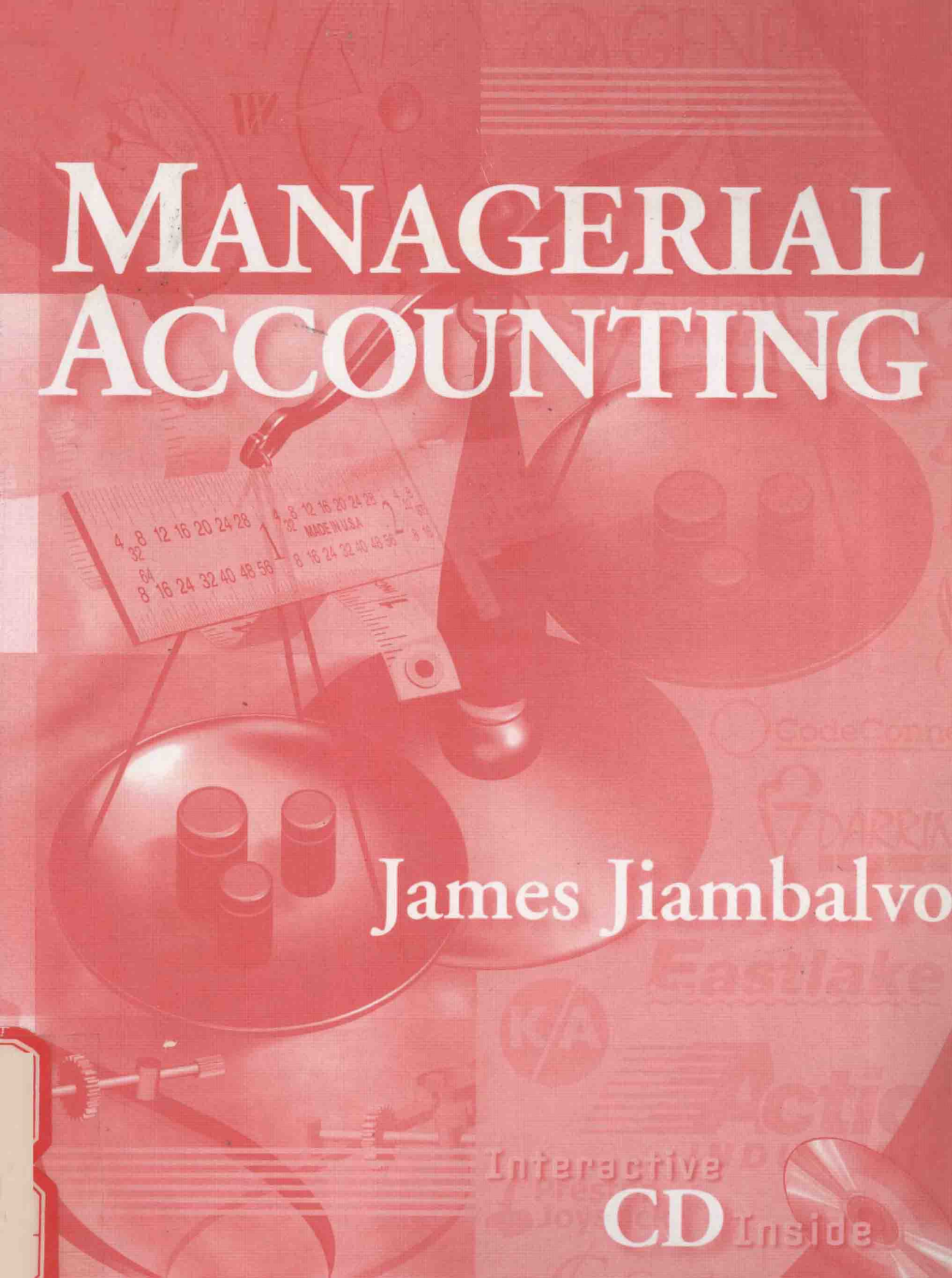
