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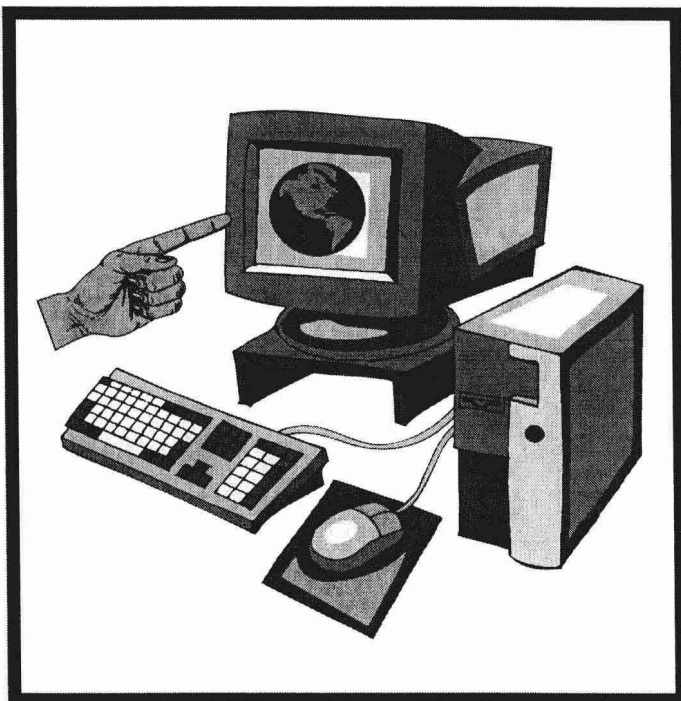
# **Managerial Accounting**



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# Managerial Accounting



Paul E. Dascher  
Stetson University

Jeffrey W. Strawser  
Sam Houston State University

Robert H. Strawser  
Texas A&M University

2002

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Artist: Jan Tiefel

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# *Managerial Accounting*

## *11th Edition*

### **TO THE STUDENT**

A *Study Guide*, *Working Papers*, and *Student Solutions Manual* are available through your bookstore. The purpose of the Study Guide is to assist you in studying and reviewing the text material and provide you with a means of self-test by the study of the detailed outline and use of the true-false questions, multiple choice questions, matching and completion statements, and exercises included in the *Study Guide*. These may be used both in your initial study of the chapter material and in your subsequent review. The *Working Papers* have prepared forms and check figures for your problem assignments. The *Student Solutions Manual* has complete solutions for the even numbered problems, check figures for the odd numbered problems, and sample examinations with answers. If the *Study Guide*, *Working Papers*, or *Student Solutions Manual* are not in stock in your bookstore, ask the bookstore manager to order copies for you.

# Preface

The tenth edition of this text, like its predecessors, was written as an integrated work in managerial accounting, and is intended for use as a basic text for students completing a first semester or quarter course in financial accounting at either the undergraduate or graduate level. This text is organized around the following major areas of managerial accounting:

- **An Overview of Managerial Accounting.** In this section, the text discusses the uses of managerial accounting and contrasts the type and use of information provided by managerial accounting and financial accounting (Chapter 1). Chapter 2 focuses on basic cost information and behavior. In this chapter, we distinguish between the different types of costs incurred by organizations. In addition, this chapter discusses the behavior of these costs with changes in activity as well as the effect of cost behavior on managerial decisions.
- **Cost Accumulation.** Chapters 3 through 5 illustrate the process through which the organization accumulates costs with its inventory products and services. In Chapter 3, we focus on production and service processes that require different levels of effort across individual jobs (job-order costing). Chapter 4 illustrates the cost accumulation process for manufacturing environments characterized by the production of a large number of similar products (process costing). Chapter 5 focuses on the process through which overhead costs are accumulated with the organization's inventory and services. The dedication of an entire chapter to overhead costs represents a significant change from the prior editions of this text and is considered necessary, given the importance of controlling overhead costs to organizations in manufacturing inventory and providing services.
- **The Use of Managerial Accounting Information.** Chapters 6 through 11 describe various uses of managerial accounting information. Topics discussed in these chapters include variable costing and cost-volume-profit analysis (Chapter 6), standard costing and determination of variances (Chapter 7), budgeting (Chapter 8), responsibility accounting (Chapter 9), short-term managerial decisions (Chapter 10), and capital budgeting (Chapter 11). In these chapters, the basic principles of cost behavior and cost accumulation discussed in the preceding two sections are applied to important decisions facing managers in today's business world.

