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# COST MANAGEMENT

A Strategic Emphasis

# Cost Management

**A Strategic Emphasis**

*Third Edition*

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## COST MANAGEMENT: A STRATEGIC EMPHASIS

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We dedicate this edition . . .

To my wife Sandy, and our children Joseph and David

Ed Blocher

To my wife Mary, and our children Robert and Melissa

Kung Chen

To my wife Pam Tower, and my mentor Robert A. Bonsack, a true craftsman in the field of cost management

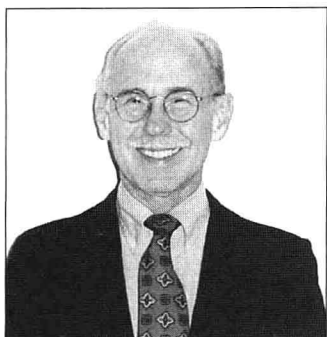
Gary Cokins

To my wife Angela, and our children Bill and Margaret

Tom Lin



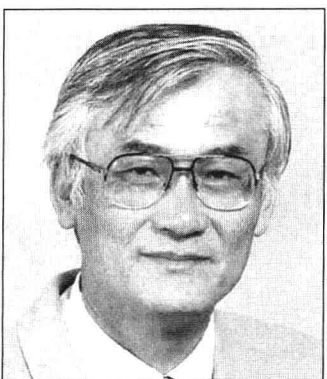
# Meet the Authors



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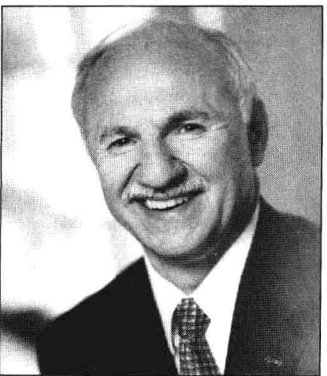
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Putting research and teaching into practice is important to Professor Blocher, who has worked closely with other firms and organizations in developing products, publications, and teaching materials. He was the principal designer of an accounting analysis system developed by Financial Audit Systems, Inc. Also, he has worked with Blue Cross and Blue Shield of North Carolina, the American Institute of CPAs, KPMG Peat Marwick, Grant Thornton, and the Chancellor's Office at the University of North Carolina at Chapel Hill, among others.



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# Blocher/Chen/Cokins/Lin:

**A**t first glance, the jumbled letters on the front cover of this text do not seem to serve a purpose. However, when one stands back from the cover and takes in the entire design at once, it's easy to see that the letters spell out *Cost Management, 3e*.

Just as the letters spelling out the book's title seem unclear at first, the same can be said of the course content by students first entering this course. Students fail to see the relevance of cost management concepts and procedures and how they will use this information in their future.

The strategic placement of the letters is clear when viewed as a whole—as the big picture. Similarly, *Cost Management: A Strategic Emphasis, 3e* by Blocher, Chen, Cokins, and Lin uses a **strategic emphasis** to make a connection for students between the concepts and procedures they learn in the class and how they will use them. In short, it makes cost information **relevant** for students.

Once viewed simply as technical experts in accounting methods and procedures, accountants are now participants on multifunctional management teams. *Cost Management: A Strategic Emphasis, 3e* helps students understand the critical role that cost management information plays in the overall success of an organization and teaches them the strategic and **decision-making skills** necessary to become tomorrow's cost accountant.

**Strategic framework.** At the heart of the strategic emphasis of *Cost Management: A Strategic Emphasis, 3e* is its organization. The introductory chapters develop important strategic concepts used throughout the text—how firms compete and the nature of the key measures that managers must use to gain and maintain competitive advantage. Through the text Parts, *Cost Management: A Strategic Emphasis, 3e* emphasizes the role of cost management information in each of the four management functions. Each cost management method is clearly linked not only to the firm's overall strategy but also to each management function that uses the method:

Part I: Strategic Management

Part II: Planning and Decision Making

Part III: Product Costing

Parts IV and V: Operational Control and Management Control

**Running theme:** How does the topic we are discussing help the firm more effectively compete in its industry? *Cost Management: A Strategic Emphasis, 3e* uses this strategic theme to integrate individual chapters into a coherent whole so that each of the text Parts contributes to overall understanding of the role of cost information and a firm's strategy for competitiveness. This organization helps students gain an understanding of cost accounting techniques and how they serve the company as a whole.