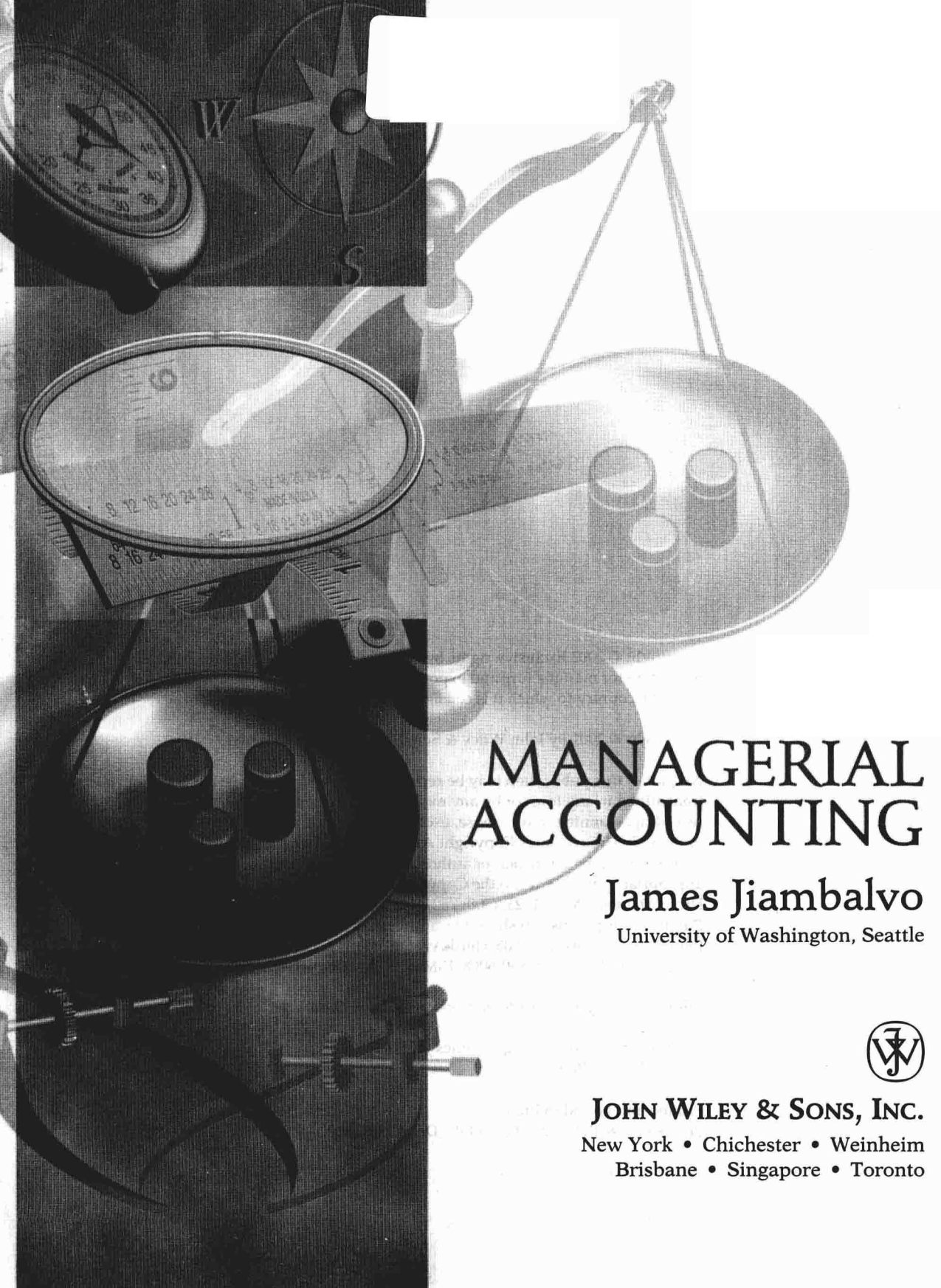


