



MANAGERIAL ACCOUNTING

CONCEPTS FOR PLANNING, CONTROL, DECISION MAKING

Sixth Edition

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*To my wife,
Mary Jean,*

who has contributed greatly to the success of this book
through encouragement, assistance in proofing, and the
willingness to give up many hours of my time to which she
had a clear and rightful claim.

.....

Preface

This text is designed for a one-term course in managerial accounting for use by students who have already completed one or two terms of basic financial accounting. The emphasis of *Managerial Accounting* is on uses of accounting data internally by managers in directing the affairs of business and nonbusiness organizations.

As suggested by the subtitle to the book, managers need information to carry out three essential functions in an organization: (1) planning operations; (2) controlling activities; and (3) making decisions. The purpose of *Managerial Accounting* is to show what kind of information is needed, where this information can be obtained, and how this information is used by managers as they carry out their planning, control, and decision-making responsibilities.

Although the emphasis of the book is on uses of accounting data in the management process, care has been taken to not sacrifice the student's need for basic technical understanding. To this end, topics are covered in enough depth to ensure full comprehension of basic concepts. Thus, armed with both conceptual and technical understanding, students are able to proceed with confidence in applying managerial skills to a wide variety of organizational problems as contained in the end-of-chapter assignments.

A paramount objective in the writing of *Managerial Accounting*, as well as in its various revisions, has been to make a clear and balanced presentation of relevant subject matter. This focus on relevance continues in the current edition where greater recognition is given to many exciting new concepts that are reshaping traditional costing systems and procedures. Accordingly, users will find extensive discussion of topics such as just-in-time systems, activity-based costing, flexible manufacturing systems, computer-integrated performance measures, and the impact of automation on capital budgeting decisions. Moreover, these topics are *integrated* into the text and problem material *throughout the book*, rather than isolated in one or two chapters at the end. Also, in recognition of the widespread application of management accounting concepts, users will find many examples and problems that deal with not-for-profit, service, retail, and wholesale organizations as well as examples and problems that deal with manufacturing organizations. In short, the watchwords for this edition of *Managerial Accounting* have again been *relevance* of subject matter, *balance* of topics, and a continued tradition of *clarity* in presentation.

New in This Edition

The following specific additions and changes have been made to the current edition of *Managerial Accounting*:

1. As in prior editions, special attention has been given to writing new exercise and problem material. The majority of exercises and problems in the current edition are therefore either new or completely rewritten. Users will again find a wide range of problems in terms of level of difficulty.
2. The use of short cases is continued in the current edition. To keep the material fresh and challenging, the majority of these cases are either new or rewritten.
3. The material on just-in-time (JIT) inventories has been removed from Chapter 8, expanded and rewritten, and moved to Chapter 2, "Cost Terms, Concepts, and Classifications." Also, an introductory discussion of flexible manufacturing systems (FMS) has been added to Chapter 2. It is important to introduce JIT and FMS concepts early in the book because of their pervasive impact on other managerial accounting topics.
4. The discussion on overtime premium, fringe benefits, and related labor costs has been removed from the main body of Chapter 2 and placed in an appendix. This change reflects the decreasing importance of trying to distinguish between the costs of direct and indirect labor.
5. A major, new section dealing with activity-based costing has been added to Chapter 3, "Systems Design: Job-Order Costing." The relationship between activity-based costing and JIT inventory systems is also discussed. Both problems and cases relating to activity-based costing have been added to the chapter.
6. An appendix that deals with cost flows in a JIT system has been added to Chapter 3. This material compares JIT to a conventional system, and discusses the concept of backflush costing.
7. In Chapter 4, "Systems Design: Process Costing," the production report has been modified somewhat to allow a simpler and more direct computation of equivalent units.
8. A new section that discusses the impact of JIT inventory systems on process costing has been added to Chapter 4.
9. Another new section has been added to Chapter 4 that discusses operation costing and identifies the situations in which it may be useful to the manager.
10. A discussion of the impact of automation on cost-volume-profit (CVP) analysis has been added in Chapter 6.
11. Material that discusses the impact of a JIT system on the differences in net income between absorption and direct costing has been added to Chapter 7, "Segmented Reporting and the Contribution Approach to Costing."
12. Material relating to the master budget income statement has been removed from Chapter 10 and moved to Chapter 8, "Profit Planning," where it fits more logically. With this change, the general concept of flexible budgeting is now introduced in Chapter 8.
13. A major, new section that deals with JIT purchasing has been added to Chapter 8. This section also helps students to understand the difference between JIT purchasing and JIT production.
14. Chapter 9, which was titled "Control through Standard Costs" in the prior edition, has been retitled "Standard Costs and JIT/FMS Performance Measures." This new title reflects the addition to the chapter of performance measures that relate to throughput time, delivery cycle time, velocity of production, and so forth in an automated environment.
15. With the movement of the master budget income statement to Chapter 8, Chapter 10, "Flexible Budgets and Overhead Analysis," now focuses only on overhead costs, as it did in earlier editions of the book.

