## **Brief Contents**

Chapter One	Managerial Accounting: An Overview 1
Chapter Two	Managerial Accounting and Cost Concepts 24
Chapter Three	Job-Order Costing 83
Chapter Four	Process Costing 141
Chapter Five	Cost-Volume-Profit Relationships 183
Chapter Six	Variable Costing and Segment Reporting: Tools for Management 229
Chapter Seven	Activity-Based Costing: A Tool to Aid Decision Making 272
Chapter Eight	Profit Planning 335
Chapter Nine	Flexible Budgets and Performance Analysis 383
Chapter Ten	S t a n d a r d Costs and Variances 4 1 8
Chapter Eleven	Performance Measurement in Decentralized Organizations 472
Chapter Twelve	Differential Analysis: The Key to Decision Making 527
Chapter Thirteen	Capital Budgeting Decisions 579
Chapter Fourteen	Statement of Cash Flows 639
Chapter Fifteen	Financial Statement Analysis 679
Appendix A	Pricing Products and Services 715
Appendix B	Profitability Analysis 731

Credits 745 Index 747





#### Managerial Accounting: An Overview 1

What Is Managerial Accounting? 2 Planning 3 Controlling 3

Decision Making 4

Why Does Managerial Accounting Matter to Your Career? 5 Business Majors 5

Accounting Majors 7 Professional Certification—A Smart Investment

7

#### What Skills Do Managers Need to Succeed? 8

Strategic Management Skills8Enterprise Risk Management Skills9Process Management Skills11

Lean Production 11 The Theory of Constraints (TOC) 12 Measurement Skills 13 Leadership Skills 14

#### The Importance of Ethics in Business 14

Code of Conduct for Management Accountants 15

#### Corporate Social Responsibility 17

Summary 19 Glossary 19 Questions 19 Appendix 1A: Corporate Governance 20



#### Managerial Accounting and Cost Concepts 24

#### General Cost Classifications 25

Manufacturing Costs 25 Direct Materials 25 Direct Labor 25 Manufacturing Overhead 26

Nonmanufacturing Costs 26 Product Costs versus Period Costs 27 Product Costs 27 Period Costs 27 Prime Cost and Conversion Cost 27 **Cost Classifications for Predicting Cost Behavior** 29 Variable Cost 29 Fixed Cost 30 The Linearity Assumption and the Relevant Range 31 Mixed Costs 33 The Analysis of Mixed Costs 35 Diagnosing Cost Behavior with a Scattergraph Plot 35 The High-Low Method 38 The Least-Squares Regression Method 40 **Traditional and Contribution Format Income** Statements 42 The Traditional Format Income Statement 42 The Contribution Format Income Statement 43 **Cost Classifications for Assigning Costs to Cost** Objects 43 Direct Cost 44 Indirect Cost 44 Cost Classifications for Decision Making 44 Differential Cost and Revenue 44 Opportunity Cost 45 Sunk Cost 46 Summary 47 Review Problem I: Cost Terms 47 Review Problem 2: High-Low Method 48 Glossary 49 Questions 51 Applying Excel 51 Exercises 53 Problems 58 Cases 65 **Appendix 2A: Least-Squares Regression** Computations 67 **Appendix 2B: Cost of Quality** 72



#### Job-Order Costing 83

#### Job-Order Costing—An Overview 84 Job-Order Costing—An Example 85

Measuring Direct Materials Cost 86 Job Cost Sheet 86 Measuring Direct Labor Cost 87 **Computing Predetermined Overhead Rates** 88 Applying Manufacturing Overhead 89 Manufacturing Overhead—A Closer Look 90 The Need for a Predetermined Rate 90 Choice of an Allocation Base for Overhead Cost 91 Computation of Unit Costs 92

#### Job-Order Costing—The Flow of Costs 93

The Purchase and Issue of Materials 94 Issue of Direct and Indirect Materials 94 Labor Cost 95 Manufacturing Overhead Costs 96 Applying Manufacturing Overhead 97 The Concept of a Clearing Account 97 Nonmanufacturing Costs - 98 Cost of Goods Manufactured 99 Cost of Goods Sold 99

