value Added” (EVA).
- C. One approach advocates the use of traditional bottom-up budgeting, and another the use of a more centralized top-down budgeting process.

Question 15

What is a transfer price?

- A. The price at which products or services are transferred between profit centers between different firms.
- B. The price at which products or services are sold when settling demand and supply in an open market, such as Chicago Mercantile Exchange.
- C. The price at which products or services are transferred between profit centers within the same firm

Question 16

What is the purpose of transfer prices within an organization?

- A. It provides for unprofitable profit centers to be made profitable through the use of subsidizes prices
- B. It provides proper economic signals so that profit center managers make good economic decisions from a corporate standpoint
- C. It provides profitable profit centers to be made even more profitable, as a form of incentive to the profit center manager.

Questions 17

The case on Kranworth Chair corporation discussed in class illustrated the use of a performance measure using operating division income and controllable assets. The controllable assets in this case was defined as

- A. Fixed assets + Working capital
- B. Accounts receivables + inventories
- C. Machinery and Equipment + Accounts Receivables - Accounts Payable + Inventories

Question 18

The case on Kranworth Chair Corporation discussed in class illustrated among other things:

- A. the benefits and costs of decentralization.
- B. the use of action controls and incentives linked to these controls
- C. the benefit of using the same performance measure through out an organization, regardless of form of responsibility center.

Question 19

Which of the following statements is incorrect regarding the purpose of planning and budgeting?

- A. It establishes “challenging-but-achievable” performance targets
- B. It engages in long(er)-term thinking
- C. It achieves decentralization

Question 20

Which of the following statements is true regarding “good targets”?

- A. In theory good targets are about 25-40% achievable
- B. In practice good targets are about 25-40% achievable
- C. In theory, good targets are about 80-90% achievable

Question 21

The case with Citibank Indonesia, where planning and target setting was specifically discussed in class, illustrated among other things what principle about budgeting:

- A. Budgeting is best carried out when targets are set in a bottom-up fashion.
- B. Budget targets can be set in a top-down fashion.
- C. The benefits of long term planning and its effects on target setting.

Question 22

From our ethics lecture, we discussed amongst other things earnings management. What is earnings management?

- A. Actions taken to capture the true economic performance of the firm or division
- B. Actions taken to make performance look better in the short-run than it otherwise would.
- C. Actions taken to better smooth earnings by making sure the sales force better brings in more sales when earnings are falling short of budget

Question 23

When discussing the case on Two Budget Targets in class, we concluded what principle about ethics and budgeting:

- A. After analyzing an ethical issue, with for instance the 4 step approach used in our textbook, we tend to collectively agree on what is the most ethical way to deal with an ethical dilemma
- B. Despite analyzing an ethical issue, with for instance the 4 step approach used in our textbook, we discovered that it is sometimes difficult to reach a consensus on an ethical dilemma.
- C. It was ethically fair for Joe to continue with the two budget targets.

Question 24

The Activity-Based Budgeting Approach is best described as a:

- A. process generating a budget from a series of activities, such as board members engaging in various marketing activities.
- B. process generating a budget from a traditional product-market, responsibility center, or departmental focus.
- C. process on generating a budget connected to the underlying operational model of the organization

Question 25

An investor has purchased a stock at NOK 200 and after 4 years sells it at NOK 300. S/he has made a profit of NOK 100. Each year the investor received NOK 8 in a dividend. What is the total shareholder return (annual %)?

- A. 50%
- B. 14%
- C. 66%

Question 26

If the Return on Investment is 18% and the Margins are 15%, the asset turnover is

- A. 1.2
- B. 0.03
- C. 0.8

Question 27

Cash Flow Return on Investment (CFROI) is a performance measure which differs from EVA (Economic Value Added) in that:

- A. CFROI is a measure of the economic value added, whereas EVA measures the share price appreciation
- B. CFROI is a measure of the economic return, whereas EVA is the value of that economic return
- C. CFROI is intended for operating decisions whereas EVA is better suited for strategic decisions.

Question 28

The net book value problem with measures such as ROI and RI is that

- A. It does not represent a replacement value of the assets, and therefore as time passes decreases over time.
- B. As time passes, the capital charge and the return both increase.
- C. With the passage of time, aging assets increases both values.

