Managerial Accounting

Fifth Edition

Dominiak and Louderback

FIFTH EDITION

MANAGERIAL ACCOUNTING

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PREFACE

The fifth edition, like the first four editions, is designed for an introductory course in managerial accounting. Though we wrote the book with the undergraduate student in mind, we have had many reports of its successful use in both graduate and management development courses. One reason is the wide variety of assignment material, allowing instructors to select assignments consistent with the backgrounds of their students.

The book emphasizes the *uses* of managerial accounting information and is therefore appropriate not only for accounting majors but also for nonaccounting business majors (in marketing, management, finance, etc.), as well as for majors in nonbusiness areas such as engineering, mathematics, and the physical sciences. Our concern for a broad audience is consistent with trends in enrollments in managerial accounting courses.

We make few assumptions in this book about the background knowledge of the reader. We assume that a reader has had one or two terms of financial accounting or a working exposure to basic financial statements. From this limited, assumed background, we expect only that a reader will have developed some understanding of the most basic principles upon which financial statements are based. The journal-entry/T-account framework appears only in Chapter 15 and is not, with the exception of that chapter, of critical importance to the understanding of the concepts being presented.

Most discussions in the book focus on the important functions of management: planning, decision making, controlling, and performance evaluation. This emphasis is apparent even in the three chapters on product costing (Chapters 13–15), a topic often presented in accounting textbooks but seldom discussed with the nonaccountant in mind. Thus, the product-costing chapters approach that subject from the standpoint of analyzing results under different costing systems, rather than concentrating on cost-accumulation procedures or on the accounting problems related to those procedures.

Our objectives in this edition remain essentially the same as those for the first four editions:

1. To present clearly and understandably the most important conceptual and practical aspects of managerial accounting;

2. To order the material in a way that allows the reader to build from elementary concepts to more complex topics and thus to integrate and expand early understanding;
3. To show students some of the interrelationships among the several courses that are required parts of a normal business curriculum;
4. To show the reader, through discussion, illustration, and assignment material, what seems to us the almost infinite number of applications of managerial accounting principles to decision making in economic entities of all types (including personal decisions);
5. To encourage the reader to recognize that *people*, not entities, make decisions and are responsible for the results of those decisions.

We use several means to achieve these objectives. First, we use examples and illustrations liberally. Sometimes we introduce an important concept by means of an example; sometimes we try to give meaning to a rather abstract concept by immediately concentrating on an illustration. Second, we proceed through the text (and its increasingly complex concepts) in a building-block fashion. Thus, we begin with the principles of cost behavior and volume-cost-profit analysis, which underlie virtually all of managerial accounting, and use this basis for approaching the more complex problems encountered in decision making, comprehensive budgeting, responsibility accounting, and product costing. A reader will see the continued reliance on previously developed concepts by the regularity of text references to earlier chapters. Our frequent text references to the concepts, research, and practices of other business disciplines are intended both to encourage further study and to remind the reader that decision making requires an integration of knowledge from many areas.

The applicability of the concepts of managerial accounting to a wide variety of economic entities is most obvious in the specific sections of the text that refer to nonbusiness situations. But the reader will also see, through examples in other parts of the text and in the decision situations posed in the assignment material, our efforts to demonstrate the many opportunities for using managerial accounting concepts in a nonbusiness context.

We pay attention to the qualitative and difficult-to-quantify aspects of a topic. As part of the qualitative considerations, we discuss behavioral problems and point out the implications of such problems. In raising these qualitative issues, our intention is to emphasize that decisions are made by individuals with beliefs and feelings. We expect readers to gain an appreciation of the role of accounting data: to provide relevant information but not to *dictate* courses of action.

Throughout the book we emphasize that decisions are made on the basis of estimates and that it is difficult to quantify some factors important to a decision. Our intentions are to underscore (1) the presence of the manager's constant companion, uncertainty, and (2) the importance of recognizing all the available alternatives and all the factors relevant to each alternative. Both the text and many of the problems—especially those that come relatively late in the assignment material—emphasize that a major problem in managing any enterprise is determining the right questions to ask and, concomitantly, what kinds of information to seek. In our opinion, students should learn that real-world problems do not present themselves in the form of schedules to be filled in and manipulated. Indeed, sometimes a manager's most difficult task is to discern, from the mass of economic activity taking place all around, exactly what the problem is that requires investigation and resolution.

PLAN OF THE BOOK

We organized this book to emphasize the fundamental importance of cost behavior patterns to all aspects of managerial decision making. After an introductory chapter, Part One, Volume-Cost-Profit Analysis and Decision Making, consists of four chapters that are intended to help the student develop a clear and firm grasp of the basic implications and applications of this fundamental issue. These chapters introduce different types of cost behavior, the reasons for such behavior, a tool for using information about behavior (volume-cost-profit analysis), and the basic analytical approaches used for making short-term decisions.

