# BRIEF CONTENTS

# PART ONE Introduction to management and cost accounting 2

- 1 Introduction to management accounting 4
- 2 An introduction to cost terms and concepts 27

#### **PART TWO**

# Cost accumulation for inventory valuation and profit measurement 52

- 3 Cost assignment 54
- 4 Process costing 97
- 5 Joint and by-product costing 126
- 6 Income effects of alternative cost accumulation systems 144

# PART THREE Information for decision-making 164

- 7 Cost-volume-profit analysis 166
- 8 Measuring relevant costs and revenues for decision-making 194
- 9 Pricing decisions and profitability analysis 238
- 10 Activity-based costing 265
- 11 Decision-making under conditions of risk and uncertainty 297
- 12 Capital investment decisions: appraisal methods 321
- 13 Capital investment decisions: the impact of capital rationing, taxation, inflation and risk 352

#### PART FOUR Information for planning, co

Information for planning, control and performance measurement 380

Replacement of equipment: the Irrelevance of

- 14 Management control systems 382
- 15 The budgeting process 419
- 16 Standard costing and variance analysis 1 458
- 17 Standard costing and variance analysis 2: further aspects 498
- 18 Divisional financial performance measures 521
- 19 Transfer pricing in divisionalized companies 553

#### PART FIVE

Strategic performance and cost management for value creation; digitalization, sustainability and the future of management accounting 584

- 20 Strategic performance management 586
- 21 Strategic cost management and value creation 624
- 22 Management accounting: contemporary technologies and data analytics 673
- 23 Sustainability and environmental management accounting 698
- 24 Challenges for the future 727

#### PART SIX

Addendum: the application of quantitative methods to management accounting 746

- 25 Cost estimation and cost behaviour 748
- Quantitative models for the planning and control of inventories 772

# CONTENTS

About the authors IX
Preface X
Acknowledgements XVI

### PART ONE Introduction to management and cost accounting 2

# 1 Introduction to management accounting 4

The users of accounting information 5

Differences between management accounting and financial accounting 6

The decision-making, planning and control process 6

The impact of the changing business
environment on management accounting 10
Focus on customer satisfaction
and new management approaches 17
Functions of management accounting 19
Summary of the contents of this book 21

### 2 An introduction to cost terms and concepts 27

Guidelines for using this book 21

Manufacturing, merchandising and service organizations 28
Direct and indirect costs 29
Period and product costs 32
Cost behaviour 34
Relevant and irrelevant costs and revenues 37
Avoidable and unavoidable costs 38
Sunk costs 38
Opportunity costs 39
Incremental and marginal costs 40

Controllable and uncontrollable costs 41

The cost and management accounting information system 42

# PART TWO Cost accumulation for inventory valuation and profit measurement 52

#### 3 Cost assignment 54

Assignment of direct and indirect costs 55 Different costs for different purposes 57 Cost-benefit issues and cost systems design 57 Assigning direct costs to cost objects 58 Plant-wide (blanket) overhead rates 59 The two-stage allocation process 60 An illustration of the two-stage process for a traditional costing system 61 An illustration of the two-stage process for an ABC system 66 Extracting relevant costs for decision-making 70 Budgeted overhead rates 71 Under- and over-recovery of overheads 72 Non-manufacturing overheads 73 Cost assignment in non-manufacturing organizations 74 The indirect cost assignment process 76 Accounting entries for a job costing system 76

#### 4 Process costing 97

Flow of production and costs in a process
costing system 98
Process costing when all output is fully
complete 99
Process costing with ending work in progress
partially complete 105

Beginning and ending work in progress of uncompleted units 108

Partially completed output and losses in process 113

Process costing in service organizations 113
Batch/operating costing/standard costing 113
Appendix 4.1: Losses in process and partially
completed units 115

### 5 Joint and by-product costing 126

Joint products and by-products 127
Methods of allocating joint costs 127
Irrelevance of joint cost allocations for decision-making 133
Accounting for by-products 134

# 6 Income effects of alternative cost accumulation systems 144

External and internal reporting 145

Variable costing 147

Absorption costing 148

Variable costing and absorption costing: a comparison of their impact on profit 149

Some arguments in support of variable costing 150

Some arguments in support of absorption costing 152

Alternative denominator-level measures 153
Appendix 6.1: Derivation of the profit
function for an absorption costing
system 156

