Third Edition

CONTEMPORARY ISSUES IN COST AND MANAGERIAL ACCOUNTING

A Discipline in Transition

Anton · Firmin
Grove

Contemporary Issues in Cost and Managerial Accounting

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A Discipline in Transition

Third Edition

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Contemporary Issues in Cost and Managerial Accounting

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Preface

The theme of the third edition of our cost and managerial accounting readings book is a familiar one: a discipline in transition. The readings again reflect behavioral-science, information-system, and quantitative-method analyses of cost and managerial accounting problems. The final section of the book further develops emerging trends, information system design, human resource accounting, social accounting, and operational not-for-profit performance evaluation techniques.

Increasing concern for efficiency and public accountability in the not-for-profit sector of the economy makes the concepts and techniques of managerial accounting quite relevant to public administration, management, and social work.

We have attempted to include articles that reflect the "frontier" of existing knowledge in the cost and managerial accounting disciplines. The articles cover such "frontier" issues as: using zero-base budgeting techniques to justify an organization's existence; using expectancy theory to analyze behavioral impacts on budgeting; tracking cost variances with cusum charts; applying standard costs to a service industry (for example, incorporating them into a bank's information system); using organization theory to solve the transfer pricing problem of decentralized entities; and linking nonmonetary outcome measurements to costs in an interdisciplinary perspective to provide nonprofit performance evaluations.

The articles appear in the following seven-part sequence: a perspective in managerial accounting; forecasting, budgeting, and responsibility accounting; capital budgeting; cost estimation and cost-volume-profit analysis; standard costs and performance evaluation; cost allocation and decentralization; and emerging areas in managerial accounting. The perspective developed in Part One considers information system, decision model, and behavioral science concepts. Within this perspective we will view the specific managerial accounting topics covered in Parts Two through Six. The emerging areas in Part Seven reflect the extension of these concepts in recent cost and managerial accounting developments.

The thirty articles in this book reflect various degrees of quantitative application ranging from a mere mention of method to the development or application of specific quantitative techniques. In selecting the latter type of article, we have chosen, as much as possible, "self-contained" articles with sufficient explanations of quantitative techniques that the reader will not have to consult other sources. The degree of self-containment depends upon the background of the reader, however, and some may wish to study certain quantitative techniques in greater depth. A list of such supplemental sources, keyed to various articles used in the text, is given in the Appendix.

The editors again extend their gratitude to the authors of the articles included and to the publishers who kindly consented to allow the reprints.

We appreciate the special contribution of Barbara Wihera and Joyce Frakes, graduate students who participated in the literature review and helped select the articles from their unique and crucial point of view: usefulness and accessibility to the student. We also express our appreciation to Robert Hamilton, of the University of Minnesota, and Roger Roemmich, of the University of Georgia, who reviewed the original manuscript and made valuable comments.

H.R.A.

P.A.F.

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PART ONE

A Perspective in Managerial Accounting

Cost and managerial accounting, like accounting in general, are dynamic, evolving disciplines. Traditional cost accounting has dealt largely with the accumulation and allocation of factory costs and product for inventory valuation and income determination. The discipline is now more generally designated as managerial accounting to emphasize its conceptual expansion in order to provide relevant accounting data to decision-makers. These conceptual developments include the consideration of management information systems, decision models, behavioral science, budgeting, cost estimation and control, not-for-profit performance evaluation, internal pricing, and various decision-oriented problem areas. Part One introduces the general development and integration of management information systems, decision models, and behavioral science in the managerial accounting discipline.

Horngren outlines the scope, content, and method of management accounting in a management information system context. He distinguishes financial accounting from "... internal reporting for managers for planning, controlling current operations ... [and] for making special decisions and formulating long-range plans." He also develops objectives and informational requirements for decision-makers. Although it stresses management accounting, the Horngren article applies equally to not-for-profit organizations. Indeed, cost and management accounting are increasingly being recognized as relevant to hospitals, government, and other fiduciary organizations. Horngren also foresees many later developments such as decision analysis, divisional reporting problems, and flexible organizational systems for the managerial accounting discipline.

In providing relevant information to decision-makers, managerial accounting starts with the examination of actual decision models that indicate specific types of desired accounting information. The "Report of the

Committee on Managerial Decision Models" of the American Accounting Association develops the investigation of various decision models and interactions with accounting and information systems. The report begins with an exploration of the general nature of decision models and general attributes of information for decision models. It then elaborates implications of decision models and information systems for managerial accounting. Finally, the report explores specific decision models to develop the types of information desired. With a cost-benefit perspective, the reader may then assess the difference between information traditionally provided by managerial accounting and that which should be provided.

