

Contents

- 1 Introduction 1**
 - A. Managerial Accounting: Decision Making and Control 2**
 - B. Design and Use of Cost Systems 4**
 - C. Marmots and Grizzly Bears 8**
 - D. Management Accountant's Role in the Organization 10**
 - E. Evolution of Management Accounting: A Framework for Change 12**
 - F. Vortec Medical Probe Example 15**
 - G. Outline of the Text 18**
 - H. Summary 18**

- 2 The Nature of Costs 22**
 - A. Opportunity Costs 23**
 - 1. Characteristics of Opportunity Costs 24
 - 2. Examples of Decisions Based on Opportunity Costs 24
 - B. Cost Variation 28**
 - 1. Fixed, Marginal, and Average Costs 28
 - 2. Linear Approximations 31
 - 3. Other Cost Behavior Patterns 32
 - 4. Activity Measures 33
 - C. Cost–Volume–Profit Analysis 35**
 - 1. Copier Example 35
 - 2. Calculating Break-Even and Target Profits 35
 - 3. Limitations of Cost–Volume–Profit Analysis 39
 - 4. Multiple Products 40
 - 5. Operating Leverage 42
 - D. Opportunity Costs versus Accounting Costs 44**
 - 1. Period versus Product Costs 45
 - 2. Direct Costs, Overhead Costs, and Opportunity Costs 46
 - E. Cost Estimation 48**
 - 1. Account Classification 48
 - 2. Motion and Time Studies 48
 - F. Summary 49**
 - Appendix: Costs and the Pricing Decision 50**

- 3 Opportunity Cost of Capital and Capital Budgeting 87**
 - A. Opportunity Cost of Capital 88**
 - B. Interest Rate Fundamentals 91**
 - 1. Future Values 91
 - 2. Present Values 92

3. Present Value of a Cash Flow Stream	93
4. Perpetuities	94
5. Annuities	95
6. Multiple Cash Flows per Year	96
C. Capital Budgeting: The Basics	98
1. Decision to Acquire an MBA	98
2. Decision to Open a Day Spa	99
3. Essential Points about Capital Budgeting	100
D. Capital Budgeting: Some Complexities	101
1. Risk	101
2. Inflation	102
3. Taxes and Depreciation Tax Shields	104
E. Alternative Investment Criteria	106
1. Payback	106
2. Accounting Rate of Return	107
3. Internal Rate of Return (IRR)	109
4. Methods Used in Practice	112
F. Summary	112
4 Organizational Architecture	129
A. Basic Building Blocks	130
1. Self-Interested Behavior, Team Production, and Agency Costs	130
2. Decision Rights and Rights Systems	136
3. Role of Knowledge and Decision Making	136
4. Markets versus Firms	137
5. Influence Costs	139
B. Organizational Architecture	140
1. Three-Legged Stool	141
2. Decision Management versus Decision Control	145
C. Accounting's Role in the Organization's Architecture	147
D. Example of Accounting's Role: Executive Compensation Contracts	149
E. Summary	150
5 Responsibility Accounting and Transfer Pricing	163
A. Responsibility Accounting	164
1. Cost Centers	165
2. Profit Centers	167
3. Investment Centers	168
4. Economic Value Added (EVA®)	172
5. Controllability Principle	176
B. Transfer Pricing	177
1. International Taxation	178
2. Economics of Transfer Pricing	180
3. Common Transfer Pricing Methods	184
4. Reorganization: The Solution If All Else Fails	189
5. Recap	189
C. Summary	191

6	Budgeting	219
	A. Generic Budgeting Systems	222
	1. Country Club	222
	2. Large Corporation	226
	B. Trade-Off between Decision Management and Decision Control	229
	1. Communicating Specialized Knowledge versus Performance Evaluation	229
	2. Budget Ratcheting	230
	3. Participative Budgeting	232
	4. New Approaches to Budgeting	234
	5. Managing the Trade-Off	236
	C. Resolving Organizational Problems	237
	1. Short-Run versus Long-Run Budgets	237
	2. Line-Item Budgets	239
	3. Budget Lapsing	240
	4. Static versus Flexible Budgets	241
	5. Incremental versus Zero-Based Budgets	242
	D. Summary	245
	Appendix: Comprehensive Master Budget Illustration	246
7	Cost Allocation: Theory	283
	A. Pervasiveness of Cost Allocations	285
	1. Manufacturing Organizations	286
	2. Hospitals	287
	3. Universities	287
	B. Reasons to Allocate Costs	289
	1. External Reporting/Taxes	289
	2. Cost-Based Reimbursement	290
	3. Decision Making and Control	291
	C. Incentive/Organizational Reasons for Cost Allocations	292
	1. Cost Allocations Are a Tax System	292
	2. Taxing an Externality	293
	3. Insulating versus Noninsulating Cost Allocations	299
	D. Summary	302
8	Cost Allocation: Practices	329
	A. Death Spiral	330
	B. Allocating Capacity Costs: Depreciation	335
	C. Allocating Service Department Costs	335
	1. Direct Allocation Method	337
	2. Step-Down Allocation Method	339
	3. Service Department Costs and Transfer Pricing of Direct and Step-Down Methods	341
	4. Reciprocal Allocation Method	344
	5. Recap	346
	D. Joint Costs	346
	1. Joint Cost Allocations and the Death Spiral	348
	2. Net Realizable Value	349
	3. Decision Making and Control	353

