

FIFTH EDITION



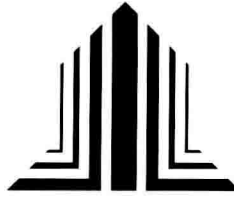
# **Managerial Accounting**

An Introduction to Concepts,  
Methods, and Uses

**Michael W. Maher**  
**Clyde P. Stickney**  
**Roman L. Weil**

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*Dartmouth College*

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**For our students, with thanks.**

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Whatever be the detail with which you cram your students, the chance of their meeting in after-life exactly that detail is almost infinitesimal; and if they do meet it, they will probably have forgotten what you taught them about it. The really useful training yields a comprehension of a few general principles with a thorough grounding in the way they apply to a variety of concrete details. In subsequent practice the students will have forgotten your particular details; but they will remember by an unconscious common sense how to apply principles to immediate circumstances.

**Alfred North Whitehead**

*The Aims of Education and Other Essays*

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## Reference

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If we were to place managerial accounting textbooks on a continuum from managerial orientation at one end to procedural cost accounting orientation at the other end, *Managerial Accounting: An Introduction to Concepts, Methods, and Uses*, would be on the managerial end of the continuum. We have always assumed that most students using this book will be *users*, not producers, of accounting information. We want these students to understand the relevance of accounting information in marketing, production, systems design, engineering, management, and other non-accounting activities. Consequently, we focus on managerial accounting concepts and applications, not procedures.

Users and reviewers of previous editions have generally regarded *Managerial Accounting* as nurturing and stretching the critical thinking skills of students. A *critical thought approach* views accounting as a process of reporting information for people to use in decision making, as opposed to a view of accounting as a set of rules or procedures to follow. Both producers and users of accounting information must make many judgments based on the usefulness of information. We convey this idea throughout the book in text and assignment materials. Indeed, we have devoted an entire chapter (Chapter 16, *Getting the Most from Managerial Accounting*) to critical thinking about the accounting process.

In building on the book's enduring strengths—user orientation, conceptual focus, and critical thinking approach—we have thoroughly revised the Fifth Edition to make the book even more useful for current and future managers. Among other changes, we include a new chapter on activity-based management and costing (Chapter 6). We have rewritten chapters to make the concepts and applications clearer and more understandable at first reading. We have moved the Problems for Self Study to strategic points in the text for more immediate feedback. By significantly increasing the number of real-company references and illustrations, we have made the material more relevant for emerging managers.

## Major Features of the Book

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The Fifth Edition contains many features that differentiate it from other textbooks in the field.

### Conceptual Approach

We present managerial accounting concepts to prepare students to focus on relevant issues. *This preparation is more important than ever with the increased emphasis on developing critical thinking skills in current curricula.* The Accounting Education Change Commission argues for a more conceptual approach to accounting education. We agree, and provide it in this book. Methods follow concepts, so students

start with the big picture before they learn specific procedures. The book supports this conceptual approach with numerous examples and many short exercises.

For example, our presentation of variances starts with a “big picture” comparison of budgeted and achieved results in Chapter 12, then presents variance calculations in Chapters 13 and 14 as a more detailed presentation of the budget-versus-achieved comparison. This approach has two advantages. First, it keeps the larger view and the purpose of variance calculations in students’ minds; they do not lose sight of their overall objectives as they analyze detailed variances. Second, students find the approach intuitive. They may forget how to compute particular variances, but they will remember the overall model, which will enable them to reconstruct variance analysis later.

### **Managerial Applications**

Students are more highly motivated to learn the material if they see its application to real-world problems, particularly ones they believe they will face. These Managerial Applications allow the student to explore actual company practices that illustrate concepts discussed in the text without disrupting the flow of the concepts. Students often remember these real-company illustrations long after classes are over.

### **Extensive Use of Nonmanufacturing Applications**

We have included numerous examples and applications to nonmanufacturing settings. Traditionally, accountants have considered certain topics, like cost accumulation and variance analysis, to be the domain of manufacturing. Our chapters on these topics show how to use the concepts in nonmanufacturing organizations.

### **Integrated Self-Study Problems and Solutions**

Self-study problems are a vital part of the Fifth Edition. Integrated into the chapters, they give students instant feedback and critical thinking exposure at the points in the text where students need it most. (Solutions precede the assignment material.) Many chapters have three or four self-study problems.

### **Solutions to Even-Numbered Exercises**

We have included Suggested Solutions to Even-Numbered Exercises at the end of every chapter with exercises. These fully annotated solutions give students even more feedback on their understanding of the text.