Question 29

The myopia problem occur when

- A. financial measures create pressures for short-term performance potentially at the expense of long-term value creation
- B. financial measures create pressures for long-term performance, potentially at the expense of employee retention
- C. financial measures create situations when from a corporate perspective things are not valuable, but from a socioeconomic perspective they are

Question 30

The Statoil case represented an example of a large company embracing a beyond budgeting approach with a balanced scorecard. While all of the below statements contain some truth relating to Statoil, which statement by Bjarte Bogsnes best illustrates the success behind the Balanced Scorecard.

- A. The Balanced Scorecard cannot work unless we restrict our employees' autonomy. You can't let a majority drive your management concepts.
- B. The Balanced Scorecard cannot work unless resources are made available or allocated on a bi-annual basis. The bank cannot be open 24 hours.
- C. The Balanced Scorecard cannot work unless you do away with the budget. When we kicked out our budget, we got an amazing turbo charging of the process.

Question 31

Management at Statoil were influenced by the theories of Douglas McGregor from 1960 on Theory X and Y as key assumptions about people working for Statoil. Theory X can best be described as viewing:

- A. employees as being self-directed if they are committed to organizational objectives and accepting of responsibility
- B. employees as inherently lazy, unambitious, averse to taking responsibility, and valuing security above all else.
- C. employees as disloyal, manipulating potentially harmful to the organization

Question 32

When measuring performance, firms are susceptible to various uncontrollable factors. One of these is economic factors, which can be described as:

- A. microeconomic effects such as loss of income due to a poor marketing campaign
- B. act of nature, so called (forced majeure), i.e. for instance acts of man or government
- C. business cycles, competitor actions, changing laws, or foreign exchange rate movements

Question 33

What is beyond-budgeting?

- A. A management control system which is more than just command-and-control, and strives towards a management model that is more empowered and adaptive.
- B. A management control system which in addition to budgeting also typically emphasizes more command-and-control from the top.
- C. A management control system which in addition to an accounting based budgeting approach, also typically implement a cash flow based performance measurement approach, such as Economic Value Added or CFROI.

Question 34

In the case with Catalytic Solutions, discussed in class, why were bonuses based mostly on non-financial measurements?

- A. They believed accounting data to lag the actual economic development of the firm, and therefore made use of quicker softer measures of performance.
- B. The non-financial measures communicate to employees how top management wants the company to create long-term value (no need to be short term focused since they are not publicly listed)
- C. Since the salaries were based on financial measurements, they felt the bonuses complemented the salaries and captured other dimensions important to the performance during the year

Question 35

What is an example of a non-monetary punishment?

- A. Promotion
- B. No promotion
- C. Vacation trip

Question 36

What is the benefit of a lower cut-off in performance pay?

- A. To maintain vertical compensation equity
- B. To avoid undeserved bonuses due to “windfall” gains
- C. To avoid paying bonuses for performance which is considered mediocre or worse

Question 37

In the case of Houston Fearless, discussed in class, an interesting feature of the case illustrated what important challenge in a budget:

- A. Making accurate forecasts
- B. Avoiding the classic hockey-stick
- C. Creating a balanced budget

Question 38

In the article “Designing Effective Reward Systems” by Van der Stede (2009), what is being proposed?

- A. Disproportionate incentives – Give more emphasis to certain dimensions rather than other
- B. Weaker incentives - If what is measured is not what is intended, strong incentives will only get the organization faster to the undesired result
- C. More short term focus – Formula bonus plans often induce long term focus which need to be balanced with a shorter risk-adjusted focus.

Question 39

In the article “The Pitfalls of Pay-for-Performance” by Van der Stede (2007), what is the key message?

- A. Cash is king – When Warren Buffet recently sought after a “new Buffet” to help run his investment empire, he looked specifically for money focused individuals, so called “money grubbers”.
- B. If performance is measured using traditional accounting data, it may be misleading. Therefore, a cash based measure (“cash is king”) will better help link an incentive plan to the economic performance of the firm.
- C. One should complement monetary incentives with non-monetary awards, thus challenging one of the most widely-held beliefs about human behavior is that monetary incentives are the most powerful drivers of performance.

Question 40

What is the benefit of a subjective bonus determination approach?

- A. The performance-reward link is explicit
- B. Alleviates bias or favoritism in assessing and rewarding performance
- C. Allows performance to be evaluated more “completely” considering any of a number of hard-to-quantify, but important, performance areas



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