

Ninth Edition



Accounting for Decision Making and Control

Jerold L. Zimmerman
University of Rochester

**Mc
Graw
Hill**
Education

Brief Contents

1	Introduction	1
2	The Nature of Costs	22
3	Opportunity Cost of Capital and Capital Budgeting	85
4	Organizational Architecture	127
5	Responsibility Accounting and Transfer Pricing	161
6	Budgeting	216
7	Cost Allocation: Theory	280
8	Cost Allocation: Practices	327
9	Absorption Cost Systems	392
10	Criticisms of Absorption Cost Systems: Incentive to Overproduce	448
11	Criticisms of Absorption Cost Systems: Inaccurate Product Costs	483
12	Standard Costs: Direct Labor and Materials	538
13	Overhead and Marketing Variances	575
14	Management Accounting in a Changing Environment	609
	Solutions to Concept Questions	655
	Glossary	665
	Index	675

Contents

1	Introduction	1
	A. Managerial Accounting: Decision Making and Control	2
	B. Design and Use of Cost Systems	4
	C. Marmots and Grizzly Bears	8
	D. Management Accountant's Role in the Organization	9
	E. Evolution of Management Accounting: A Framework for Change	12
	F. Vortec Medical Probe Example	15
	G. Outline of the Text	18
	H. Summary	18
2	The Nature of Costs	22
	A. Opportunity Costs	23
	1. Characteristics of Opportunity Costs	24
	2. Examples of Decisions Based on Opportunity Costs	24
	B. Cost Variation	29
	1. Fixed, Marginal, and Average Costs	29
	2. Linear Approximations	31
	3. Other Cost Behavior Patterns	33
	4. Activity Measures	33
	C. Cost–Volume–Profit Analysis	35
	1. Copier Example	35
	2. Calculating Break-Even and Target Profits	36
	3. Limitations of Cost–Volume–Profit Analysis	39
	4. Multiple Products	41
	5. Operating Leverage	42
	D. Opportunity Costs versus Accounting Costs	45
	1. Period versus Product Costs	46
	2. Direct Costs, Overhead Costs, and Opportunity Costs	46
	E. Cost Estimation	48
	1. Account Classification	49
	2. Motion and Time Studies	49
	F. Summary	49
	Appendix: Costs and the Pricing Decision	50
3	Opportunity Cost of Capital and Capital Budgeting	85
	A. Opportunity Cost of Capital	86
	B. Interest Rate Fundamentals	89
	1. Future Values	89
	2. Present Values	90

3. Present Value of a Cash Flow Stream	91
4. Perpetuities	92
5. Annuities	93
6. Multiple Cash Flows per Year	94
C. Capital Budgeting: The Basics	96
1. Decision to Acquire an MBA	96
2. Decision to Open a Day Spa	97
3. Essential Points about Capital Budgeting	98
D. Capital Budgeting: Some Complexities	99
1. Risk	99
2. Inflation	100
3. Taxes and Depreciation Tax Shields	102
E. Alternative Investment Criteria	104
1. Payback	104
2. Accounting Rate of Return	105
3. Internal Rate of Return (IRR)	107
4. Methods Used in Practice	110
F. Summary	110
4 Organizational Architecture	127
A. Basic Building Blocks	128
1. Self-Interested Behavior, Team Production, and Agency Costs	128
2. Decision Rights and Rights Systems	133
3. Role of Knowledge and Decision Making	134
4. Markets versus Firms	135
5. Influence Costs	137
B. Organizational Architecture	139
1. Three-Legged Stool	139
2. Decision Management versus Decision Control	143
C. Accounting's Role in the Organization's Architecture	145
D. Example of Accounting's Role: Executive Compensation Contracts	147
E. Summary	148
5 Responsibility Accounting and Transfer Pricing	161
A. Responsibility Accounting	162
1. Cost Centers	163
2. Profit Centers	165
3. Investment Centers	166
4. Economic Value Added (EVA [®])	170
5. Controllability Principle	173
B. Transfer Pricing	175
1. International Taxation	175
2. Economics of Transfer Pricing	177
3. Common Transfer Pricing Methods	181
4. Reorganization: The Solution if All Else Fails	186
5. Recap	186
C. Summary	188

6 Budgeting 216

- A. Generic Budgeting Systems 219**
 - 1. Country Club 219
 - 2. Large Corporation 222
- B. Trade-Off between Decision Management and Decision Control 226**
 - 1. Communicating Specialized Knowledge versus Performance Evaluation 226
 - 2. Budget Ratcheting 227
 - 3. Participative Budgeting 229
 - 4. New Approaches to Budgeting 230
 - 5. Managing the Trade-Off 232
- C. Resolving Organizational Problems 233**
 - 1. Short-Run versus Long-Run Budgets 233
 - 2. Line-Item Budgets 235
 - 3. Budget Lapsing 236
 - 4. Static versus Flexible Budgets 236
 - 5. Incremental versus Zero-Based Budgets 239
- D. Summary 241**
- Appendix: Comprehensive Master Budget Illustration 242**