MANAGERIAL ACCOUNTING

The background is a red-tinted collage of various objects. At the top, there's a faint image of a clock face. Below it, a pair of compasses is shown. In the center, a protractor is visible. To the left, a small ruler with markings like '4 8 12 16 20 24 28' and 'MADE IN U.S.A.' is shown. Below the ruler, there are three small cylindrical objects. At the bottom, there's a CD-ROM and some mechanical parts like gears and a screw.

James Jiambalvo

Interactive
CD Inside



MANAGERIAL ACCOUNTING

James Jiambalvo

University of Washington, Seattle



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A NOTE TO STUDENTS ON HOW TO STUDY MANAGERIAL ACCOUNTING

Dear Students of Managerial Accounting:

In your business career, you'll be asked to plan operations, evaluate subordinates, and make a variety of decisions using accounting information. An understanding of managerial accounting will contribute to your success in these key activities, and this book, CD, and the related Web site are designed to optimize learning the subject. To get the most out of these materials, I recommend that you take a three-step approach to the study of each chapter in Managerial Accounting:

- First, skim the chapter for a quick overview.
- Second, read the chapter carefully and pay particular attention to the illustrations. When you're finished, make sure you understand each of the learning objectives.
- Third, enhance and test your knowledge using the interactive CD and the Web site. These materials will also help you achieve one of your immediate goals—excellent performance on tests!

The CD will review the learning objectives, provide a matching exercise to test your understanding of key terms, and provide a set of multiple-choice questions to test your knowledge of concepts and techniques. Demonstrations will illustrate the planning and control process, operation of a job order costing system, overhead allocation, and other concepts and techniques in managerial accounting. Cases and critical thinking exercises will test your understanding of incremental analysis, activity based management, the balanced scorecard, and other concepts and techniques in an interesting, interactive environment. Videos will highlight real companies and their use of managerial accounting. The Web site related to this book will provide additional material to test your understanding of managerial accounting.

A program on the Web site will *assess the learning style* that works best for you. Helpful tips will be provided on how to study of Managerial Accounting given your particular learning style.

Best wishes for success,

Jim Jiambalvo

ABOUT THE AUTHOR



PROFESSOR JAMES JIAMBALVO joined the accounting faculty at the University of Washington after receiving a Ph.D. in accounting from The Ohio State University. A CPA, he has audit experience with the firm of Haskins and Sells (now Deloitte & Touche), and currently serves on the national academic advisory board of Deloitte & Touche LLP. From 1992–1996, Professor Jiambalvo served as chairman of the University of Washington accounting department.

Professor Jiambalvo's research has been published in top accounting journals, including *The Accounting Review*, *Contemporary Accounting Research*, the *Journal of Accounting and Economics*, and the *Journal of Accounting Research*. He is a past associate editor of *The Accounting Review* and currently serves on the editorial boards of *The Accounting Review*, *Contemporary Accounting Research*, *Auditing: A Journal of Practice and Theory*, and the *Journal of Management Accounting Research*.

Professor Jiambalvo has received the Burlington Northern Foundation Faculty Achievement Award and he was recognized for his teaching of managerial accounting with the MBA Professor of the Year Award. He has taught numerous executive education courses, including courses for a number of software companies. At the University of Washington, he holds the Price-waterhouseCoopers and Alumni Endowed Professorship.

PREFACE

This book is intended to drive home the fundamental ideas of managerial accounting, and motivate students to actually *want* to study the subject. As you will see, the text has a number of unique features that help accomplish these two objectives. These features reflect assumptions I make about the goals of students, how they learn, and what they find interesting. In particular, I assume that:

- Most students will become managers, not accountants.
- Students benefit more from a deep understanding of a relatively small number of concepts compared to a shallow understanding of a relatively large number.
- Students learn a great deal by expressing their thoughts and ideas inside the classroom.
- Students are motivated to learn managerial accounting when they see its connection to the real world.
- Students benefit from testing themselves outside of the classroom.
- Technology can be used to enhance student learning and the enjoyment of the learning process.

Here's how these assumptions are reflected in the textbook, the accompanying interactive CD, and the related Web site.

