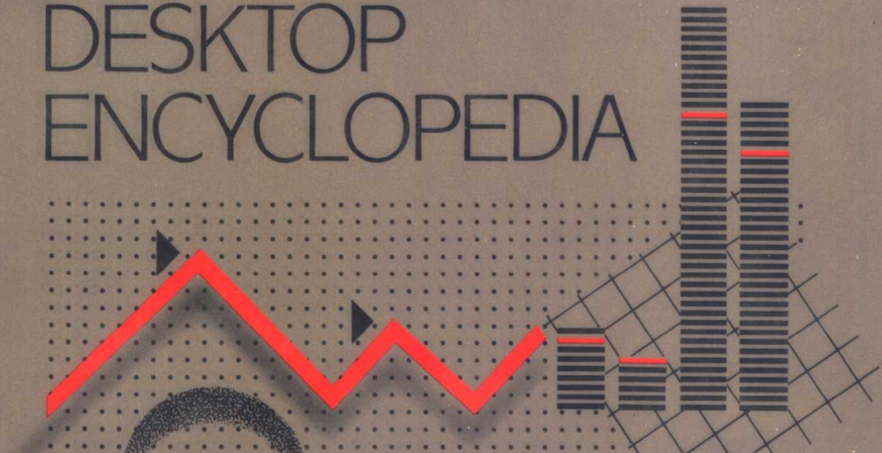
Budgeting, Pricing & Cost Controls

A Desktop Encyclopedia



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BUDGETING, PRICING & COST CONTROLS

A DESKTOP ENCYCLOPEDIA

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Preface

Budgeting, Pricing & Cost Controls: A Desktop Encyclopedia is a significant sourcebook and reference for managers, executives, accountants, consultants, academicians, and graduate students. Concepts related to management, production, finance, economics, and accounting are discussed in detail and cross-referenced to provide the reader with easy access to related topics. This one-volume, state-of-the-art encyclopedia is a comprehensive, accurate, and convenient source of management information that is available at one's fingertips. It provides an update on contemporary trends in managing, planning, controlling, budgeting, and pricing. It offers a current analysis of basic management functions including:

Managing	Decision making
Setting goals and objectives	Budgeting
Planning	Forecasting
Controlling	Pricing
Organizing	Negotiating
Directing	Delegating
Motivating	Understanding organizational behavior
Evaluating	Maintaining quality control
Communicating	
Leading	

The encyclopedia focuses on basic objectives:

1. It establishes a balance between management theory and management objectives.
2. It effectively relates management theory to management practice.
3. It offers a contemporary view of how a business can be organized and managed.
4. It deals constructively with many of the problems managers and other decision makers must solve.
5. It serves as a practical guide to applying modern management theory to solving everyday problems.
6. It emphasizes the importance of establishing goals and objectives as the basis of the planning, controlling, and evaluating processes.

Difficult, complex, and significant management topics are presented clearly, understandably, and authoritatively. This encyclopedia is conveniently alphabetized and indexed for easy reference. Each of the entries is cross-referenced to provide easy access to related concepts. Most of the entries contain bibliographies which lead to primary and secondary sources. Numerous exhibits are used throughout the book to clarify important concepts.

Many major analytical procedures associated with financial planning, controlling, and decision making are included in the encyclopedia. The analytical procedures are carefully described and illustrated with meaningful examples. These procedures include:

Return-on-investment analysis
Break-even analysis
Contribution margin analysis
Opportunity cost analysis
Incremental cost analysis
Financial statement analysis
Benefit-cost analysis
Distribution (marketing) cost analysis
Variance analysis
Game theory
Linear programming
Learning curves

This book is designed and written for a selective audience who must have immediate access to authoritative management information on a day-to-day basis:

- Managers and executives
  - Top management
  - Middle-level management
  - Operating management
- Managers of small, medium size, and large businesses and not-for-profit organizations
- CEOs
- Corporate officers and directors
- Sole proprietors
- Controllers
- Financial planners
- Financial managers
- Accountants
- Business educators
- Behavioral scientists
- Operations researchers
- Forecasters
- Statisticians
- Industrial engineers

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ACCOUNTING

Accounting is an information system which accumulates, processes, and communicates information, primarily financial in nature, about a specific economic entity.

The American Accounting Association defined accounting in a Statement of Basic Theory, 1966, as follows:

> "Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information.... The objectives of accounting are to provide for the following purposes:
>
> 1. Making decisions concerning the use of limited resources, including crucial decision areas, and determination of goals and objectives.
>
> 2. Effectively directing and controlling an organization's human and material resources.
>
> 3. Maintaining and reporting on the custodianship of resources.
>
> 4. Facilitating social functions and controls."

This definition identifies the major role of accounting as providing information for those who use the information. The definition specifies three major functions of accounting: identifying, measuring, and communicating economic information.