In addition, to allow coverage of these topics (if desired), Chapters 12 and 13 provide discussions of financial statement analysis and the statement of cash flows, respectively.

Several pedagogical improvements initiated in previous editions are continued in this edition. These include:

1. The use of illustrations and diagrams to provide students with a conceptual "picture" of many important concepts associated with managerial accounting. For example, in discussing cost flows and the allocation of service department costs, pictorial representations are used to accompany written text discussion.
2. Additional "real-world" examples have been added throughout the text to allow students to see how managerial accounting topics apply in today's business environment. Included are a wealth of excerpts from articles in such publications as *Business Week*, *Forbes*, and *The Wall Street Journal*.
3. A variety of hypothetical corporations are used to illustrate basic managerial accounting concepts. The use of a number of examples allows students to encounter each concept with a "fresh" approach. In addition, this also illustrates the wide variety of situations in which managerial accounting concepts are commonly applied.

Numerous end-of-chapter materials (Questions, Exercises, and Problems) allow instructors maximum flexibility in tailoring the course to fit their students' needs. These materials are identified by topic area to allow instructors to include all major concepts and issues in their assignments. Questions are designed to focus on concepts, definitions, and descriptions introduced in that chapter. Exercises and Problems usually require analytical analysis of chapter concepts.

A new feature of the 11<sup>th</sup> edition is the addition of ten (or more) multiple choice questions at the end of the problem material. This feature may be used to allow the student additional self-testing of the material or may be assigned by the instructor.

Numerous appendices are included throughout the text in proximity to the relevant chapters of interest. The use of appendices is designed to allow instructors the maximum amount of flexibility in tailoring the course to suit their students' needs. These appendices can be assigned as instructors see fit without disrupting the main concepts embodied in the chapters. A new feature of the 11<sup>th</sup> edition is the inclusion of the PepsiCo Annual Report as an Appendix to Chapter 12, Financial Statement Analysis.

In addition to the text, a *Study Guide*, *Working Papers*, and *Student Solutions Manual* have been prepared by the authors and are available. The *Study Guide* contains an outline of key text concepts along with extensive self-testing materials. These materials include true-false questions, completion exercises, multiple choice questions, and short exercises. The purpose of the *Study Guide* is to allow students additional exposure to and practice in applying concepts discussed in each text chapter. The *Working Papers* contain prepared forms and check figures for problem assignments. The

*Student Solutions Manual* has complete solutions for the even-numbered problems, check figures for the odd-numbered problems, and sample examinations with answers.

We are indebted to many people for their ideas and assistance. The following professors made constructive comments on the manuscript: Natalie Allen (Texas A&M University), Kathryn Lancaster (California Polytech State University–San Luis Obispo), and Haresh Sapra (University of Minnesota). Additional thanks are due to N. Ross Quarles and R. Dean Lewis of Sam Houston State University, Jerry R. Strawser, A. Benton Cocanougher and James J. Benjamin (of Texas A&M University) for providing the environment for this effort. We would like to also thank Jerry R. Strawser of Texas A&M University for his careful review of the text and for his helpful suggestions.

We also appreciate the permission received from the American Institute of Certified Public Accountants and the Institute of Management Accountants for allowing us to use problem materials from past Uniform CPA and CMA Examinations, respectively. The authors thank Roger A. Enrico, Chairman and Chief Executive Officer of PepsiCo, for his permission to use PepsiCo's Annual Report.