A CLEAR, CURRENT, AND CONCISE APPROACH

Reviewers have said that this book is clearly written, and does a good job addressing current topics in managerial accounting, such as use of the balanced scorecard and economic value added. Additionally, as you can see (and weigh!), the text provides a compact treatment of managerial accounting. This reflects the assumption that most students will become managers, not accountants. It's less likely that future managers will need to know the FIFO approach to process costing or how to calculate four overhead variances—so these and other less essential topics are not covered. Both faculty members and students have constraints on time. A more compact treatment allows faculty members to spend more time driving home critical concepts, and it allows students more time to focus on cases that make managerial accounting come alive in classroom discussions. To cover all, or even most, of the mater-

ial in traditional managerial accounting books, instructors must move very quickly through the various topics—a topic is discussed, a related exercise or problem is solved, and the next (and possibly last) time students see the topic is on an exam. But to really “own” a topic, students need to solve multiple exercises, problems, and cases. The concise treatment here means that students will spend less time reading and more time applying their knowledge to challenging exercises, problems, and cases that drive home critically important concepts.

A FOCUS ON TWO KEY IDEAS

Two key ideas are introduced in Chapter 1 and emphasized in **every** chapter: (1) Decision making relies on incremental analysis—an analysis of the revenues that increase (decrease) and the costs that increase (decrease) if a decision alternative is selected, and (2) You get what you measure! In other words, performance measures greatly affect the behavior of managers. How important are these ideas? I’d consider this text to be a success if, years after reading it, students can point to these two key ideas as concepts they internalized from their study of managerial accounting.

LINKS TO PRACTICE

Throughout the text *Link to Practice* boxes relate the material to real companies. Students are motivated to learn material when they see its connection to the real world, and the *Links* help make the connection. The *Links* provide examples of product and period costs at Dell Computer, demonstrate the effect of operating leverage at Microsoft, explain why Baskin-Robbins focuses on the contribution margin while Sears focuses on the contribution margin ratio, explain the decision to drop product lines at Apple Computer, discuss how JIT is creating transportation woes in Japan, and address a variety of other real world situations.

CUTTING-EDGE TECHNIQUES

Students who read *The Wall Street Journal*, *Fortune*, and other business periodicals are exposed to activity-based costing (ABC), activity-based management (ABM), economic value added (EVA), and the balanced scorecard. They know that real companies are using these cutting-edge techniques, and they want their managerial accounting class to help them gain the knowledge needed to assess their merits. The text and problem material aim to help students gain a level of understanding sufficient for them to take an active role in discussing the managerial accounting techniques that real companies are using to create shareholder value.

CASES THAT REQUIRE CRITICAL THINKING

Each chapter has one or more cases, and the CD provides additional, interactive cases. “Solving” them requires critical thinking and several integrate other business disciplines such as management, finance, and marketing. The cases demonstrate, for example, how overhead allocation can distort product

costs, how management of earnings is accomplished by alternative product costing decisions, how operating leverage affects changes in profit, the conflict between participation and performance evaluation in budgeting, and how a standard costing system can lead to overproduction. My experience is that students actually enjoy discussing these cases in class. By articulating their views, they gain confidence and deepen their understanding of the concepts and practices of managerial accounting.

SELF-ASSESSMENT USING THE TEXT, THE INTERACTIVE CD, AND THE WEB SITE

Because it helps students pinpoint areas for additional study, self-testing is a significant aid to learning outside of the classroom. At the end of each chapter, students confront a number of multiple-choice questions that they can use to assess their understanding—answers are at the end of the book. That's a feature found in many textbooks. What's different here is that students also have an interactive CD that they can use to deepen and test their understanding of managerial accounting in an environment that is stimulating, exciting, and fun! Students can work with the CD on their own, and instructors have the flexibility to demonstrate or assign material from the CD.