# Bringing the Big Picture into Focus for Your Students

## Problem Material.

The Blocher team has taken great care to develop problems and cases that effectively demonstrate the strategic issues presented in each chapter. Included are a variety of exercises and problems that deal with emerging **strategic**, **international**, **service**, and **ethics** issues. These problems are marked appropriately for easy identification:



Strategy



International



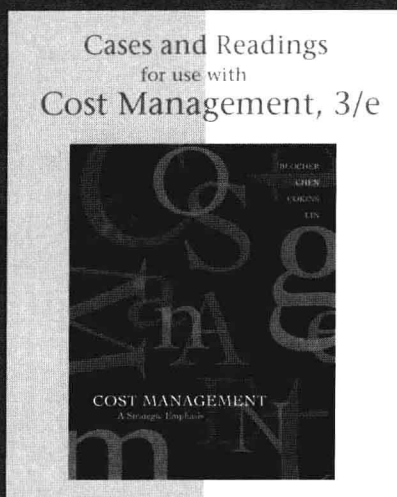
Service



Ethics

## Real-World Focus.

All firms strive to have a competitive edge—for some it may be low cost, for others it might be high quality or unique product features. To compete today, companies must develop a strategy to set themselves apart from competitors and ensure attractiveness to customers. *Cost Management: A Strategic Emphasis, 3e* teaches why, when, and how cost information is used to help accountants and managers develop a company's competitive strategy, focused on adding value for customers or shareholders. To augment this coverage, the Blocher team encourages students to explore real-world companies both in the text material, through the Chapter Openers and Real-World Focus and Cost Management in Action boxes, in the end-of-chapter material, and via the Cases and Readings Manual. Students are challenged to think about and use cost management information in a real-world setting.



### REAL-WORLD FOCUS Job Costing: JIT and Mass Customization

Job costing has a natural application in companies that have a traditional materials flow through work in process to finished goods, and where customer orders of varying sizes are common. The construction industry, furniture manufacturing, professional services, and many other industries continue to rely upon this costing method to conveniently and effectively track direct costs to jobs and customer orders. In contrast, to be competitive many firms in the consumer goods and electronics industries are moving to advanced manufacturing techniques such as flexible manufacturing systems, just-in-time inventory management, and mass customization (as explained in Chapter 1). Such changes have led to changes in costing systems. Less effort into tracing costs to specific jobs, by simplifying the accounting, which usually labor and overhead divided levels of work in process

and finished goods inventory in these firms do not justify the additional accounting effort of tracing costs to these accounts. Also, in flexible systems where an employee might be simultaneously working on two or more different jobs, the tracing of labor costs becomes difficult. While some degree of costing accuracy is lost, the speed and economy of the simpler systems has made them desirable for some firms. Another downside of JIT—it increases the volatility of customer orders. Since customers can expect JIT delivery, some will wait until the last minute to place the order, adding to the unpredictability of the firm's sales. The increased volatility of capital goods orders in the United States in 2001 and 2002 has been attributed in part to the increased use of JIT systems.

Source: Dale Ansberry, "A New Hazard for Recovery: Last-Minute Pace of Orders," *The Wall Street Journal*, June 25, 2002, p. 1.

