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Report Earnings Accurately

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LETTERS
TO THE EDITOR

ROBERT F. RANDALL, EDITOR

REPORT EARNINGS ACCURATELY

As authors of the March article, "Is Managing Earnings Ethically Acceptable?," we wish to thank Alfred M. King for his letter in the April issue questioning some of the contentions in our article. In a time when corruption seems to be rampant in many aspects of our national life, it is important for accountants to discuss openly what are their ethical responsibilities and what are the limits to those responsibilities. The credibility of accounting numbers is vital to our success as a profession and as individual accountants. There will be no demand for accounting service if accounting information is not trusted by users. Accountants have incorporated into their ethical codes the obligation to present information fairly and in an undistorted manner.

Mr. King must have misunderstood our definition of earnings management. As we stated, earnings management includes the actions of a manager that serve to change current reported earnings without generating a corresponding change in the long-run economic profitability of the unit. Managers who change earnings in this way are trying to influence positively the perceptions of their unit by users of the earnings numbers when there have not been any changes in the operation of that unit to warrant it. This is manipulative and unethical. How can anyone question this?

Mr. King seems especially concerned about whether earnings management can come about through operating decisions. For example, how can the selling of excess assets be bad? We do not question whether it is good or bad to sell off excess assets; we question the timing of that decision by management during periods when earnings need to be enhanced or reduced. When the timing of the operating transaction is selected to influence earnings rather than for valid operational reasons, the earnings are distorted and users' interests may be damaged.

We have expressed in our article our qualms with limiting operating managers' range of action in making operating decisions and do not advocate a complex set of rules to prevent earnings management by operating decisions. We feel that a major part of the problems the accounting profession faces in the area of accounting manipulation is the excessive rules orientation toward the measurement of earnings. This perpetuates the view among accountants that if a transaction is permitted by the rules, it is justified. However, virtually all accountants recognize the significant ability to influence earnings by choice among alternative acceptable accounting rules.

Rather, we advocate that both accountants and managers commit themselves to the positive obligation to report earnings in an accurate and undistorted manner. No set of rules will ever be able to fully prevent earnings management due to the complexity and changing nature of business transactions and operations. In order to assure the provision of accurate and usable accounting information, it will be necessary to rely on the internalized ethical values of accountants and managers.

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The Topical Index to articles in Management Accounting for Volume LXXV, Nos. 1-12, will not be published in this issue. The Institute is pursuing other means, including electronic media, of compiling a comprehensive index to help readers research topics. During the transition from printed to electronic media, a topical index covering the last volume year (1993-94) will be developed in-house and made available to members on request. The IMA research service also will continue to be available to members via CD-ROM databases by contacting Mr. Shahé Sanentz, manager of library services, (201) 573-6235.

LEAD-TIME BASED COSTING

In the February issue we were pleased to see Richard Schonberger's Letter to the Editor about our August 1993 article ("Strategic Management Accounting—Why and How"). Schonberger faults us for suggesting our lead-time based costing could unify production and accounting in the future as ABC has in the past. Schonberger did indeed discuss allocating factory burden to products based on lead time in his earlier (1986) *World Class Manufacturing*. But his purpose was tactical: to induce the supervisor of work center X to reduce lead time and thereby reduce X's share of the burden.

Our point is different: We put lead-time based costing in a strategic position. We presented the traditional and new formulas, but we apparently failed to make that clear.

We submit there are prior and greater purposes than how to allocate burden to which lead-time based costing contributes. Lead-time based costing allows us to find the "sweet spots" among cost factors so that cost reduction efforts are more effective and can occur earlier in the production chain. For example, cutting costs at the design stage rather than downstream on the shop floor. Lead-time based costs helped us make prices strategically relevant and helped us load plants with the best product mix. Such were genuine contributions that helped Teijin Seiki gain the largest share of the global, reduction gear market.

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DISMAYED

I read with interest the letter on "Managing Earnings Is Ethical" in MANAGEMENT ACCOUNTING® (April 1994). I was dismayed by the author's question, however, that "...since when was incompetence an ethical issue?" Incompetence became an ethical issue when IMA (NAA) published the Standards of Ethical Conduct for Management Accountants (June 1, 1983), which included four standards: Competence, Confidentiality, Integrity and