7 Cost Allocation: Theory 280

- A. Pervasiveness of Cost Allocations 281**
 - 1. Manufacturing Organizations 283
 - 2. Hospitals 284
 - 3. Universities 284
- B. Reasons to Allocate Costs 286**
 - 1. External Reporting/Taxes 286
 - 2. Cost-Based Reimbursement 287
 - 3. Decision Making and Control 288
- C. Incentive/Organizational Reasons for Cost Allocations 289**
 - 1. Cost Allocations Are a Tax System 289
 - 2. Taxing an Externality 290
 - 3. Insulating versus Noninsulating Cost Allocations 296
- D. Summary 299**

8 Cost Allocation: Practices 327

- A. Death Spiral 328**
- B. Allocating Capacity Costs: Depreciation 333**
- C. Allocating Service Department Costs 333**
 - 1. Direct Allocation Method 335
 - 2. Step-Down Allocation Method 337
 - 3. Service Department Costs and Transfer Pricing of Direct and Step-Down Methods 339
 - 4. Reciprocal Allocation Method 342
 - 5. Recap 344
- D. Joint Costs 344**

1. Joint Cost Allocations and the Death Spiral	346
2. Net Realizable Value	348
3. Decision Making and Control	352
E. Segment Reporting and Joint Benefits	353
F. Summary	354
Appendix: Reciprocal Method for Allocating Service Department Costs	354
9 Absorption Cost Systems	392
A. Job Order Costing	394
B. Cost Flows through the T-Accounts	396
C. Allocating Overhead to Jobs	398
1. Overhead Rates	398
2. Over/Underabsorbed Overhead	400
3. Flexible Budgets to Estimate Overhead	403
4. Expected versus Normal Volume	406
D. Permanent versus Temporary Volume Changes	410
E. Plantwide versus Multiple Overhead Rates	411
F. Process Costing: The Extent of Averaging	415
G. Summary	416
Appendix A: Process Costing	416
Appendix B: Demand Shifts, Fixed Costs, and Pricing	422
10 Criticisms of Absorption Cost Systems: Incentive to Overproduce	448
A. Incentive to Overproduce	450
1. Example	450
2. Reducing the Overproduction Incentive	453
B. Variable (Direct) Costing	454
1. Background	454
2. Illustration of Variable Costing	454
3. Overproduction Incentive under Variable Costing	457
C. Problems with Variable Costing	458
1. Classifying Fixed Costs as Variable Costs	458
2. Variable Costing Excludes the Opportunity Cost of Capacity	460
D. Beware of Unit Costs	461
E. Summary	463
11 Criticisms of Absorption Cost Systems: Inaccurate Product Costs	483
A. Inaccurate Product Costs	484
B. Activity-Based Costing	488
1. Choosing Cost Drivers	489
2. Absorption versus Activity-Based Costing: An Example	495
C. Analyzing Activity-Based Costing	499
1. Reasons for Implementing Activity-Based Costing	499
2. Benefits and Costs of Activity-Based Costing	501
3. ABC Measures Costs, Not Benefits	503
D. Acceptance of Activity-Based Costing	505
E. Summary	509

12	Standard Costs: Direct Labor and Materials	538
A.	Standard Costs	539
1.	Reasons for Standard Costing	540
2.	Setting and Revising Standards	541
3.	Target Costing	545
B.	Direct Labor and Materials Variances	546
1.	Direct Labor Variances	546
2.	Direct Materials Variances	550
3.	Risk Reduction and Standard Costs	554
C.	Incentive Effects of Direct Labor and Materials Variances	554
1.	Build Inventories	555
2.	Externalities	555
3.	Discouraging Cooperation	556
4.	Mutual Monitoring	556
5.	Satisficing	556
D.	Disposition of Standard Cost Variances	557
E.	The Costs of Standard Costs	559
F.	Summary	561
13	Overhead and Marketing Variances	575
A.	Budgeted, Standard, and Actual Volume	576
B.	Overhead Variances	579
1.	Flexible Overhead Budget	579
2.	Overhead Rate	580
3.	Overhead Absorbed	581
4.	Overhead Efficiency, Volume, and Spending Variances	581
5.	Graphical Analysis	585
6.	Inaccurate Flexible Overhead Budget	587
C.	Marketing Variances	588
1.	Price and Quantity Variances	588
2.	Mix and Sales Variances	589
D.	Summary	591
14	Management Accounting in a Changing Environment	609
A.	Integrative Framework	610
1.	Organizational Architecture	611
2.	Business Strategy	612
3.	Environmental and Competitive Forces Affecting Organizations	615
4.	Implications	615
B.	Organizational Innovations and Management Accounting	616
1.	Total Quality Management (TQM)	616
2.	Just-in-Time (JIT) Production	621
3.	Six Sigma and Lean Production	624
4.	Balanced Scorecard	626
C.	When Should the Internal Accounting System Be Changed?	632
D.	Summary	633
	Solutions to Concept Questions	655
	Glossary	665
	Index	675