### Schedules of Cost of Goods Manufactured and Cost of Goods Sold 102

#### Underapplied and Overapplied Overhead—A Closer Look 103

Computing Underapplied and Overapplied Overhead 103 Disposition of Underapplied or Overapplied Overhead Balances 105 *Closed Out to Cost of Goods Sold 105 Allocated between Accounts 106* Which Method Should Be Used for Disposing of Underapplied or Overapplied Overhead? 106 A General Model of Product Cost Flows 107

Multiple Predetermined Overhead Rates 107

#### Job-Order Costing in Service Companies 108

Summary 108 Review Problem: Job-Order Costing 109 Glossary 111 Questions 112 Applying Excel 113 Exercises 114 Problems 122 Cases 129

Appendix 3A: The Predetermined Overhead Rateand Capacity131Appendix 3B: Further Classification of Labor Costs137



#### Process Costing 141

#### Comparison of Job-Order and Process Costing 142

Similarities between Job-Order and Process Costing 142 Differences between Job-Order and Process Costing 142

#### Cost Flows in Process Costing 143

Processing Departments 143
The Flow of Materials, Labor, and Overhead Costs 144
Materials, Labor, and Overhead Cost Entries 145
Materials Costs 145
Labor Costs 145
Overhead Costs 145
Completing the Cost Flows 145

#### Equivalent Units of Production 146

Weighted-Average Method 148

#### Compute and Apply Costs 150

Cost per Equivalent Unit—Weighted-Average Method 150 Applying Costs—Weighted-Average Method 151 Cost Reconciliation Report 152

#### **Operation Costing** 152

Summary 153 Review Problem: Process Cost Flows and Costing Units 153 Glossary 156 Questions 156 Applying Excel 157 Exercises 158 Problems 162 Cases 166

Appendix 4A: FIFO Method167Appendix 4B: Service Department Allocations176

xxx





#### Cost-Volume-Profit Relationships 183

#### The Basics of Cost-Volume-Profit (CVP) Analysis 184 Contribution Margin 185 CVP Relationships in Equation Form 187 CVP Relationships in Graphic Form 188 Preparing the CVP Graph 188 Contribution Margin Ratio (CM Ratio) 190 Some Applications of CVP Concepts 192 Change in Fixed Cost and Sales Volume 192 Change in Variable Costs and Sales Volume 193 Change in Fixed Cost, Sales Price, and Sales Volume 194 Change in Variable Cost, Fixed Cost, and Sales Volume 195 Change in Selling Price 196

#### Target Profit and Break-Even Analysis 196

Target Profit Analysis 196 The Equation Method 196 The Formula Method 197 Target Profit Analysis in Terms of Sales Dollars 197 Break-Even Analysis 198 Break-Even in Unit Sales 198 Break-Even in Sales Dollars 198 The Margin of Safety 199

#### CVP Considerations in Choosing a Cost Structure 200

Cost Structure and Profit Stability 201 Operating Leverage 202

### Structuring Sales Commissions204Sales Mix204

The Definition of Sales Mix205Sales Mix and Break-Even Analysis205

#### Assumptions of CVP Analysis 207

Summary 207 Review Problem: CVP Relationships 208 Glossary 210 Questions 211 Applying Excel 211 Exercises 213 Problems 219 Cases 227





#### Variable Costing and Segment Reporting: Tools for Management 229

**Overview of Variable and Absorption Costing** 230 Variable Costing 230 Absorption Costing 230 Selling and Administrative Expense 231 Summary of Differences 231 Variable and Absorption Costing—An Example 232 Variable Costing Contribution Format Income Statement 232 Absorption Costing Income Statement 234 **Reconciliation of Variable Costing with Absorption** Costing Income 235 Advantages of Variable Costing and the Contribution Approach 238 Enabling CVP Analysis 238 Explaining Changes in Net Operating Income 239 Supporting Decision Making 239 Adapting to the Theory of Constraints 240 Segmented Income Statements and the Contribution Approach 240 Traceable and Common Fixed Costs and the Segment Margin 240

Identifying Traceable Fixed Costs 241 Traceable Costs Can Become Common Costs 242

#### Segmented Income Statements—An Example 242

Levels of Segmented Income Statements243Segmented Income Statements and Decision Making245