Part Two, Budgeting, treats operating, financial, and capital budgeting in four chapters. Chapter 6 concentrates on operating budgets, building on the material in Part One and introducing, on a more formal basis, behavioral considerations. Chapter 7 deals with financial budgeting, including cash budgets and pro forma balance sheets, and considers the special problems of budgeting for not-for-profit entities. Chapter 8 introduces capital budgeting, covering income taxes but dealing only with relatively straightforward types of decisions involving the acquisition of new assets. Chapter 9 considers more complex decisions, such as those involving the replacement of assets, as well as a few of the more technical aspects of the tax laws (especially the Accelerated Cost Recovery System) as they relate to capital budgeting decisions. A full understanding of the topics covered in Chapters 8 and 9 requires an understanding of the concepts of present value analysis. In an Appendix we offer a basic discussion and illustrations of present value analysis, with the emphasis on promoting an understanding of relationships and without the mathematical development of present value factors.

Part Three integrates the topics of control and performance evaluation. Chapter 10 introduces responsibility accounting, alternative organizational structures, and cost allocation, emphasizing the behavioral aspects of these topics. Chapter 11 treats divisional performance evaluation—again, emphasizing behavioral issues. Chapter 12 discusses standard variable costs and variance analysis to evaluate cost centers.

Part Four consists of three chapters on product costing. These chapters emphasize the uses of product-cost information and analysis of reports prepared under different product-costing methods. Chapter 13 introduces the general ideas of cost flows, absorption costing, and predetermined overhead rates; both actual and normal costing are illustrated in a job-order context. Chapter 14, building on the standard cost concepts of Chapter 12 and the absorption costing ideas of Chapter 13, contrasts absorption and variable costing as well as developing the idea of a standard fixed cost per unit. Chapter 15 completes the product-costing coverage by introducing the special problems of a process-costing situation and illustrating the flows of costs through accounts. (An Appendix to Chapter 15 illustrates the first-in-first-out cost-flow assumption under process costing.)

Part Five consists of three chapters, the topical coverage in which will fit the plans for some, but not all, courses in managerial accounting. Chapter 16 discusses several quantitative methods of analysis that might be applied to some of the situations presented in earlier chapters of this text. Included are basic applications of statistical decision theory, linear programming, learning curves, and inventory control models. Chapter 17 deals with the statement of cash flows, which is used by decision makers both inside and outside of the entity. Chapter 18 is an introduction to the analysis of financial statements, with special attention given to the interpretation (and misinterpretation) of commonly used ratios. Throughout these last two chapters, the topics in which are often considered to be part of financial rather than managerial accounting, the emphasis is on why and how a manager might use the available information.

NEW FEATURES

1. We have rewritten Chapters 2 through 5 extensively. Our major objective was to integrate the principles of cost behavior into the framework of volume-cost-profit analysis.
   a. Chapter 2 now provides more illustrations of techniques that were implicit in previous editions. It also simplifies coverage of the contribution margin percentage. Income taxes in volume-cost-profit analysis, formerly in Chapter 3, are now in an Appendix to Chapter 2.
   b. Chapter 3 provides more discussion of the types of fixed costs (avoidable, unavoidable, direct, and indirect). This makes it easier for instructors to omit Chapter 4 if they do not wish to cover its topics.
   c. Chapter 4 now uses the weighted-average contribution margin per unit as well as the weighted-average contribution margin percentage.
   d. The examples in Chapter 5 focus more sharply on the specific types of short-term decisions. We have simplified and strengthened the discussion of sunk costs and opportunity costs.
2. Chapter 8 no longer covers the Accelerated Cost Recovery System (ACRS). It still introduces income taxes, *after* covering the basics of capital budgeting. The changes brought about by the 1986 Tax Reform Act, including those in ACRS, are covered in Chapter 9.
3. We rewrote Chapter 10, with special attention to reasons for allocating indirect costs. The chapter also distinguishes more clearly between transfer prices and cost allocations. We changed Chapter 11 for consistency with the changes in Chapter 10.
4. Chapter 13 has been simplified. It still covers actual and normal costing in a job-order framework. It also still covers the analysis of misapplied overhead into budget and volume components, to reflect our concern with the uses of product-costing information and to provide more continuity with Chapter 12's coverage of standard costs and variances.
5. Chapter 17 now covers only the cash flow statement, in keeping with the trend in financial reporting and the deliberations of the Financial Accounting Standards Board. It still stands independent of any other chapter and can be covered at any time.

6. Over one-third of the assignment material is new or revised. The total number of assignments is slightly higher than in the fourth edition. In revising assignment material, we have included even more short exercises covering one or two essential points. There are several additional integrative assignments, including those that begin in one chapter and continue in a later one.
7. We have simplified and strengthened the coverage of long-term budgeting in Chapter 7.
8. Chapter 16 introduces the increasingly important subject of learning curves.

ASSIGNMENT MATERIAL

End-of-chapter material includes questions for discussion, exercises, problems, and cases. We believe there are no discussion questions that can be answered simply by referring to a sentence or two, or to a list of points in the chapter. Rather, discussion questions are meant to increase understanding of concepts introduced in the chapter, and many questions have no clearly correct answers. Exercises are generally short and cover the most basic applications of one or two key concepts. Problems tend to be longer than exercises, are more challenging, sometimes contain irrelevant information, and often ask the student to state reservations about whatever solutions are proposed. Both exercises and problems are generally arranged in order of increasing difficulty.

