



Accounting Questions

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Discussion 1: Mixed Costs

Strategy Comparison

One of the strategies applied in all airlines is exploring modern technology to reduce fixed and variable costs. Through the use of technology, the companies can improve the efficiency of their services as well as reduce other related costs primary in managing operations that would involve a high level of human capital (Javad & Bijan, 2017). Through benchmarking, the companies can identify specific metrics that enable them to compare the costs of the firms with the aviation industry, and that enhances their ability to adjust variable cost like the amount of money used in advertisement programs. The firms also hire employees only if necessary, and that helps to control both fixed and variable cost used in areas such as administration. The idea of negotiated transfer prices is also used among different companies to assist in cost saving when budgeting for new products (Javad & Bijan, 2017). Alaska Air Group, Inc. tends to reduce its cost when buying cheaper and used aircrafts, and it focuses on allocation based budget. However, Turkish Airline uses cost-based budgeting because it invests only in areas that have been planned during the previous financial year.

Conversion of Fixed Costs to Variable

The Airline Companies apply the concept of outsourcing as the primary strategy for converting fixed cost to variable one. For example, companies hire independent firms to delegate the management of public relation matters. Before selecting any company to provide such services, they sign performance contracts that highlight the objectives that the companies want to achieve. It is necessary to note that all the activities that the firms outsource are those for which they are not hiring full-time employees (Javad & Bijan, 2017). For example, hiring professionals who are responsible for inventories or designing specific products that are used by the firms. Therefore, using methods such as production incentives and sales commission help airline companies to convert the fixed cost to variable one. Alaska Air Group, Inc net profit for 2017/2018 financial year was \$ 250 million due to increase in the number of passengers while the loss was \$ 217 million because of merger-related cost.

Discussion 2: Airline Financial Accounting

Frequent-flyer Programs

Qantas and Lufthansa have quite similar frequent flyer programs. Qantas allows the passengers to collect points for shopping in Qantas rewards store, purchasing wine, using travel

insurance, and booking hotels. Lufthansa grants points only for certain mileage. Both airlines provide benefits such as awarding miles, booking guarantee, flying one class higher, priority check-in, etc. For Qantas, frequent flyer revenue has been increasing over the past ten years, and the liability has shown the same trend. As for Lufthansa, both revenue and liability balance for the frequent flyer programs have been declining over the same time.

Advantages and Disadvantages

The airlines benefit as they allow the company to track the behavioral trends. These programs provide information on how passengers earn their points, which can be used in future forecasting. Also, the frequent-flyer programs ensure the loyalty of the passengers (Knorr, 2019). Credit card companies also serve as a short-term source of financing as they presale the tickets. However, at the same time these programs cost a lot of money to the airlines, and this is a major disadvantage.

Incremental Cost Method and Deferred Revenue Method

The incremental cost method does not require airlines to defer the revenue. Instead, the airlines record the liability for the marginal cost of providing future services to the passengers (Javad & Bijan, 2017). Considering the fact that a significant portion of the airline's costs is fixed, this method allows the companies to reduce the selling price of a mileage credit. According to the deferred revenue method, on the other hand, the liability for the fair value of the outstanding mileage credits is recognized (Knorr, 2019).

Airline Accounting

The specifics of the airlines accounting lie in the following spheres:

- Maintenance accounting: the maintenance expenditures can be capitalized or not based on the classification of 'minor' and 'major' repairs;
- Revenue accounting: ticket breakage revenue is recognized on the day of the flight, not on the day of sale;
- The loyalty programs accounting: the companies recognize the frequent flyer bonuses as liabilities;
- Travel vouchers are treated either as deferred revenue or a deduction from revenue based on their type.

Discussion 3: Absorption and Variable Costing

Comparison of Absorption and Variable Costing

The primary difference between these costing methods lies in the fact that variable costing accounts only for variable costs and absorption costing makes both fixed and variable costs. The production process involves different types of costs, which cannot be directly associated with a certain activity or a type of product. Nevertheless, these costs cannot be treated as fixed ones as they have a variable component. These kind of expenses are often called overhead costs.