Segmented Income Statements—Common Mistakes 245

Omission of Costs 246 Inappropriate Methods for Assigning Traceable Costs among Segments 246 *Failure to Trace Costs Directly 246 Inappropriate Allocation Base 246* Arbitrarily Dividing Common Costs among Segments 246

Income Statements—An External ReportingPerspective247Companywide Income Statements247Segmented Financial Information248

хххі

#### xxxii

#### Contents

249 Summary Review Problem 1: Contrasting Variable and Absorption Costing 249 **Review Problem 2: Segmented Income Statements** 251 Glossary 252 Questions 252 253 Applying Excel Exercises 255 Problems 261 Cases 269



#### Activity-Based Costing: A Tool to Aid Decision Making 272

#### Activity-Based Costing: An Overview 273

Nonmanufacturing Costs and Activity-Based Costing 273 Manufacturing Costs and Activity-Based Costing 274

Cost Pools, Allocation Bases, and Activity-Based Costing 274

#### Designing an Activity-Based Costing (ABC) System 277

Steps for Implementing Activity-Based Costing 279 Step 1: Define Activities, Activity Cost Pools, and Activity Measures 279

#### The Mechanics of Activity-Based Costing 280

Step 2: Assign Overhead Costs to Activity Cost Pools 280

Step 3: Calculate Activity Rates 284

Step 4: Assign Overhead Costs to Cost Objects 285

Step 5: Prepare Management Reports 288

#### Comparison of Traditional and ABC Product Costs 291

Product Margins Computed Using the Traditional Cost System 291 The Differences between ABC and Traditional **Product** Costs 292

# Targeting Process Improvements296Activity-Based Costing and External Reports296The Limitations of Activity-Based Costing297

Summary 298 Review Problem: Activity-Based Costing 298 Glossary 300 Questions 301 Applying Excel 301 Exercises 304 Problems 312

Appendix 7A: ABC Action Analysis317Appendix 7B: Using a Modified Form of Activity-Based Costing to Determine Product Costs for ExternalReports328



#### Profit Planning 335

#### The Basic Framework of Budgeting 336

Advantages of Budgeting 336 Responsibility Accounting 337 Choosing a Budget Period 337 The Self-imposed Budget 338 Human Factors in Budgeting 339 The Budget Committee 340 The Master Budget: An Overview 341

#### Preparing the Master Budget 342

The Sales Budget 343 The Production Budget 344 Inventory Purchases-Merchandising Company 346 The Direct Materials Budget 346 The Direct Labor Budget 348 The Manufacturing Overhead Budget 349 The Ending Finished Goods Inventory Budget 350 The Selling and Administrative Expense Budget 351 The Cash Budget 352 356 The Budgeted Income Statement The Budgeted Balance Sheet 357

359 Summarv Review Problem: Budget Schedules 359 361 Glossary Questions 362 Applying Excel 362 Exercises 364 370 Problems Cases 380



#### Flexible Budgets and Performance Analysis 383

#### Flexible Budgets 384

Characteristics of a Flexible Budget 384 Deficiencies of the Static Planning Budget 385 How a Flexible Budget Works 387

#### Flexible Budget Variances 388

Activity Variances 388 Revenue and Spending Variances 389 A Performance Report Combining Activity and Revenue and Spending Variances 391 Performance Reports in Nonprofit Organizations 394 Performance Reports in Cost Centers 394

#### Flexible Budgets with Multiple Cost Drivers 394 Some Common Errors 396

Summary 397 Review Problem: Variance Analysis Using a Flexible Budget 398 Glossary 399 Questions 400 Applying Excel 400 Exercises 402 Problems 410 Cases 414



#### Standard Costs and Variances 418

#### Standard Costs—Setting the Stage 419

Who Uses Standard Costs? 420
Setting Standard Costs 420
Setting Direct Materials Standards 421
Setting Direct Labor Standards 422
Setting Variable Manufacturing Overhead
Standards 422
Using Standards in Flexible Budgets 423