### Cost Management in Action

#### Health Care Providers Allocate Cost for Medicare Reimbursement

Since the advent of Medicare in 1966 to cover medical expenses of aged, blind, and disabled individuals, health care providers have been required to use cost allocation methods to receive reimbursement from the federal government for services covered by Medicare. The costs of health care service activities are allocated to the patient revenue-generating services. Some examples of service activities and patient revenue-generating services in a hospital follow.

How do hospitals respond to Medicare requirements and allocate the costs of service activities to the patient revenue-generating services? What methods are likely to be preferred?  
(Refer to comments on Cost Management in Action at the end of the chapter.)

#### Patient Revenue-Generating Services

Intensive care unit  
Psychiatric care  
Coronary care  
Surgery  
Anesthesia

Laboratory  
Radiology  
Emergency Room  
Pharmacy

#### Service Activities

Dietary  
Laundry and linen  
Admissions  
Social services  
Nursing administration  
Operation of hospital buildings  
Administrative and general  
Housekeeping

### Disposition of Underapplied and Overapplied Overhead

What do we do with the discrepancy between factory overhead applied and the actual overhead? Since overhead is applied to production costs, it is logical to allocate the

#### EXHIBIT 12.7 Departmental Allocation, Second and Third Phases Using the Step Method

##### Second Phase: Allocate Service Department Costs to Production Departments: Using the Step Method

	Service 2	Production 1	Production 2	Total
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# What's NEW about 3e?

## Chapter 1: Cost Management and Strategy

- Coverage of strategy simplified by moving strategic positioning from Chapter 2 to Chapter 1
- Strategic positioning now presented as a fundamental concept of general knowledge

## Chapter 2: Implementing Strategy

- Chapter 2 now deals entirely with the implementation of strategy, using accounting concepts and techniques, such as the balanced scorecard and the value chain
- Ethical and environmental concerns are enhanced through new material in Chapter 2 related to the Sarbanes-Oxley Act and additional material on sustainability

## Chapter 3: Basic Cost Concepts

- General updating of material through new problems and exercises and new real-world focus boxes

## Chapter 4: Job Order Costing

- The chapter on job costing was moved up in the text to provide a more orderly transition from the basic methods in Chapter 3 to ABC costing in Chapter 4. Also, it allows the instructor to cover job costing and overhead application prior to ABC costing, if desired
- The content of Chapter 4 was reduced somewhat to convey essential concepts of the chapter more simply and directly

## Chapter 5: Activity Based Costing and Management

- Revised two-stage model depicting different drivers for different processes in cost assignment
- Section added with an extensive discussion on customer profitability analysis, including types of customers, customer cost categories, customer revenue analysis, and customer cost analysis
- General updating through new real world applications

## Chapter 6: Cost Estimation

- General updating through new real world examples and problems
- Addition of the concept of mean absolute percentage error

## Chapter 7: Cost-Volume-Profit Analysis

- General updating through new problems and examples
- ABC costing and sensitivity analysis incorporated

## Chapter 8: Strategy and the Master Budget

- General updating through new problem and examples, with an emphasis on Excel applications

## Chapter 9: Decision Making with Relevant Costs and a Strategic Emphasis

- General updating through new problems and examples, some incorporating Excel and ABC costing

## Chapter 10: Cost Planning for the Product Life Cycle

- New section on pricing is added, including methods based on the cost life cycle and methods based on the sales life cycle
- Concept of Takt time is introduced

## **Chapter 11: Process Costing**

- New section on the relationship of process costing to ABC costing
- New section on sustainability
- New section on the theory of constraints

## **Chapter 12: Cost Allocation**

- General updating through new real world examples and problems

## **Chapter 13: The Flexible Budget and Standard Costing**

- General updating through new real world examples and problems
- New emphasis on Excel applications

## **Chapter 14: Standard Costing: Factory Overhead**

- General updating through new real world examples and problems
- New emphasis on Excel applications

## **Chapter 15: Productivity, Marketing Effectiveness, and Strategic Profitability Analysis**

- Extensive discussion on strategic implications of marketing and productivity variances
- New section on operational profitability analysis examining effects on operating results attributable to growth, changes in price and cost, and variations in productivity over the years, including extensive discussion on strategic implications of these effects

