

Video Transcript

Pathways Vision Model: Part 2

Topics

- Part 2: Centers on the Vision Model elements where people are making decisions or are otherwise involved in activities.

Transcript

Welcome to Part 2 of the 4-part series on the Vision Model. Here we'll focus on the model's elements where all the people are located, either making decisions or are otherwise involved in activities. We'll refer to this as the model's spine.

We begin with a question we'd like you to ponder during this video: Given your career plans, how does the model relate to you? Where will you fit in? To answer this question, you'll need to understand the Vision Model elements in this video.

We begin with the economic activity element. One of the model's really neat features is it can be used to analyze economic activity in business units of sizes ranging all the way from individual employees; to departments; to a whole company; to industries; and even to entire countries.

But when applying the model, the very first step is to specify the scope of the economic activity being analyzed. This is really important because the scopes of the other elements of the model, they're all affected by the scope of the economic activity.

To illustrate this point, we'll develop two examples over the four parts of this video series: For the first example, which we'll use in Parts 2 and 3, the scope is restricted to the economic activities associated with a company's sales department. For the second example, which we'll use in Part 4, the scope is far broader and includes all of the company's economic activities.

For both examples, we'll maintain three assumptions:

- First, the company manufactures kitchen appliances, which it sells to distributors.
- Second, you work in the sales department. That's right, you're in the model.
- Third, executives at the corporate office have agreed to award bonuses to you and others in the department, but only if sales for the current quarter exceed a specified target. So, you've got to make your numbers.



Now let's see how the model's other elements relate to the example where we focus solely on sales activities. So we're going to be down here and our economic activity is going to be restricted to sales activities. But keep in mind as we do this restriction that similar scenarios play out in the company's other departments, like research and development.

The model's good decisions element has two characteristics you need to specify when applying the model: first, you need to specify the decision makers and second, their decisions. For our sales example, we'll assume the decision makers are executives at the corporate office. Right here, making decisions. Well, they're corporate executives. Their decisions are whether the sales department, that's you, should receive a bonus at the end of the quarter, and if so, the size of the bonus. So the corporate executives are going to make a decision and they're going to make bonus decisions. These decisions will be based on a sales report issued by the sales department at the end of the quarter. And this is where accounting comes in and so they're going to issue a sales report at the end of the quarter.

Now understand what's happening. This is the corporate executives. Well, they are going to make a bonus decision. But that bonus decision is going to depend on a sales report. And the sales report is going to refer back to the economic activity. So everything moves in this direction.

Because we'll focus on decision makers who use accounting reports, we will often refer to the model's good decisions element as users' decisions. Meaning, decisions by users of accounting reports, such as the sales report.

Next we discuss the useful information element of the model.

Prior to using the sales report, the executives, perhaps with help from their accountants, well, they're going to assess the usefulness of the report for their bonus decisions. So the numbers are useful, but only to the extent they help them with their decisions. So their goal here is to assess usefulness.

Based on the discussion thus far, you might be thinking the quarter's total sales would be the most useful measure for determining whether the sales department met its sales target. After all, it is called a sales target!

True, but while the term "sales target" is widely used in practice for situations exactly like our example, a much more precise term would be "revenue target".

We will study revenue in great detail in a later module and discuss it briefly shortly. For now, you only need to know two things:

First, while revenues are closely related to sales, they can differ from sales to varying degrees depending on the sales agreement with customers.

Second, corporate executives focus on revenues much, much more than sales. Why? Because companies' stock prices, that is, the prices of ownership shares, they can be significantly affected by revenues and executives are greatly concerned about share prices, because, among other reasons, they usually own plenty of shares.

Next we turn to accounting decisions, which determine when revenue can be recognized.

More generally, accounting decisions determine what information about economic activity is reported to users and when it is reported. And that's going to be really important. Right? If you're making a decision you really care about what you get for information and when do you get it. Is it timely?

Some of these decisions require considerable judgment on the part of the accountants, meaning objective experts, well; they can reasonably disagree on the outcomes. Other decisions are black or white.

For our sales example, the accounting decision is when, when should revenue be recognized in the sales report and financial statements issued to shareholders. So the big question here is going to be when should revenues be recognized in the sales report and ultimately in the financial statements that go to shareholders.

Accounting standard setters in the US and most other countries have agreed on the criteria that must be met before revenue can be recognized and these are rather complex. And the reason they're complex is because the sales agreements can be very complex sometimes. We will examine these criteria in a later module.

But for now, to keep our example relatively simple, we'll assume these criteria are met when the company has done two things. First of all, they sold an appliance to a distributor and second, they delivered it to this distributor. So, let's look at a timeline because it's a matter of when, that's time. Two things happen: a sale and a delivery. They have to make a sale and a delivery before they can recognize revenue.

In particular, revenue cannot be recognized in the current period, and thus count towards meeting the sales target, unless an appliance has been delivered by the end of the period. So if the end of the period is right here and you've made your sale. Well, you better not start smiling yet. You may not have made your target, because the revenue isn't going to count until the next period when the delivery occurs.

In the next video in this series, we consider the consequences of the corporate executives' bonus decisions for the sales department and explain the remaining elements of the Vision Model.

Hope you enjoyed this video. See you in Part 3.