### **Chapter 16: “Getting the Most from Managerial Accounting”**

Chapter 16 uniquely challenges students to analyze the uses of accounting critically. This chapter also discusses fraudulent financial reporting. Students can read this chapter anytime after Chapter 3.

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## Variety and Depth of Assignment Materials

Accounting instructors know the need for accurate and interesting assignment materials. We have class-tested the assignment material and worked every question, exercise, problem, and case at least twice in preparing this book.

The variety and quantity of assignment materials in the Fifth Edition allow the book to be used in various levels of courses. To help the instructor assign homework and select items for class presentation, we have divided the assignment materials into four categories:

1. *Questions* include both straightforward questions about key concepts and thought-provoking questions about the challenging issues that managers and accountants face. Questions are particularly good for written essays and class discussions.
2. *Exercises* reinforce key concepts in the chapter, often referring the student to a particular illustration. Exercises typically deal with a single topic and are particularly useful for classroom demonstration.
3. *Problems* challenge the student to apply and interpret the material in the chapter, many with thought-provoking discussion or essay questions. (Instructors also can easily add additional essay and critical thought questions.) Problems generally require students to think about managerial issues as well as accounting issues.
4. *Cases* encourage students to apply concepts from multiple chapters and their other courses to deal with complex managerial issues. Cases are particularly good for advanced students and graduate students with some previous background in managerial accounting.

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## Major Changes in This Edition

### Increased Managerial Orientation

Although previous editions had a strong managerial orientation, we made the Fifth Edition even more managerial in both the text and assignment materials. We have reduced preparer-based requirements and added a managerial decision context to many assignment items. In Chapters 1 through 6, we have increased the emphasis on product costing and cost management for decision making and reduced the emphasis on costing for inventory values in external financial statements. The new chapter on activity-based costing and management (Chapter 6) focuses on managers' problems in managing activities and includes a discussion of strategic uses of activity-based costing and management.



## **New Chapter on Activity-Based Costing and Management**

Chapter 6 is a new chapter on activity-based costing and management (ABCM). We added this chapter to alert students to current developments and opportunities for improvement in management accounting. This chapter takes a management orientation to activity and product costing using ABCM by emphasizing choices among accounting alternatives, benefits of activity management, and strategic opportunities provided by ABCM. Topics include applying cost-benefit tests to ABCM, the process of accounting system change, the use of ABCM to eliminate non-value-added costs, the use of ABCM in marketing, and opportunities to improve ABCM in practice.

## **Additional Discussion of New Production Methods Throughout the Text**

In addition to the new chapter on activity-based costing and management, we have incorporated additional discussion of new production methods throughout the book. (We call these new “production” methods while others call them new “manufacturing” methods. We prefer the term “production” to “manufacturing” to recognize the importance of these new methods in producing services, not just goods.) Here are some examples:

- Chapter 1: Sections on activity-based costing and management, lean production, and quality.
- Chapter 3: Discussion of alternative cost drivers used to apply overhead to products.
- Chapter 4: Section on just-in-time and backflush costing; discussion of use of just-in-time to achieve lean production; discussion of difficulties in implementing just-in-time methods.
- Chapter 6: New chapter on activity-based costing and management.
- Chapter 7: Section on use of regression to identify cost drivers for activity-based costing including discussion of empirical research in identifying cost drivers.
- Chapter 9: Discussion of flexible manufacturing methods.
- Chapter 13: Section on nonfinancial performance measures emphasizing quality. Managerial Application on Texas Instruments’ cost of quality program. Section on variance analysis when activity-based costing is used to derive standard costs.
- Chapter 14: Managerial Application on quality management and the Baldrige Award.

## **New Coverage of Ethical Issues That Affect Managers and Accountants**

Our students face a future of increasing concern about the accountability of accountants and managers for their actions. This edition contains discussions of ethics that demonstrate the types of complex ethical choices students are likely to encounter during their careers. While the discussions focus on managerial accounting issues,

inevitably the situations evoke organizational and managerial issues, corporate accountability, the role of internal and external auditors, and societal expectations for accountability.

Following is a sample of the new ethics materials in this edition:

- Chapter 1: Ethical implications of accounting choices and discussion of corporate codes of ethics such as the Johnson & Johnson Credo.
- Chapter 3: Ethical issues in increasing production to increase profits under full-absorption costing.
- Chapter 4: Improprieties in assigning costs to jobs, especially on government contracts.
- Chapter 12: Ethical issues in budgeting, including discussion of General Electric's attempts to deal with conflicts between behaving ethically and meeting performance standards.
- Chapter 16: Management ethics and financial fraud including discussion of actual financial fraud situations. This material provides students with a conceptual framework for evaluating situations conducive to fraud, including concepts drawn from work by the Treadway Commission. The assignment material has been class-tested; undergraduates, MBA students, and executives have found it interesting.