In 1970 the Accounting Principles Board of the American Institute of Certified Public Accountants developed the following definition of accounting:

> *"Accounting is a service activity. Its function is to provide quantitative information, primarily financial in nature, about economic activities that is intended to be useful in making economic decisions—in making reasoned choices among alternative courses of action."*

The definition of accounting is goal-oriented rather than process-oriented or function-oriented. It emphasizes economic decision-making activities rather than the functions of accounting as the major objectives of accounting.

In a popular sense, accounting has been referred to as *the language of business*, since it is the basic tool for recording and reporting economic events and transactions that affect business enterprises. Other concepts view accounting as a historical record, a mirror of current economic reality, a subset of a total business information system, or as a commodity that is the product of economic activity.

Accounting equation. The accounting equation expresses the relationship that exists between assets, liabilities, and owners' equity. In its simplest form, the accounting equation can be represented as follows:

ASSETS - LIABILITIES = OWNERS' EQUITY

The accounting equation in terms of net assets is

ASSETS - LIABILITIES = NET ASSETS

The accounting equation states an equality and establishes a relationship among the three major accounting elements. Owners' equity is shown as the residual of assets over liabilities, which also equals "net assets." The accounting equation can be restated in this form:

ASSETS = LIABILITIES + OWNERS' EQUITY

When the accounting equation is expressed in this format, owners and creditors are shown as having claims against the assets of the enterprise. The accounting equation can also be expressed in a format that combines liabilities and owners' equity into a single concept referred to as *equities*:

ASSETS = EQUITIES

Accounting functions. Accounting deals with numbers and measurable quantities. The accounting system accumulates, measures, and communicates numbers and measurable quantities of economic information about an enterprise. These three functions can be represented as a flow of information from source to destination as follows:

$\boxed{\text{ACCUMULATION}} \dashrightarrow \boxed{\text{MEASUREMENT}} \dashrightarrow \boxed{\text{COMMUNICATION}}$

Accumulation refers primarily to recording and classifying data in journals and ledgers. The accounting system accumulates data relating primarily to completed transactions and events. Measurement refers to the quantification of business transactions or other economic events that have occurred or that may occur. Measurement determines how to select the best amounts to recognize in the financial statements. The accounting system communicates relevant and reliable information to investors, creditors, managers, and others for internal and external decision making.

Accounting period. Custom as well as income tax and other legal considerations has focused on annual reporting periods and an annual accounting cycle. A reporting period that begins on January 1 and ends on December 31 is referred to as a *calendar - year* accounting period. Any other beginning and ending period of one year is called a *fiscal - year*. The accounting period should be clearly identified on the financial statements.

In selecting an annual reporting period, some entities adopt a period that ends when operations are at a low point in order to simplify year-end accounting procedures and permit more rapid preparation of financial statements. At such a date, inventories and accounts receivable will normally be at their lowest point. Such an accounting period is referred to as *natural business year* since it conforms to the natural annual cycle of the entity.

Financial reports for periods shorter than one year, such as quarterly reports, are referred to as *interim reports* or *interim statements*.

For income tax purposes, the accounting period is usually a year. Unless a fiscal year is chosen, taxpayers must determine their tax liability by using the calendar year as the period of measurement. A change in accounting period requires the approval of the Internal Revenue Service.

See also Objectives of financial reporting; Elements of financial statements; Qualitative characteristics of accounting information; Accounting principles; Financial statements; Accounting basis; Accounting controls; Accounting policies and procedures; Measurement.

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ACCOUNTING ASSUMPTIONS

Accounting assumptions are those broad concepts that underlie generally accepted accounting principles and serve as a foundation for these principles. Accounting assumptions are statements accepted without proof that also serve as the basis for accounting activities. The major accounting assumptions include the following: the business entity assumption, the continuity assumption, the periodic and timely reporting assumption, and the monetary unit assumption.

A basic assumption in accounting is that economic activity can be identified with a particular unit or entity of accountability. This unit or entity is the one to be accounted for. The business entity assumption determines the nature and scope of the reporting that is required for the unit or entity. The entity for accounting purposes is identified as the economic unit that controls resources, incurs obligations, and otherwise is involved in directing economic activities which relate to a specific accountability unit. Accounting units or entities include corporations, partnerships, proprietorships, not-for-profit entities, trusts, and others.

Accounting is based on the assumption that the accounting unit or entity is engaged in continuous and ongoing activities. The accounting unit or entity is assumed to remain in operation into the foreseeable future to achieve its goals and objectives. This assumption is referred to as the continuity or going-concern assumption.

The continuous operations of a business or other economic unit or entity over an extended period of time can be meaningfully segmented into equal time periods, such as a year, quarter, or month. The periodic and timely reporting assumptions require that accounting reporting should be done periodically and on a timely basis so that it is relevant and reliable.

The monetary unit assumption requires that financial information be measured and accounted for in the basic monetary unit of the country in which the enterprise is located (dollars for U.S. firms). The monetary value of an economic event or transaction, determined at the time it is recorded, is not