# PART THREE Information for decision-making 164

### 7 Cost-volume-profit analysis 166

Curvilinear CVP relationships 167
Linear CVP relationships 168
A numerical approach to CVP analysis 170
The contribution margin ratio 172
Relevant range 173
Margin of safety 174
Constructing the break-even or CVP chart 174
Alternative presentation of CVP analysis 175
Multi-product CVP analysis 177
Operating leverage 179
CVP analysis assumptions
and limitations 181
The impact of information technology 183

### 8 Measuring relevant costs and revenues for decision-making 194

Identifying relevant costs and revenues 195
Importance of qualitative/non-financial factors 195

Special pricing decisions 196
Product mix decisions when capacity
constraints exist 200

Replacement of equipment: the irrelevance of past costs 203

Outsourcing and make-or-buy decisions 204

Discontinuation decisions 208

Determining the relevant costs of direct materials 210

Determining the relevant costs of direct labour 211

Appendix 8.1: The theory of constraints and throughput accounting 213

Appendix 8.2: Development of capacity constraints: the application of linear programming 217

Uses of linear programming 222

# 9 Pricing decisions and profitability analysis 238

The role of cost information in pricing decisions 239

A price-setting firm facing short-run pricing decisions 239

A price-setting firm facing long-run pricing decisions 240

A price-taking firm facing short-run product mix decisions 244

A price-taking firm facing long-run product mix decisions 245

Surveys of practice relating to pricing decisions 247

Limitations of cost-plus pricing 247
Reasons for using cost-plus pricing 248
Pricing policies 248
Customer profitability analysis 250

Appendix 9.1: Calculating optimal selling prices using differential calculus 255

### 10 Activity-based costing 265

The need for a cost accumulation system in generating relevant cost information for decision-making 266

Types of cost system 267

A comparison of traditional and ABC systems 267

The emergence of ABC systems 269
Volume-based and non-volume-based cost
drivers 270
Designing ABC systems 273
Activity hierarchies 275
ABC profitability analysis 277
Cost versus benefits considerations 279
Time-driven ABC 280
Resource consumption models and unused

Capacity 283
Periodic review of an ABC database 285
ABC cost management applications 285

# 11 Decision-making under conditions of risk and uncertainty 297

Probability distributions and expected value 300
Measuring the amount of risk 301
Attitudes to risk by individuals 302
Decision tree analysis 304
Buying perfect and imperfect information 306
Maximin, maximax and regret criteria 307
Risk reduction and diversification 308

### 12 Capital investment decisions: appraisal methods 321

The opportunity cost of an investment 323

Compounding and discounting 324
The concept of net present value 326
Calculating net present values 327
The internal rate of return 329
Relevant cash flows 332
Timing of cash flows 332
Comparison of net present value and internal rate of return 333
Techniques that ignore the time value of money 335
Payback method 335
Accounting rate of return 338
The effect of performance measurement on

# 13 Capital investment decisions: the impact of capital rationing, taxation, inflation and risk 352

capital investment decisions 339

Qualitative factors 341

Capital rationing 352
Taxation and investment decisions 354
The effect of inflation on capital investment appraisal 357

Calculating risk-adjusted discount rates 359
Risk-adjusted discount rates and the weighted average cost of capital 363
Sensitivity analysis 365
Initiation, authorization and review of projects 366

### PART FOUR Information for planning, control and performance measurement 380

# 14 Management control systems 382

The scope of management control systems 384 Different types of control mechanisms 386 Feedback and feed-forward controls 388 Management accounting control systems 390 Responsibility centres 393 Applying the controllability principle 394 Setting performance targets and determining how challenging they should be 398 Determining how much influence managers should have in setting targets 399 Harmful side-effects of controls 400 Rewards and incentives 401 Different approaches that managers use to evaluate budgetees' performance 402 Contingency theory 404 Alternative uses of management accounting information 404