E. Segment Reporting and Joint Benefits	354
F. Summary	355
Appendix: Reciprocal Method for Allocating Service Department Costs	356

9 Absorption Cost Systems 391

A. Job Order Costing	393
B. Cost Flows through the T-Accounts	395
C. Allocating Overhead to Jobs	398
1. Overhead Rates	398
2. Over/Underabsorbed Overhead	400
3. Flexible Budgets to Estimate Overhead	403
4. Expected versus Normal Volume	405
D. Permanent versus Temporary Volume Changes	410
E. Plantwide versus Multiple Overhead Rates	411
F. Process Costing: The Extent of Averaging	415
G. Summary	415
Appendix A: Process Costing	416
Appendix B: Demand Shifts, Fixed Costs, and Pricing	421

10 Criticisms of Absorption Cost Systems: Incentive to Over-produce 449

A. Incentive to Overproduce	451
1. Example	451
2. Reducing the Overproduction Incentive	454
B. Variable (Direct) Costing	455
1. Background	455
2. Illustration of Variable Costing	455
3. Overproduction Incentive under Variable Costing	458
C. Problems with Variable Costing	460
1. Classifying Fixed Costs as Variable Costs	460
2. Ignores Opportunity Cost of Capacity	461
D. Beware of Unit Costs	462
E. Summary	464

11 Criticisms of Absorption Cost Systems: Inaccurate Product Costs 483

A. Inaccurate Product Costs	484
B. Activity-Based Costing	488
1. Choosing Cost Drivers	489
2. Absorption versus Activity-Based Costing: An Example	495
C. Analyzing Activity-Based Costing	499
1. Reasons for Implementing Activity-Based Costing	499
2. Benefits and Costs of Activity-Based Costing	501
3. ABC Measures Costs, Not Benefits	503
D. Acceptance of Activity-Based Costing	505
E. Summary	509

12 Standard Costs: Direct Labor and Materials 538

A. Standard Costs 539

1. Reasons for Standard Costing 540
2. Setting and Revising Standards 541
3. Target Costing 545

B. Direct Labor and Materials Variances 546

1. Direct Labor Variances 546
2. Direct Materials Variances 550
3. Risk Reduction and Standard Costs 554

C. Incentive Effects of Direct Labor and Materials Variances 554

1. Build Inventories 555
2. Externalities 555
3. Discouraging Cooperation 556
4. Mutual Monitoring 556
5. Satisficing 556

D. Disposition of Standard Cost Variances 557

E. The Costs of Standard Costs 559

F. Summary 561

13 Overhead and Marketing Variances 574

A. Budgeted, Standard, and Actual Volume 575

B. Overhead Variances 578

1. Flexible Overhead Budget 578
2. Overhead Rate 579
3. Overhead Absorbed 580
4. Overhead Efficiency, Volume, and Spending Variances 580
5. Graphical Analysis 584
6. Inaccurate Flexible Overhead Budget 586

C. Marketing Variances 587

1. Price and Quantity Variances 587
2. Mix and Sales Variances 588

D. Summary 590

14 Management Accounting in a Changing Environment 608

A. Integrative Framework 609

1. Organizational Architecture 610
2. Business Strategy 611
3. Environmental and Competitive Forces Affecting Organizations 614
4. Implications 614

B. Organizational Innovations and Management Accounting 615

1. Total Quality Management (TQM) 616
2. Just-in-Time (JIT) Production 619
3. 6 Sigma and Lean Production 623
4. Balanced Scorecard 625

C. When Should the Internal Accounting System Be Changed?	631
D. Summary	632
Solutions to Concept Questions	653
Glossary	663
Index	672