Variable costing method combines all fixed costs and reports them as a single item. Therefore, it may not provide sufficient information for management to make pricing decisions. Also, it does not allow the managers to see what other costs have to be covered so that the product is profitable. The absorption costing method, on the other hand, is related to both fixed and mixed costs (Javad & Bijan, 2017). Nevertheless, this method may also impede managerial decision making when, for instance, it is necessary to price the products from different product lines. The companies resort to other costing approaches that help to reflect the nature of costs in

the best possible way, e.g. by applying activity-based costing. The absorption costing method is still used because it helps to reflect more complete cost of inventories on the balance sheet.

Mathematical Reconciliation

It is possible to reconcile the net income received using the absorption costing with the income obtained under variable costing method. First of all, it is necessary to subtract the manufacturing overhead carried forward as these costs have been absorbed by closing inventories. Secondly, it is necessary to add the manufacturing overhead brought in, which have been included in the beginning inventory.

Discussion 4: Budgeting

Benefits of Budgeting

The development of the realistic budget is extremely crucial for managerial decision making. The budgeting is an essential process for business because it is necessary to plan the sources of income and to forecast the expenditure. It allows to determine whether there would be a deficit of funds and how it can be covered (Malaval, Benaroya, & Aflah, 2014). The company may consider getting a loan or just "tighten the belt" and reduce its costs.

Control Function

Also, the budgeting process ensures constant monitoring of the actual receipt of money, carrying out of payments, and managing of the firm's cash flow. Besides, Knorr (2019) emphasized that budget planning provides the owner with relevant information, which allows the management of the company to analyze the current situation and make necessary decisions.

Continuous Budgeting

Continuous budgeting helps the company to identify the "weak" areas that cause either deficit or surplus. This may help identify the gaps in the operational flow and adequately address them.

Budget Participation

Each department should collect data and provide it to the managers in order to ensure that the budget is based on realistic figures. Also, it is necessary to inform the financial manager about the assumptions for the forecast (e.g., change of the supplier). Such an approach will help to ensure that the company's budgets are useful and realistic.

Coordination and Business Planning

Budgeting helps managers to evaluate the performance of each department and, therefore, control spending. It allows managers to allocate costs between the department in a manner that helps to achieve strategic goals. According to Xu, Chan, and Zhang (2019), budgetary targets are often tied to specific monetary goals, which ensures clear communication between management and employees, as well as helps to set objective performance benchmarks.

Sales Budget

The sales budget is important because it serves as a basis for other budgets (e.g., production or manufacturing overhead budget). Therefore, careful planning of sales budget ensures accurate preparation of the other ones.

Negative Outcomes

Nevertheless, the budgetary process has certain negative outcomes. First of all, it focuses on the financial side, only overlooking the qualitative aspects of the business. Secondly, budgeting may be inaccurate and lead to improper cost allocation.

Discussion 5: Ethics

The corporate scandals have caused enormous damage to the US economy. The financial markets lost hundreds of billions of dollars, when people lost thousands of jobs. Nevertheless, business scandals have taught at least one important lesson. These cases have shown the importance of the corporate culture, code of ethics, non-material incentives, and reputation (Ledgerwood, Vilderson, & Curtis, 2016). The “stakeholder” philosophy appeared as a counterweight to the idea of maximizing corporate profits. This approach should be taken by companies to address ethical issues. Moreover, the idea of corporate social responsibility (CSR) started to gain much popularity and applies to all organizations. Ledgerwood et al. (2016) assert that CSR is a business obligation that contributes to sustainable development, labor relations with employees, their families, the local community, and society as a whole to improve their quality of life.

The whistleblowing is a policy that encourages employees to share information that may prevent or reveal fraud. It is conducted by the companies to eradicate unethical behavior in the workplace and minimize the abuse of authority, corruption, and unethical conduct (Ledgerwood et al., 2016). Sarbanes-Oxley Act punishes the companies for an inappropriate influence on auditors and protects “whistle-blowers” – the employees who report on the shortcomings in the work of the company. In this case, the likelihood that fraud will be revealed increases. The law and whistleblower protection programs defend workers from retaliation. Due to these laws, it is a challenge for an employer to retaliate against the employees who have reported safety concerns (d'Huart & Belobaba, 2012). All workers have the right to work in a safe and healthy environment. In case it is not so, an employee can file a complaint and can get protection.