Here's what is included on the CD:

1. Multiple-choice questions
2. Key term matching exercises
3. Demonstrations of various concepts and techniques, such as the planning and control process, tracing costs to jobs, cost-volume-profit relationships, the effect of alternative allocation schemes on product cost, incremental analysis, calculation of the internal rate of return, "what if" analysis using a spreadsheet, and computation of divisional economic value added (EVA).
4. Critical thinking exercises—short essay questions that require students to think deeply about managerial accounting concepts and techniques.
5. Videos, including use of managerial accounting at *Wizards of the Coast*, automated manufacturing at *Toyota*, ABM at *Microsoft*, the balanced scorecard at *SAFECO*, variance analysis at *Starbucks*, and cost behavior and capital budgeting at *Holland America-Westours*.

The dynamic Web site for *Managerial Accounting* provides additional self-assessment material (including a Student Learning Styles Survey), links to helpful Web sites, references, and more.



CHAPTER ORGANIZATION AND CONTENT

CHAPTER 1, INTRODUCTION TO MANAGERIAL ACCOUNTING

In Chapter 1, I describe how managerial accounting is used in planning, control, and decision making, and I discuss two key ideas in managerial accounting: (1) decision making relies on incremental analysis and (2) you get what

you measure! These two key ideas are integrated throughout the text and receive special attention in Chapter 6 (which covers design making) and Chapter 10 (which covers performance evaluation). Because the book emphasizes the use of information in decision making, I introduce a number of cost terms in the first chapter (e.g., fixed, variable, sunk and opportunity cost). That way, students can begin discussing various decisions using the appropriate vocabulary right from the start. Later in Chapters 4 and 6, these cost terms are reinforced.

The video on the CD—*Wizards of the Coast, Why Managerial Accounting?*—conveys the importance of managerial accounting at this highly successful company.

CHAPTER 2, MANUFACTURING COSTS AND JOB-ORDER COSTING SYSTEMS

Using an example of a small custom boat builder, this chapter discusses cost classifications for manufacturing firms and how costs of manufactured products are reflected in a company's financial statements. Examples of job-order costing are presented for service companies as well as manufacturing firms. The chapter ends with a discussion of changes in manufacturing practices and how these changes are helping companies succeed in a competitive global economy. Two of the Links to Practice are particularly interesting. One introduces the downside to the use of just-in-time manufacturing—in Japan, at least, JIT is adding to traffic problems. A second raises the intriguing question, "Considering that you get what you measure, can there be too much emphasis on quality?"

The video on the CD—*Toyota, Automated Manufacturing Processes*—demonstrates how automation is changing the mix of product costs (less variable labor, more fixed depreciation).

CHAPTER 3, PROCESS COSTING

This chapter presents a relatively simple, straightforward treatment of process costing using the weighted average approach. Students learn how to calculate the cost per equivalent unit and how to prepare a production cost report. They do not learn the more complex FIFO approach to process costing. The *Tech-Tonic Sports Drink* case at the end of the chapter confronts students with two ways to treat the cost of lost units: (1) include the entire cost of the lost units in cost of goods sold, or (2) assign part of the cost to cost of goods sold and part to ending inventory. The case can be used to discuss alternative accounting treatments, earnings management, and ethical issues in accounting.

CHAPTER 4, COST-VOLUME-PROFIT ANALYSIS

In this chapter I develop the tools needed to analyze cost-volume-profit relationships and show how knowledge of these relationships is used in planning, control, and decision making. Students learn how to use account analysis and scattergraphs to estimate cost behavior. Regression analysis is not covered in detail. However, end-of-chapter material is available for instructors who wish to cover regression analysis. The chapter includes a discussion of operating

leverage, shows how operating leverage affects the percentage change in profit for a given change in sales, and relates operating leverage to risk. A comparison of variable and full costing is provided in an appendix, allowing the topic to be included or omitted as desired by the instructor.

The video on the CD—*Holland America Westours*, Fixed and Variable Costs of a Cruise—provides examples of fixed and variable costs and indicates how information about cost behavior is used in planning.