Another major development in managerial accounting has been the long overdue recognition of the great impact of the behavioral sciences on accounting. This impact has been reflected in extensive non-accounting literature in the areas of motivation, behavior, and organizational theory. Benston provides a good survey of the literature and applies these concepts to accounting systems. As one of the earlier articles on behavior and accounting, it serves as an introduction to the area.

Caplan then expands the role of behavioral science in managerial accounting by specifying and comparing behavioral assumptions from the classical and modern behavioral viewpoints. The design of the management and accounting information systems depends heavily on which viewpoint management follows. If the modern behavioral viewpoint predominates, then the traditional accounting information system, which corresponds to the classical behavioral viewpoint, must also evolve into a modern system to provide relevant information. The differences between the two behavioral schools of thought are elaborated in four categories of assumptions — organization goals, participant behavior, management behavior, and the role of management accounting. The challenging implication is that traditional managerial accounting systems may be mismatched with modern behavioral viewpoints and information requirements.

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The scope and content of financial accounting is well known. In this article the author defines the scope of managerial accounting and contrasts it with financial accounting. The objectives of management accounting and the types of information requirements are clearly outlined.

The main purposes are given as routine reporting of financial data or "score-keeping"; routine reporting to management for planning and control or "attention-directing"; and special reporting to management for non-recurring decisions or "problem-solving." Any guide to management accounting must pay major attention to relevancy of information and its timeliness. Accuracy, while important, may be non-relevant. Future accounting information systems' needs are clearly outlined including structuring, cost-behavior rules, and responsibility accounting.

Choosing Accounting Practices for Reporting to Management*

Charles T. Horngren†

Objectives of Management Accounting

Management Accounting — Its Distinctive Purposes

The accounting system is the major formal information system in almost every organization. An effective accounting system provides information for three broad purposes: (1) external reporting to stockholders, government,

* *From* NAA Bulletin, *Vol. XLIV, No. 1 (September, 1962), pp. 3–15. Reprinted by permission of the publisher.*

† I am indebted to the members of the Workshop in Accounting Research, Institute of Professional Accountancy, Graduate School of Business, University of Chicago — especially Professors Sidney Davidson, David Green, Jr., Richard Lindhe, and George H. Sorter — for constructive criticism.

and other outside parties, (2) internal reporting to managers for planning and controlling current operations, and (3) internal reporting to managers for making special decisions and formulating long-range plans.

Management (internal parties) and external parties share an interest in all three important purposes, but the emphasis of financial accounting and management accounting differs. Financial accounting has been mainly concerned with the first purpose and has traditionally been oriented toward the historical, stewardship aspects of external reporting. The distinguishing feature of management accounting is its emphasis on the second and third purposes.

The job of serving both internal and external demands can be an imposing one. Conventional accounting systems have tended to grow primarily in response to external forces. Management accounting, on the other hand, attempts to implement a more balanced, multi-goaled perspective. The widespread problem that management accountants must face has been aptly described as follows:

> Very few people in business have had the opportunity to reflect on the way in which the accounting model developed, particularly on how an instrument well adapted to detect fraud and measure tax liability has gradually been used as a general information source. Having become accustomed to information presented in this form, business people have adapted their concepts and patterns of thought and communication to it rather than adapting the information to the job or person. When one suggests the reverse process, as now seems not only logical but well within economic limits, he must expect a real reluctance to abandon a pattern of behavior that has a long history of working apparently quite well.[1]

A management accounting planning and control system should be designed to spur and help executives in searching for and selecting short-run and long-run goals, formulating plans for attaining those goals, implementing plans, appraising performance and pin-pointing deviations from plans, investigating reasons for deviations, reselecting goals, etc. Management accounting is concerned with accumulating, classifying, and interpreting costs and other information that induce and aid individual executives in fulfilling organizational objectives as revealed explicitly or implicitly by top management.

Types of Information Supplied by Management Accounting

What information should the management accountant supply? The types of information needed have been neatly described by Simon *et al.* as a result

[1] William R. Fair, "The Next Step in Management Controls," in Donald G. Malcom and Alan J. Rowe, (ed.), *Management Control Systems* (New York: John Wiley & Sons, Inc., 1960), pp. 229–230.