## **Chapter 16: Total Quality Management**

- General updating through new real world examples and problems
- New emphasis on Excel applications

## **Chapter 17: Management Control and Strategic Performance Measurement**

- General updating through new real world examples and cases
- Greater emphasis on ethics

## **Chapter 18: Strategic Investment Units and Transfer Pricing**

- General updating through new real world examples and cases

## **Chapter 19: Management Compensation and Business Valuation**

- Revised chapter clarifies the difference between evaluating the performance of a business (for the purpose of evaluating top executives) from the valuation of a business (for the purpose of pricing the firm's shares, etc)
- New coverage of stock-based compensation incorporating recent developments

## **Chapter 20: Capital Budgeting**

- General updating through new real world examples and problems
- Information added on uses of financial calculators to perform capital budgeting

# Supplements

## For Instructors . . .

**Instructor's Resource CD-ROM** (ISBN 0072835370): Contains all essential course supplements such as the Instructor's Resource Manual, Solutions Manual, Test Bank Word Files, Computerized Testbank by Brownstone, and PowerPoint® Presentations, and Excel Templates.

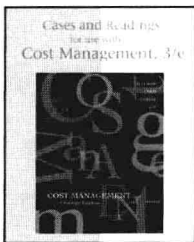


## **Online Learning Center (OLC): [www.mhhe.com/blocher3e](http://www.mhhe.com/blocher3e)**

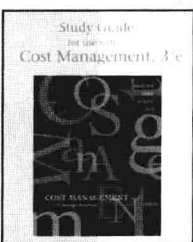
The text website includes premium content for students for FREE with the purchase of a new book, including daily and weekly news feeds from the NY Times and PowerWeb. The Instructor Edition of the *Cost Management: A Strategic Emphasis, 3e* OLC is password-protected and another convenient place for instructors to access essential course

supplements. Additional resources for professors include: Links to professional resources, Sample Syllabi, Text Updates, Solutions to the Student Excel Spreadsheets, and Solutions to Internet Exercises.

## For Students . . .



**Cases and Readings for use with *Cost Management: A Strategic Emphasis, 3e*** (ISBN 0072835699): This manual contains a host of value-added resources. It includes an extensive set of longer cases pertaining to a variety of important topics. These case scenarios put students in situations that allow them to think strategically and to apply concepts they've learned in the course. Key readings have been chosen to give students more background into the evolution of strategic cost management topics. New cases have been added that incorporate the SAS software used by actual firms to calculate ABC cost information.



**Study Guide** (ISBN 0072835664): Prepared by Roger Doost (Clemson University), the study guide reviews the highlights of each chapter in *Cost Management: A Strategic Emphasis, 3e* and includes a variety of self-study questions for student review. Every chapter includes short-answer questions organized by learning objective, multiple-choice questions, and thorough exercises. Suggested answers to all questions and exercises are included.

**Online Learning Center (OLC): [www.mhhe.com/blocher3e](http://www.mhhe.com/blocher3e)** The text website includes premium content for students for FREE with the purchase of a new book, including daily and weekly news feeds from the NY Times and PowerWeb. The Student Edition of the *Cost Management: A Strategic Emphasis, 3e* OLC also contains many tools designed to help students study including: Check Figures, Text Updates, Links to Professional Resources, eLearning Sessions, Chapter Overviews, Chapter Objectives, Multiple-Choice Quizzes, Flashcard Key Term Reviews, Internet Exercises, Excel Spreadsheet Exercises (watch for the Excel icon by selected end-of-chapter material), and PowerPoint® Presentations.



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## Our Sincerest Thanks . . .

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*Ed Blocher*

*Kung Chen*

*Gary Cokins*

*Tom Lin*



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## PART TWO

### PLANNING AND DECISION MAKING

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