## **New Material: Chapter by Chapter**

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### **All Chapters**

- Added *learning objectives* to each chapter to give students a better sense of what they can expect to learn from the chapter.
- Integrated *self-study questions* in the chapters so students can test their knowledge for immediate feedback on their understanding of the material as they read the chapter. (Solutions to self-study questions are at the end of the chapter.)
- Increased the number of references to actual companies to make the material more interesting and relevant to students. (The Index highlights real-company references.)
- Revised odd-numbered exercises and many problems.
- Rewrote text material for increased accessibility and to focus on use by managers.
- Revised problems to make them more straightforward.

**Chapter 1** Added material on ethics, including Johnson & Johnson Credo and assignment materials, to help students see the ethical implications of management and accounting decisions. Added materials on the new production environment to emphasize the importance of lean production, quality, and activity-based management and costing.

**Chapter 3** Added discussion of ethical issues in increasing production to increase profits under full-absorption costing.

**Chapter 4** Revised the chapter for a more managerial and less procedural emphasis. Expanded coverage of alternative production methods to include operations, in addition to jobs and continuous processes. Expanded discussion of back-flush costing in just-in-time settings. Added discussion of lean production methods and the use of just-in-time to achieve lean production. Expanded discussion of just-in-time, including implementation difficulties. Discussed improprieties in assigning costs to jobs, particularly on government contracts.

**Chapter 5** Added classic dialog between a small business owner and his consultant (“Joe vs. The Efficiency Expert”) to demonstrate inherently controversial aspects of cost allocation about cost allocation issues. Simplified department allocation example.

**Chapter 6** Added new chapter on activity-based costing and management (ABCM). This chapter reflects the authors’ views that activity-based costing provides an important new concept in management by focusing on managing activities. Major features include:

- Dialog among company managers discussing inadequacies in the company’s traditional accounting system in providing the information needed for the company to remain competitive.
- Cost-benefit considerations in choosing among plantwide allocation, department allocation, and ABC.
- Description of the steps involved in ABC, including identifying activity centers and cost drivers, and assigning costs to products.
- Use of ABC to eliminate non-value-added costs.
- Use of ABC in analyzing marketing costs.
- Strategic opportunities with ABC.
- Real-world application discussing use of ABC in managing health care costs.
- Opportunities to improve ABC in practice, including the hierarchy of costs approach proposed by Cooper and Kaplan.

**Chapter 7** Added discussion of the use of regression to identify cost drivers for ABC; includes discussion of empirical research in identifying cost drivers.

**Chapter 8** Added Managerial Application on breaking even in the auto industry. Demonstrated how computer spreadsheets are used in cost-volume-profit analysis.

**Chapters 10 and 11** Simplified discussion of capital budgeting and added more basic exercises.

**Chapter 12** Combined conceptual and analytical elements of Chapters 11 and 12 from the previous edition to provide a more logical flow and focus on operating

budgets. Added discussion of ethical issues in budgeting, including managerial application discussing conflict between ethical issues and meeting performance standards at General Electric. Added Managerial Application on the State of California's problems in balancing its budget.

**Chapter 13** Added section on nonfinancial performance measures. Added Managerial Application on Texas Instruments' cost of quality program. Added discussion of variance analysis when activity-based costing is used to derive standard costs.

**Chapter 14** Added Managerial Application on quality management and the Baldrige Award.

**Chapter 15** Added section on transfer pricing practices in the U.S., Canada, and Japan. Added discussion of multinational transfer pricing, including a Managerial Application of a transfer pricing dispute between U.S. tax authorities and a Japanese company.

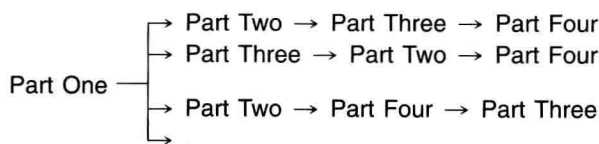
**Chapter 16** Added section on fraudulent financial reporting and added considerable assignment material on financial fraud. Text describes actual financial fraud situations and discusses ways to prevent and detect fraud. Features include:

- Common types of fraud, such as early revenue recognition and inventory overstatement.
- Motives and opportunities to commit fraud.
- The importance of the "tone at the top."
- Analysis of actual case studies of financial fraud.

## Organization and Use of This Book

We divided the book into five major parts, as follows: Part One, Fundamental Concepts, Chapters 1–2; Part Two, Cost Methods and Systems, Chapters 3–6; Part Three, Managerial Decision Making, Chapters 7–11; Part Four, Managerial Planning and Performance Evaluation, Chapters 12–15; and Part Five, Special Topics, Chapters 16–18.