CHAPTER 5, COST ALLOCATION AND ACTIVITY-BASED COSTING

In this chapter, I begin with an explanation of *why* costs are allocated, then I discuss the allocation process, and identify a number of problems related to allocation. This rather extensive background sets the stage for a thorough discussion of activity-based costing, since ABC addresses problems arising from using too few cost pools and only volume-related allocation bases. At this point in the book, students have a reasonable understanding of fixed and variable costs and the need for incremental analysis. This lets them grasp a major drawback with ABC in practice—namely, in practice ABC is generally used to develop the *full cost* of products and services, and this information isn't consistent with the incremental analysis used in decision making. I also note that ABC may lead to improvements in cost control. This follows because with ABC, managers see costs broken out by a number of activities rather than buried in one or two overhead cost pools. The discussion of ABC's use in cost control naturally leads to a discussion of a related approach, activity based management (ABM).

The video on the CD—*Microsoft*, Activity Based Management (ABM)—compares activity-based management to activity-based costing and discusses the use of ABM at this world-class company.

CHAPTER 6, THE USE OF COST INFORMATION IN MANAGEMENT DECISION MAKING

By the time students get to chapter 6, they already have a **fair** understanding of incremental analysis. After reading chapter 6, my hope is that their understanding will be **excellent**. The chapter addresses decisions involving joint costs and stresses the importance of qualitative considerations in management decisions. An appendix is provided on pricing decisions. Here, I make the point that the logic behind marking up cost to set a price is inherently circular. And I demonstrate how to consider demand in setting prices.

CHAPTER 7, CAPITAL BUDGETING DECISIONS

In this chapter, I show how to take the time value of money into account when evaluating capital investment opportunities. Consistent with the idea that the book is an introduction to managerial accounting and most users of the book will become managers rather than accountants, I decided to simplify the treatment of taxes. Students learn that taxes play an important role in investment decisions, but they are not forced to learn complex tax rules (which may change before they have a chance to apply their knowledge). The

chapter notes that managers may concentrate erroneously on the short-run profitability of investments rather than their net present values. This follows because you get what you measure! In other words, performance measures may drive managers to have a short-run focus. Two appendices allow instructors to explore capital budgeting in more depth. The first focuses on how to calculate the internal rate of return when there are uneven cash flows. The second evaluates criticisms that time-value-of-money approaches discourage investment in high-tech projects of strategic importance. My conclusion is that these criticisms relate more to inappropriate use of NPV and IRR rather than inherent flaws in the methods.

The video on the CD—*Holland America Westours*, Present Value Analysis, Buying a Cruise Ship—demonstrates how this company computes the net present value of an investment in a cruise ship.

CHAPTER 8, BUDGETARY PLANNING AND CONTROL

The role of budgets in planning and control is presented in this chapter, and students learn how to prepare the various budget schedules that make up the master budget. Students also learn why flexible budgets are needed for performance evaluation and that the planning and control uses of budgets may conflict (managers who participate in the development of their own budgets may tend to understate budgeted revenues and overstate budgeted expenses). The Abruzzi Olive Oil Company case clearly conveys to students that budgets should be prepared using spreadsheets (exploring the various budget assumptions is easy using a spreadsheet and very tedious using a hand-held calculator).

CHAPTER 9, STANDARD COSTS AND VARIANCE ANALYSIS

In this chapter, students learn how to compute and interpret variances for direct material, direct labor, and manufacturing overhead. Consistent with a focus on future managers, not future accountants, the treatment of overhead variances focuses on only a controllable variance and an overhead volume variance (rather than four overhead variances). To provide flexibility to instructors, recording of standard costs and variances in accounts is discussed in an appendix.

The video on the CD—*Starbucks Coffee Company*, Variance Analysis—shows how Starbucks uses variance analysis to control the use of beans in its roasting process.

CHAPTER 10, DECENTRALIZATION AND PERFORMANCE EVALUATION

In this chapter, I discuss the pros and cons of decentralization and explain why companies evaluate the performance of subunits and subunit managers. This is the chapter where I really emphasize the idea that you get what you measure. In particular I focus on why evaluation in terms of profit can lead to overinvestment (investing in projects with an expected return that is less than the cost of capital) while evaluation in terms of ROI can lead to underinvestment (failure

to invest in projects with an expected return that is greater than the cost of capital). Residual income (and the related measure, economic value added or EVA) solve, to some extent, the problems of over- and under-investment. The chapter ends with a discussion of the Balanced Scorecard. There are two cases that relate to this chapter. The *Mayfield Software* case asks students to develop a balanced scorecard for the division of a software company and the *Super Club Stores* case asks students to evaluate a company in terms of EVA.