#### 15 The budgeting process 419

The strategic planning, budgeting and control process 420

The multiple functions of budgets 423

Conflicting roles of budgets 424

The budget period 424

Administration of the budgeting process 425

Stages in the budgeting process 426

A detailed illustration 428

Computerized budgeting 437

Activity-based budgeting 438

The budgeting process in non-profit-making organizations 440

Zero-based budgeting 441

Criticisms of budgeting 443

### 16 Standard costing and variance analysis 1 458

Operation of a standard costing system 459
Establishing cost standards 461
Purposes of standard costing 465
A summary of variance analysis for a variable

costing system 466 Material variances 466

Labour variances 472

Variable overhead variances 473

A generic routine approach to variance analysis for variable costs 474

Fixed overhead expenditure or spending variance 475

Sales variances 475

Reconciling budgeted profit and actual profit 479

Standard absorption costing 479

Reconciliation of budgeted and actual profit for a standard absorption costing system 483 Appendix 16.1: A generic routine approach to variance analysis 486

### 17 Standard costing and variance analysis 2: further aspects 498

Direct materials mix and yield variances 499
Sales mix and sales quantity variances 503
Distinguishing between planning and operating variances 505

The investigation of variances 507
The role of standard costing when ABC has been implemented 508

### 18 Divisional financial performance measures 521

Divisional organizational structures 522
Advantages and disadvantages of
divisionalization 523

Prerequisites for successful divisionalization 524

Distinguishing between the managerial and economic performance of the division 524

Alternative divisional profit measures 525

Surveys of practice 527

Return on investment 528

Residual income 529

Economic value added (EVA(TM)) 530

An illustration of the calculation of EVA(TM) 531

Determining which assets should be included in the investment base 534

The impact of depreciation 535

The effect of performance measurement on capital investment decisions 536

Addressing the dysfunctional consequences of short-term financial performance measures 538

# 19 Transfer pricing in divisionalized companies 553

Purpose of transfer pricing 554
Alternative transfer pricing methods 555
Market-based transfer prices 556
Cost plus a mark-up transfer price 557
Marginal/variable cost transfer prices 559
Full cost transfer prices without a mark-up 560
Negotiated transfer prices 560
Marginal/variable cost plus opportunity cost transfer prices 561
Comparison of cost-based transfer pricing methods 562
Proposals for resolving transfer pricing conflicts 563
Domestic transfer pricing

# PART FIVE Strategic performance and cost management for value creation; digitalization, sustainability and the future of management accounting 584

### 20 Strategic performance management 586

recommendations 566

International transfer pricing 567

The performance management framework 587
Strategy and strategic positioning 588
Performance measurement and performance
management systems 590
Alternative performance management
frameworks 590
The balanced scorecard 591
Linking performance evaluation with the
balanced scorecard 601
Benefits and limitations of the balanced
scorecard approach 602

# 21 Strategic cost management and value creation 624

Cost management and the value chain 626 Life cycle cost management 629 Target costing 630
Kaizen costing 635
Activity-based management 636
Benchmarking 641
Business process re-engineering 642
Just-in-time systems 642
Quality cost management 651

### 22 Management accounting: contemporary technologies and data analytics 673

Information technology in management accounting: a brief history and context 674 Data analytics for management accountants 683

# 23 Sustainability and environmental management accounting 698

Sustainability, CSR, ESG and shared value 698 Environmental management accounting 703

#### 24 Challenges for the future 727

A brief historical review of management accounting 727

Globalization and management accounting practices 729

Information technology and digitalization 729
Sustainability and environmental issues 733
Focus on ethical behaviour 735

Intellectual capital and the knowledge-based economy 738

Integrated reporting 740
Implications for the future 742

### PART SIX

Addendum: the application of quantitative methods to management accounting 746

### 25 Cost estimation and cost behaviour 748

General principles applying to estimating cost functions 749

Cost estimation methods 750

Tests of reliability 756
Relevant range and non-linear cost functions 757

A summary of the steps involved in estimating cost functions 758

Cost estimation when the learning effect is present 759

Estimating incremented hours and incremental cost 762

Appendix 25.1: Multiple regression analysis 764

# 26 Quantitative models for the planning and control of inventories 772

Why do firms hold inventories? 773
Relevant costs for quantitative models under conditions of certainty 773
Determining the economic order

Assumptions of the EOQ formula 776
Application of the EOQ model in determining the optimum batch size for a production

Quantity discounts 778

Determining when to place the order 779

Uncertainty and safety stocks 779

The use of probability theory for determining safety stocks 780

Control of inventory through classification 782

Other factors influencing the choice of order quantity 783

Materials requirement planning 784

Just-in-time (JIT) purchasing arrangements 784

Bibliography 794
Glossary 805
Appendices 816
Answers to review problems 818
Index 902