A General Model for Standard Cost Variance Analysis 424

The Materials Quantity Variance 426	
The Materials Price Variance 427	
Materials Quantity Variance—A Closer Look 427	
Materials Price Variance—A Closer Look 429	
Isolation of Variances 429	
Responsibility for the Variance 429	
Using Standard Costs—Direct Labor Variances 430	)
Labor Efficiency Variance—A Closer Look 430	
Labor Rate Variance—A Closer Look 432	
An Important Subtlety in the Materials Variances 4 Variance Analysis and Management by Exception 4 International Uses of Standard Costs 439 Evaluation of Controls Based on Standard Costs 43	433  35  37  9
Advantages of Standard Costs 439	
Potential Problems with the Use of Standard Costs	440
Summary 440	
Review Problem: Standard Costs 441	
Glossary 443	
Questions 444	
Applying Excel 444	
Exercises 446	

Using Standard Costs—Direct Materials Variances 425

Exercises 446 Problems 448 Cases 454

# Appendix 10A: Predetermined Overhead Rates andOverhead Analysis in a Standard Costing System454Appendix 10B: Journal Entries to RecordVariances467





#### Performance Measurement in Decentralized Organizations 472

#### Decentralization in Organizations 473

Advantages and Disadvantages of Decentralization 473

#### Responsibility Accounting 474

Cost, Profit, and Investment Centers 474 *Cost Center Profit CenterInvestment Center* xxxiii

#### Evaluating Investment Center Performance—Return on Investment 475

The Return on Investment (ROI) Formula 475 Net Operating Income and Operating Assets Defined 475 Understanding ROI 476 Criticisms of ROI 479

#### Residual Income 479

Motivation and Residual Income 480 Divisional Comparison and Residual Income 481

#### **Operating Performance Measures** 482

Delivery Cycle Time 482 Throughput (Manufacturing Cycle) Time 482 Manufacturing Cycle Efficiency (MCE) 483

#### **Balanced Scorecard** 485

Common Characteristics of Balanced Scorecards485A Company's Strategy and the Balanced Scorecard487Tying Compensation to the Balanced Scorecard490Advantages of Timely and Graphic Feedback491

#### Summary 492

Review Problem: Return on Investment (ROI) and Residual Income 492 Glossary 493 Questions 493 Applying Excel 494 Exercises 495 Problems 500 Cases 506

Appendix 11A: Transfer Pricing507Appendix 11B: Service Department Charges519





### Differential Analysis: The Key to Decision Making 527

#### Cost Concepts for Decision Making 528

Identifying Relevant Costs and Benefits 528 Different Costs for Different Purposes 529 An Example of Identifying Relevant Costs and Benefits 529 Reconciling the Total and Differential Approaches 532 Why Isolate Relevant Costs? 534

	lding and Dropping Product Lines and Other gments 535
	An Illustration of Cost Analysis 535
	A Comparative Format 537
	Beware of Allocated Fixed Costs 537
Tł	ne Make or Buy Decision 539
	Strategic Aspects of the Make or Buy Decision 539
	An Example of Make or Buy 540
<b>O</b> ]	pportunity Cost 541
Sp	ecial Orders 542
Ut	ilization of a Constrained Resource 543
	Contribution Margin per Unit of the Constrained Resource 544
	Managing Constraints 546
	The Problem of Multiple Constraints 548
	int Product Costs and the Contribution oproach 548
	The Pitfalls of Allocation 550
	Sell or Process Further Decisions 550
A	ctivity-Based Costing and Relevant Costs 552
Su	mmary 552
Re	view Problem: Relevant Costs 553
G	lossary 554
Q	uestions 554
Ap	plying Excel 555
Ел	ercises 556
Pı	oblems 564
С	ases 572
_	
	Chapter 5

#### Capital Budgeting Decisions 579

Capital Budgeting—Planning Investments580Typical Capital Budgeting Decisions580The Time Value of Money580

Discounted Cash Flows—The Net Present Value Method 581

The Net Present Value Method Illustrated 581 Emphasis on Cash Flows 583 Typical Cash Outflows 583 Typical Cash Inflows 583

xxxiv

Recovery of the Original Investment 584 Simplifying Assumptions 585 Choosing a Discount Rate 585 An Extended Example of the Net Present Value Method 586