The video on the CD—*SAFECO, A Balanced Scorecard*—discusses how this large insurance company uses a balanced scorecard to motivate managers and evaluate success for a number of performance dimensions.

WHAT'S NOT INCLUDED

Four chapters, that are included in other managerial accounting textbooks, are conspicuous by their absence here:

- A second chapter on standard cost variances
- A second chapter on investment decisions
- A chapter on the statement of cash flows
- A chapter on financial statement analysis

I hope you agree that the material omitted is either covered in financial accounting courses, covered in the study of other business disciplines (e.g., finance), or not essential in a first course in managerial accounting aimed at future managers.

SPECIAL FEATURES

Each chapter has been carefully developed to enhance student understanding and connect the material to the real world with the following features.

- *Chapter Openers.* Each chapter opens with an example from a hypothetical company, posing an issue that a real manager might encounter, such as “is my costing system distorting product cost?” That issue is specifically addressed later in the chapter after students have gained an understanding of the concepts and techniques needed to address the issue.
- *Learning Objectives.* Each chapter also lists learning objectives at the beginning of the chapter and repeats them next to the text where they are addressed.
- *Link to Practice Sections.* As discussed above, these sections relate the material to real-world companies, helping students see how the principles discussed in text are applied in the real world.
- *Two Key Ideas.* Introduced in Chapter 1, the two key ideas of incremental analysis and “you get what you measure!” are applied throughout the text. To call attention to these ideas, we use icons in the margin.
- *Summary of Learning Objectives.* This Summary is organized by Learning Objectives, so that students can efficiently review and assess whether or not they have mastered the material.

INCREMENTAL ANALYSIS

YOU GET
WHAT YOU MEASURE!

- **Key Terms.** Each chapter lists key terms, and care is taken so that students are not overwhelmed with terminology.
- **Self-Assessment.** At the end of each chapter are 10–20 multiple-choice questions that students can use to assess their understanding of the chapter.
- **Interactive Learning.** The section after Self-Assessment directs students to the CD for more self-assessment, critical thinking activities, demonstrations, cases, and videos, as described above.
- **Questions, Exercise, and Problems.** Questions are posed to address each of the learning objectives. Exercises tend to confront students with fairly structured situations, while problems tend to involve more complex analysis and computation.
- **Web Exercises.** A number of exercises require students to access information via the Internet.
- **Spreadsheet Exercises and Problems.** Students who are comfortable using a spreadsheet program will probably solve most, if not all, of the exercises and problems with a spreadsheet. For others, each chapter identifies 3–5 exercises and problems with a spreadsheet icon. Templates are available for these exercises and problems along with instructional material on how to approach their solution using a spreadsheet.
- **Cases.** Each chapter has one or more cases, and the CD provides additional, interactive cases. “Solving” them requires critical thinking and several integrate other business disciplines such as management, finance, and marketing.



SUPPLEMENTS

A full range of supplements for both students and instructors is planned.



WEB SITE

For instructors, the Web site provides access to the Solutions Manual, Instructor's Manual, Computerized Test Bank, PowerPoint Presentations, Text Illustrations, Video Exercises, and more. **For students**, the Web site provides a sample of the Study Guide, access to PowerPoint text illustrations, and a Checklist of Key Figures, as well as additional Internet Exercises, Self-Testing, links, and more. The Web site can be accessed at <http://www.wiley.com/college/jiambalvo>.

INSTRUCTORS' RESOURCES

SOLUTIONS MANUAL

Prepared by the author, the Solutions Manual provides solutions for all end-of-chapter text materials. The solutions have been checked to ensure accuracy and instructors may duplicate any portion of the Solutions Manual without paying a permission fee.