**Part One** covers fundamental concepts and provides an overview of managerial accounting. Instructors may cover the other parts in any sequence, or omit them, after Part One, as the diagram below shows:



**Part Two** describes cost methods and systems companies use. Chapter 3 discusses alternative methods of measuring product costs. Chapter 4 shows how accounting is done in alternative production settings. Chapter 5 discusses cost allocation. Chapter 6 discusses activity-based management and costing.

**Part Three** discusses concepts and methods useful for managerial decision making. Chapter 7 discusses methods of estimating cost behavior. Chapters 8 and 9 discuss the use of accounting data in short-run decision making, where capacity is held constant. Chapters 10 and 11 discuss the use of accounting in long-run decision making involving capital budgeting.

**Part Four** discusses managerial planning, control, and internal performance evaluation. Chapter 12 provides an overview of planning and control, and discusses development of budgets as tools for planning and control. Chapters 13 and 14 deal with variances. Chapter 13 presents the fundamental cost variance model that applies to any type of manufacturing or nonmanufacturing cost and includes a discussion of nonfinancial performance measures. Chapter 14 provides more detailed variance analysis. Chapter 15 focuses on performance evaluation in decentralized operations.

**Part Five** deals with special topics. Chapter 16 describes situations where managers may have incentives to take actions that do not serve the best interests of the firm but that make them look good to reviewers of accounting reports. The text and assignment material include coverage of financial fraud. Chapters 17 and 18 present an overview of financial accounting. For readers familiar with financial accounting, these chapters will serve as a review. Readers who have not studied financial accounting can use these chapters as an introduction to financial accounting concepts, methods, and uses. These chapters are independent of the rest of the book and students may read them at any time.

The Appendix to the book discusses compound interest calculations used in discounted cash flow analysis. It is also independent of the rest of the book. The glossary defines comprehensively the concepts and terms used in managerial accounting.

Instructors can cover any of the above chapters out of sequence or omit them, with two exceptions: Chapter 11 should follow Chapter 10 and Chapter 14 should follow Chapter 13.

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## **Related Materials Accompanying the Text**

### **Instructor's Manual by Anne J. Rich and Kathleen Simone**

The Instructor's Manual includes sample course outlines, assignments, additional writing questions, ethical issues, chapter overviews, lecture notes, short progress tests to be given at the beginning or end of class, and other instructor help. A master list of Check Figures is available. Professors Anne J. Rich and Kathleen Simone both teach at Quinnipiac College.

## **Solutions Manual by the authors**

This manual contains responses to questions and solutions to all exercises, problems, and cases. We have checked these solutions to eliminate errors.

## **Test Bank by Anne J. Rich**

The test bank contains multiple choice questions and exercises for examinations. It also features a new Matching Section and short essay questions with suggested responses. Topical heads have been added for easier test creation, and all solutions are fully annotated.

## **Computerized Test Bank**

The test bank is available in EXAMaster+ computerized format for most DOS-based and Macintosh personal computers.

## **RequesTest**


Call (800) 447-9457 toll-free to order test masters through the HB RequesTest service. Allow 48 hours for compiling the test in addition to first-class mail delivery (fax delivery available). RequesTest service and software support are available Monday through Friday, 9 A.M. to 4 P.M. (Central Time) for questions, guidance, or other help.

## **Study Guide by Anne J. Rich**

For each chapter and the appendix, the Study Guide includes

1. A brief summary of the chapter.
2. An outline of the chapter with emphasis on key points.
3. Several self-test and practice exercises, with answers or suggested solutions. Included are matching exercises and short problems.
4. A study plan designed to help students solve the problems in the text. Included here are references to text exhibits for review and coverage of those text problems solvable using the spreadsheet templates available to adopters.
5. Instructions on how to use the student software (see the following for more details).

## **Management Templates**

Professors Anne J. Rich and David Cadden (both of Quinnipiac College) have prepared this supplement to give students experience in solving management accounting problems using electronic spreadsheets. This supplement enables students to solve selected problems from this text using the templates provided. Professor Rich provides notes and comments on using the software for students in the *Study Guide* and for the instructor in the *Instructor's Manual*. Requires Lotus® 1-2-3 (DOS version) or Microsoft Excel® (Macintosh version). End-of-chapter items workable using the templates are identified with a disk icon  in the margin.

## Transparencies

Acetate transparencies of 100 of the exhibits from the textbook are available to enhance classroom instruction. In addition Transparencies are now available for numerical solutions to all Exercises, Problems, and Cases found in the Solutions Manual.

## Acknowledgments

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M.W.M.

C.P.S.

R.L.W.



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