Cases normally contain less than all the information needed to develop a single solution, the intention being to emphasize this inconvenient characteristic of real-life situations. For most cases, the student must propose an analytical approach appropriate to the available, relevant information. The cases, and the later problems, require the student to determine what principles are relevant and how those principles apply in a given situation. That is, these assignments are designed to encourage the student to think, since a manager must do so.

One of the strongest features of this book is the integration of assignment material and text. We have been told by users of previous editions that judicious choice of assignment material makes it possible to teach this course, and the individual topics therein, at various levels of difficulty. Considering the variety of economic enterprises and the dynamic nature of the economic environment, it is impossible to illustrate every conceivable application of every fundamental principle covered in the text. We do believe, however, that the principles and the variety of situations presented in the text and assignment material provide a student with sufficient background to develop an approach for analyzing almost any economic decision.

ALTERNATIVE CHAPTER SEQUENCING

This text contains more material than is normally needed for a one-term course. We recommend covering the chapters in the order presented. Nevertheless, the text offers considerable flexibility in the order of coverage, and several users have found alternative sequencing to be practical.

Chapters in Part Four are the most likely candidates for alternative sequencing. Chapters 17 and 18, on cash flows and financial analysis, are intended primarily for students whose financial accounting backgrounds did not include these topics. The chapters contain only a few, noncritical references to earlier chapters. Accordingly, either one or both of these chapters can be taken up at any time or omitted entirely.

Chapter 16, which discusses several quantitative methods of analysis, can be covered separately at any time after Chapter 12. Or, individual segments of that chapter can be assigned in conjunction with earlier chapters. The section on statistical decision theory (pages 658–668) has illustrations that use materials from Chapters 6, 8, and 12. The illustrations, while concentrating on applying the quantitative methods, draw on topics discussed in these earlier chapters. The concept of expected value could be introduced as early as Chapter 5. The section on inventory control models (pages 668–674) is particularly relevant to Chapter 6, which covers production and purchases budgets. The linear programming section (pages 674–681) extends the material in Chapter 5 on alternative uses of limited resources (pages 165–167).

Instructors desiring an earlier and greater emphasis on product costing could move to Chapters 12 through 15 after Chapter 5. A jump to Chapter 12 is also possible after covering Chapter 4 (or even after Chapter 3), but in that event we recommend giving additional time to the early discussion of joint/common costs. (Note that if early emphasis on product costing is desired, it is necessary to incorporate Chapter 12 in the coverage of product costing rather than as a part of the study of responsibility accounting. This combination is required because some understanding of standard costs is assumed in Chapters 14 and 15.) Some users have increased the time available to cover product costing by omitting Chapters 10 and 11. Alternatively, some users have omitted all product-costing material, or have omitted all or parts of Chapters 14 and 15. Chapter 4 can be omitted without loss of continuity. The basic concept of avoidability of costs is now introduced in Chapter 3. It is also possible to omit one or both chapters on capital budgeting (Chapters 8 and 9) without serious loss of continuity, and some users have taken these options.

The Appendix, which deals with present values, was designed to be used with Chapters 8 and 9 on capital budgeting. Previous exposure to the general idea of the time value of money is not assumed, but those who have had such exposure are likely to find this material useful for review.

SUPPLEMENTARY MATERIAL

An Instructor's Manual contains suggested time allocations for alternative course lengths and chapter sequencing, a brief statement of the topical coverage of each chapter, suggestions of assignment items for coverage of basic concepts, and a brief commentary about concepts or approaches that students find difficult to understand. It also suggests some text assignments that might be useful for examination purposes.

The Test Bank contains true-false and multiple-choice questions, and short problems.

The Solutions Manual contains detailed solutions for all assignment material, as well as suggested times for completing assignments. In addition, it provides notes to the instructor regarding class use of the material. Important features of these notes are (1) presentations of alternative approaches for arriving at solutions; (2) suggestions for eliciting class discussion; and (3) suggestions for expanding individual assignments to cover new issues, pursuing existing issues in more depth, or highlighting relationships between managerial accounting concepts and concepts studied in courses in other business disciplines.

A list of check figures for at least some parts of virtually every exercise, problem, and case is available in quantity from the publisher. In addition, transparencies are available upon adoption for selected solutions and text illustrations. There is also a set of Lotus® 1-2-3® templates for various assignments.

The Study Guide is designed to help students obtain full value from the study of this text. This supplement, which offers key statements to use as guides in reading the chapters, includes not only objective questions but also a variety of short and medium-length problems (solutions included) to test understanding. The final section of the Guide for each chapter identifies those concepts, practices, or approaches that cause the most difficulty or greatest misunderstanding for students.

In addition to the above supplements, all prepared by the authors, the publisher makes a computerized test bank available to adopters.

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CONTENTS

PART TWO BUDGETING 199

6 OPERATIONAL BUDGETING 201

7 FINANCIAL BUDGETING 241

8 CAPITAL BUDGETING, PART I 284