16. A key exhibit, titled Elements of Return on Investment, has been added to Chapter 11, "Control of Decentralized Operations." This exhibit serves as the basis for the ROI discussion in the chapter.
17. A major, new section that deals with investments in an automated environment has been added to Chapter 14, "Capital Budgeting Decisions." This section provides an extensive discussion of both tangible and intangible benefits from automation, with particular emphasis on how intangible benefits can be integrated into the capital budgeting decision framework.
18. The material relating to *payback* and *simple rate of return* has been moved from Chapter 15 back to Chapter 14. With this reorganization, Chapter 14 now contains both discounted cash flow and nondiscounted cash flow approaches to capital budgeting decisions.
19. The material in Chapter 14 dealing with the mechanics of present value has been removed from the body of the chapter and placed in an appendix. This material is becoming less important as greater numbers of students are exposed to present value analysis in basic math and statistics classes.
20. The content of Chapter 16, "Service Department Cost Allocations," has been reorganized somewhat to allow discussion of the direct method of allocation before discussion of the more complex step method.
21. The sequence of Chapters 17 and 18 has been reversed so that Chapter 17 now covers the statement of cash flows and Chapter 18 covers financial statement analysis.
22. The material in Chapter 17, "Statement of Cash Flows," has been updated to make it wholly consistent with the FASB's *Statement No. 95* on cash flow reporting.
23. Since the Statement of Working Capital is no longer acceptable for reporting purposes, all material relating to this statement has been removed from Chapter 17.

In addition to the above, scores of small "polishing" changes have been made throughout the book in an effort to further improve flow, comprehension, and readability. In no case, however, has change been made simply for the sake of change (other than in the assignment material). Rather, the revision has been completed with a single thought in mind—to make the sixth edition of *Managerial Accounting* the most up-to-date and teachable book available in its field.

Using the Text and Its Supplements

As in the prior editions, flexibility in meeting the needs of courses varying in length, content, and student composition continues to be a prime concern in the organization and content of the book. Sufficient text material is available to permit the instructor to choose topics and depth of coverage as desired. Appendixes, parts of chapters, or even whole chapters can be omitted without adversely affecting the continuity of the course. A Solutions Manual is available that gives a number of alternate assignment outlines and suggestions as to the problems to be assigned from various chapters.

The book contains over 800 questions, exercises, problems, and cases for in-class use or for homework assignment. In addition, a comprehensive test bank is available for preparing examinations and quizzes. The Test Bank contains over 1,000 objective questions and short problems. My appreciation is extended to Professor Kevin D. Stocks, Brigham Young University, who prepared the test bank materials.

Spreadsheet Applications Template Software (SPATS), a new software package, permits students to use the computer in working selected exercises, problems, and cases from the end-of-chapter assignment material. The exercises and problems involved are keyed in the margin with the spreadsheet symbol shown here in the margin. Little or no classroom instruction time is needed to teach students how to



use the templates since they contain built-in tutorial material. In addition to SPATS, Tutorial Software prepared by Leland Mansuetti of Sierra College is available. This package includes true/false and multiple-choice questions with explanations for both correct and incorrect answers by students. Upon adoption, these packages are available to instructors for classroom or laboratory use.

The following additional items are provided for instructors: an attractive binder containing a three-hole-punched copy of the text; an Instructor's Resource Guide, which contains chapter outlines and transparency masters for classroom instruction; Solutions Transparencies for homework exercises and problems; copies of Lotus templates with worked-out solutions that accompany SPATS; Check Figures for problems; and CompuTest 3 for preparing examinations.

For students, a Workbook/Study Guide is available for purchase, as are Working Papers keyed to end-of-chapter problems.

Acknowledgments

Ideas and suggestions have been received from many faculty members who used the prior edition of *Managerial Accounting*. Each has my thanks, since the book is a better product as a result of their insightful comments.

The efforts of many people are needed to develop a book and improve it from edition to edition. Among these people are the reviewers who point out areas of concern, cite areas of strength, and make recommendations for change. In this regard, the following professors spent considerable time providing in-depth reviews for the current edition of *Managerial Accounting*: Virginia Lewis, Southern Methodist University; Thomas J. O'Neil, American International College; S. E. Clair Purvis, University of Southern California; Paul W. Ramsey, Pensacola Junior College; Donald E. Stone, University of Massachusetts—Amherst; Gwendolyn Totterdale, San Diego State University; and Michael F. Thomas, Oklahoma State University.

Permission has been received from the Institute of Certified Management Accountants of the National Association of Accountants to use questions and/or unofficial answers from past Certificate in Management Accounting (CMA) examinations. Also, my appreciation is extended to the American Institute of Certified Public Accountants and to the Society of Management Accountants of Canada for permission to use (or to adapt) selected problems from their examinations. These problems bear the notations CMA, CPA, and SMA, respectively.

Ray H. Garrison

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PART I

THE FOUNDATION

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