SOLUTIONS TRANSPARENCIES

The *Solutions Transparencies* feature detailed solutions to all exercises and problems in the textbook, and suggested answers to the cases.

INSTRUCTOR'S MANUAL

The Instructor's Manual is a comprehensive resource guide designed to assist professors in preparing lectures and assignments. Among the features included in the manual are a chapter review of the significant topics and points contained in each chapter, enhanced lecture outlines, reading comprehension checks, vocabulary quizzes, multiple-choice quizzes, and additional exercises.

TEST BANK

This comprehensive testing package is designed to allow instructors to tailor examinations according to the content of each chapter. This package consists of over 1,000 examination questions and exercises accompanied by answers and solutions. The types of questions include True-False, Multiple Choice, Completion, Short-Answer Essays and Problems.

COMPUTERIZED TEST BANK

This Test Bank is also available for use with IBM and IBM-compatibles running Windows 3.1 or higher. This Computerized Test Bank offers a number of valuable options that allow instructors to create multiple versions of the same test by scrambling questions; generate a large number of test questions randomly or manually; and modify and customize test questions by changing existing problems or adding their own.

CHECKLIST OF KEY FIGURES

A listing of key amounts for textbook problems, allowing students to verify the accuracy of their answers as they work through the assignments, is available on the text Web site at <http://www.wiley.com/college/jiambalvo>.

POWERPOINT PRESENTATIONS

This PowerPoint lecture aid contains a combination of key concepts and images from the textbook for use in the classroom. Designed according to the organization of the material in the textbook, this series of electronic transparencies can be used to reinforce managerial accounting visually and graphically.

VIDEOS

These videos, also found on the CD-ROM accompanying the text, include frank discussions from real companies on the use of managerial accounting in their businesses—an excellent illustration of the concepts taught in the text. A full listing of these videos may be found inside the front cover of this book.

STUDENT RESOURCES

STUDY GUIDE

The purpose of this self-study guide is to enhance student understanding of the chapter material and improve student ability to solve homework assignments. Each chapter contains an Overview, Learning Objectives, Points to Guide Your Reading, True-False Review Questions, Multiple Choice Self-Test, and a walk-through of additional Exercises, Problems and Cases representative of homework assignments, with solutions.

EXCEL TEMPLATES

Each text chapter identifies 3–5 exercises and problems with a spreadsheet icon. Templates are available for these exercises and problems along with instructional material on how to approach their solution using a spreadsheet.

WORKING PAPERS

Working Papers are partially completed accounting forms for all end-of-chapter exercises, problems and cases. This is a convenient resource for organizing and completing homework assignments by demonstrating how to correctly set up solution formats; they are directly tied to textbook assignments.

ONLINE BUSINESS SURVIVAL GUIDE

The journey of 1,000 Web sites begins with one click, and this practical guide gets you on the road. The *Online Business Survival Guide* is a brief, clear introduction to using the World Wide Web as a business research tool. Starting with the basics, this manual covers everything students need to become master sleuths at finding critical information on the Internet. In addition, the guide provides a hands-on guide to using *The Wall Street Journal Interactive Edition*, as well as a discount offer for a subscription to *The Wall Street Journal Interactive Online*.

BUSINESS EXTRA

To complement the *Online Business Survival Guide*, the *Business Extra* portion of the Jiambalvo *Managerial Accounting* Web site gives professors and students instant access to a wealth of current articles dealing with all aspects of managerial accounting. The articles are organized by topic with reference to appropriate chapter use, and discussion questions follow each article.

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I am indebted to my colleagues at the University of Washington (in particular, Bob Bowen, Dave Burgstahler, Eric Noreen, and Gary Sundem) and two of my former textbook co-authors (Bob May and Chuck McDonald) for clarifying my thinking about managerial accounting. I hope the insights they have shared with me are reflected in this book. I am especially grateful to Bob Bowen for introducing me to the phrase "You get what you measure!" and to Eric Noreen for many discussions regarding cost allocation and ABC.

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