#### Discounted Cash Flows—The Internal Rate of Return Method 588

The Internal Rate of Return Method Illustrated 588 Salvage Value and Other Cash Flows 589 Using the Internal Rate of Return 589 The Cost of Capital as a Screening Tool 589 Comparison of the Net Present Value and Internal Rate of Return Methods 590

#### Expanding the Net Present Value Method 590

The Total-Cost Approach590The Incremental-Cost Approach591Least-Cost Decisions592

#### Uncertain Cash Flows 594

An Example 594 Real Options 595

# Preference Decisions—The Ranking of InvestmentProjects595Internal Rate of Return Method595

Net Present Value Method 596

### Other Approaches to Capital Budgeting Decisions 597

The Payback Method597Evaluation of the Payback Method598An Extended Example of Payback599Payback and Uneven Cash Flows600The Simple Rate of Return Method601Criticisms of the Simple Rate of Return602

#### Postaudit of Investment Projects 602

603 Summary Review Problem: Comparison of Capital Budgeting Methods 603 Glossary 605 **Ouestions** 605 Applying Excel 606 607 Exercises Problems 611 Cases 620

Appendix 13A: The Concept of Present Value622Appendix 13B: Present Value Tables629Appendix 13C: Income Taxes in Capital BudgetingDecisions631



#### Statement of Cash Flows 639

#### The Statement of Cash Flows: Key Concepts 641

Organizing the Statement of Cash Flows 641 Operating Activities: Direct or Indirect Method? 642 The Indirect Method: A Three-Step Process 643 Investing and Financing Activities: Gross Cash Flows 645 *Property, Plant, and Equipment* 646 *Retained Earnings* 647

Summary of Key Concepts 648

#### An Example of a Statement of Cash Flows 650

Operating Activities651Investing Activities652Financing Activities653Seeing the Big Picture654

#### Interpreting the Statement of Cash Flows 656

Consider a Company's Specific Circumstances 656 Consider the Relationships among Numbers 657 *Free Cash Flow* 657 *Earnings Quality* 658

Summary658Review Problem659Glossary663Questions663Exercises**664**Problems667

Appendix 14A: The Direct Method of Determining theNet Cash Provided by Operating Activities675



#### Financial Statement Analysis 679

#### Limitations of Financial Statement Analysis 680 Comparing Financial Data across Companies 680

Comparing Financial Data across Companies 680 Looking beyond Ratios 680

# Statements in Comparative and Common-Size Form680Dollar and Percentage Changes on Statements681Common-Size Statements683

Ratio Analysis—The Common Stockholder685Earnings per Share685

XXXV

Price-Earnings Ratio 687 Dividend Payout and Yield Ratios 687 *The Dividend Payout Ratio* 687 *The Dividend Yield Ratio* 687 Return on Total Assets 688 Return on Common Stockholders' Equity 688 Financial Leverage 689 Book Value per Share 689

#### Ratio Analysis—The Short-Term Creditor 690

Working Capital 690 Current Ratio 690 Acid-Test (Quick) Ratio 691 Accounts Receivable Turnover 691 Inventory Turnover 692

#### Ratio Analysis—The Long-Term Creditor 693

Times Interest Earned Ratio693Debt-to-Equity Ratio694

#### Summary of Ratios and Sources of Comparative Ratio Data 694

Summary697Review Problem:Selected Ratios and FinancialLeverage697Glossary699Questions699Exercises700Problems705



#### Pricing Products and Services 715

Introduction716The Economists' Approach to Pricing717Elasticity of Demand717The Profit-Maximizing Price718

# The Absorption Costing Approach to Cost-PiusPricing720Setting a Target Selling Price Using the Absorption<br/>Costing Approach720Determining the Markup Percentage721

Problems with the Absorption Costing Approach 722

#### Target Costing 723

Reasons for Using Target Costing724An Example of Target Costing724

Summary	725
Glossary	725
Questions	725
Exercises	726
Problems	727



#### Profitability Analysis 731

Introduction 732 Absolute Profitability 732 Relative Profitability 733 Volume Trade-Off Decisions 736 Managerial Implications 738

Summary739Glossary740Questions740Exercises740Problems741Cases744

Photo Credits 745 Index 747

xxxvi