Finally, we acknowledge a special thanks to Jan Tiefel and Pam Porter for their help in turning our draft materials into the finished product. Without their valuable assistance, the final output would not have been possible. These two individuals made the entire process truly enjoyable and ensured a timely completion of all necessary steps. Of course, the authors are solely responsible for any shortcomings of this text.

*July 2001*

*Paul E. Dascher  
Jeffrey W. Strawser  
Robert H. Strawser*

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# *Part I*

## *Introduction to Managerial Accounting*

The initial section of this text introduces the students to managerial accounting and the basic purposes of managerial accounting. In addition, important terminology related to managerial accounting and cost behavior is discussed. The chapters comprising this initial section are:

**Chapter 1:** *Introduction to Managerial Accounting*

**Chapter 2:** *Analyzing Cost Behavior*

# *Learning Objectives*

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Chapter 1 introduces managerial accounting and the role of the managerial accountant in the organization. Studying this chapter should enable you to:

1. Identify the major purposes of managerial accounting.
2. Contrast managerial accounting with financial accounting.
3. Describe the steps in an accounting system and the interrelationships within the system.
4. Portray the accountant's role in the managerial process.
5. Determine where managerial accountants gather source data and to whom they issue final reports.

# *Introduction to Managerial Accounting*

## INTRODUCTION

At the beginning of their second accounting class, two students (Rick James and Mike Hammer) were talking about the class in financial accounting they had just completed.

*Rick:* You know, that accounting class was really interesting. It's amazing how accounting can take so much information and summarize it in financial statements. How in the world would bankers and investors ever know about a company without accounting?

*Mike:* I agree. Something bothered me, though. All we talked about in financial accounting was how information can be summarized and communicated to external users. What about the management of the company? Surely they need to have information to make decisions about what products to produce, how many employees to hire, and how much to charge for their products. We didn't even discuss the need for information by the company's management.

*Rick:* I never thought about that. Surely there must be some way to provide management with information for decision-making purposes.

*Mike:* Shhh. I think class is about to start...

In today's business world, a truly irreplaceable commodity is information. In order to manage and plan for various organization activities, upper management needs to have a vast amount of information available in a timely fashion. For example, when producing automobiles, the following are examples of some of the types of questions that must be answered by the management of General Motors:

- What are expected sales during the year?
- How much does it cost to manufacture a certain type of automobile?
- How many automobiles need to be produced to meet quarterly demand?
- How much over or under budget are labor costs?
- Did we use greater or fewer pounds of steel in producing automobiles than expected?
- How profitable are the various makes of automobiles?

These are just a sample of questions that face the management of General Motors. As you will see throughout this text, the answers to these and many more questions will be provided through the process of managerial accounting.

Accounting may be defined as "... the art of recording, classifying, and summarizing ... transactions and events ... and interpreting the results thereof."<sup>1</sup> In addition to the above tasks, the process of accounting is also concerned with communicating relevant information about an entity to interested users. This information is used by these parties in making economic decisions related to the entity in question.

These "interested users" may be parties who are external to the entity, such as potential creditors and investors. For these parties, *financial accounting* describes the process through which the entity's historical transactions and events are recorded, classified, and summarized in the form of financial statements (the balance sheet, income statement, statement of retained earnings, and statement of cash flows). These financial statements are used by external third parties (potential creditors and investors) to make economic decisions (i.e., decisions to lend money to or invest money in a given entity).

*Managerial accounting*, on the other hand, is concerned with "interested users" who are internal to (i.e., employed by) the entity. These individuals include managers and other personnel who are involved in the day-to-day operations of the entity. It is important to note that the basic purposes of accounting are unchanged: to record, summarize, interpret, and communicate information to interested users. The primary differences relate to the individual needing the information and the type of information needed. The purpose of managerial accounting is to provide information to internal users for the purpose of allowing them to make various decisions concerning the operations of the entity.

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<sup>1</sup> *Accounting Terminology Bulletin No. 1—Review and Resume* (New York: American Institute of Certified Public Accountants), 9.