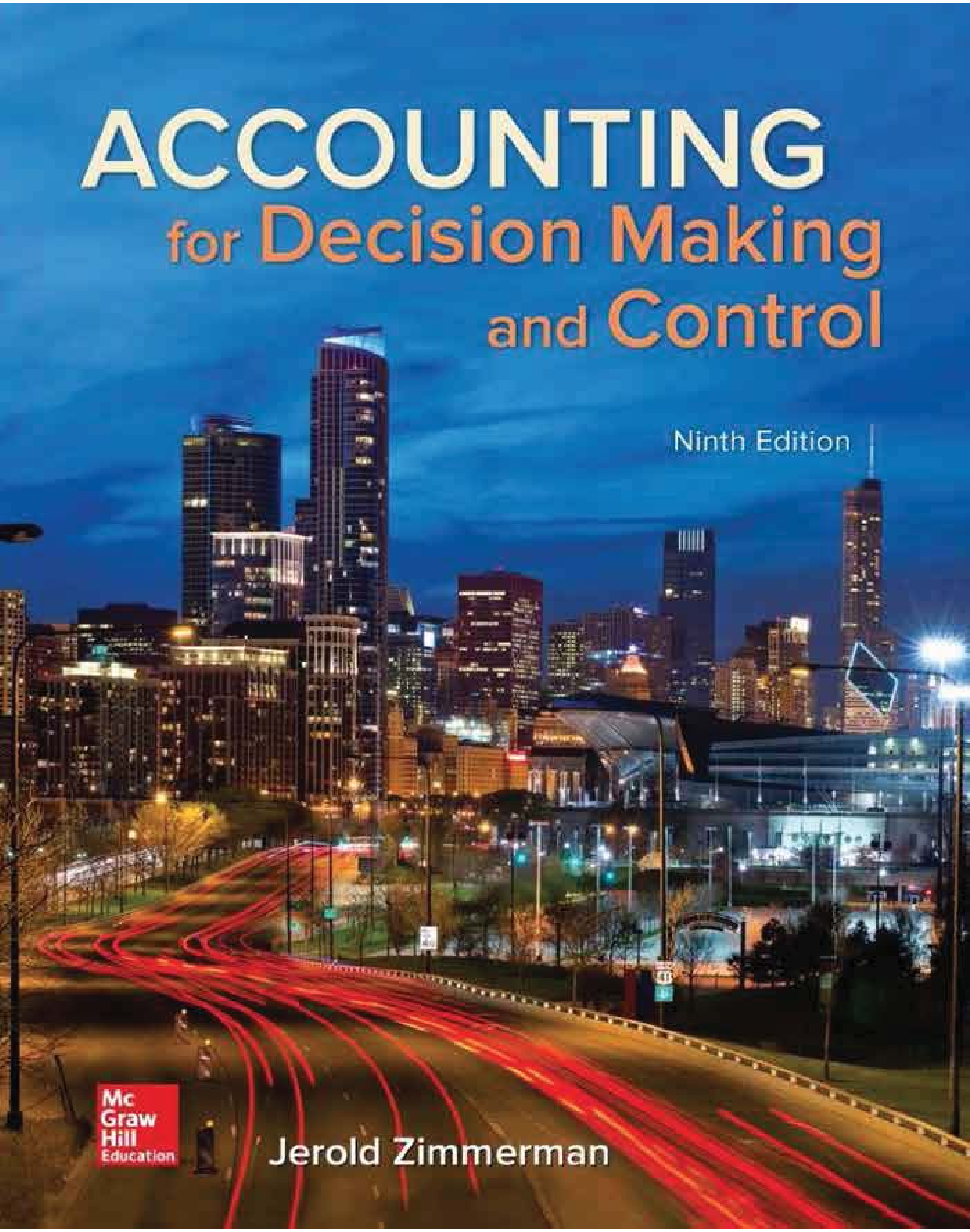
ACCOUNTING
for Decision Making
and Control
Ninth Edition
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Education
Jerold Zimmerman

Ninth Edition

Accounting for Decision Making and Control

Jerold L. Zimmerman
University of Rochester

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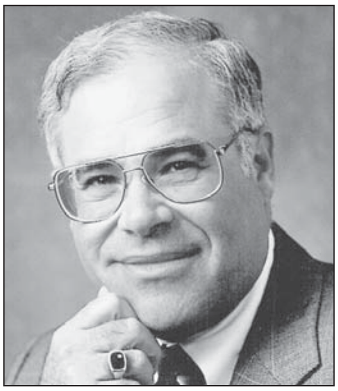
About the Author



Jerold L. Zimmerman

Jerold Zimmerman is Professor Emeritus at the William E. Simon Graduate School of Business, University of Rochester. He holds an undergraduate degree from the University of Colorado, Boulder, and a doctorate from the University of California, Berkeley.

While at Rochester, Dr. Zimmerman has taught a variety of courses spanning accounting, finance, and economics. Accounting courses include nonprofit accounting, intermediate accounting, accounting theory, and managerial accounting. A deeper appreciation of the challenges of managing complex organizations was acquired by serving as the Simon School's Deputy Dean and on the board of directors of several public corporations.

Professor Zimmerman publishes widely in accounting on topics as diverse as cost allocations, corporate governance, disclosure, financial accounting theory, capital markets, and executive compensation. His paper "The Costs and Benefits of Cost Allocations" won the American Accounting Association's Competitive Manuscript Contest. He is recognized for developing Positive Accounting Theory. This work, co-authored with colleague Ross Watts, at the Massachusetts Institute of Technology, received the American Institute of Certified Public Accountants' Notable Contribution to the Accounting Literature Award for "Towards a Positive Theory of the Determination of Accounting Standards" and "The Demand for and Supply of Accounting Theories: The Market for Excuses." Both papers appeared in the *Accounting Review*. Professors Watts and Zimmerman are also co-authors of the highly cited textbook *Positive Accounting Theory* (Prentice Hall, 1986). Professors Watts and Zimmerman received the 2004 American Accounting Association Seminal Contribution to the Literature award. Professor Zimmerman's textbooks also include *Managerial Economics and Organizational Architecture* with Clifford Smith and James Brickley, 6th ed. (McGraw-Hill, 2016) and *Management Accounting in a Dynamic Environment* with Cheryl McWatters (Routledge UK, 2016). He is a founding editor of the *Journal of Accounting and Economics,* published by Elsevier. This scientific journal is one of the most highly referenced accounting publications.

He and his wife Dodie have two daughters, Daneille and Amy. Jerry has been known to occasionally engage friends and colleagues in an amicable diversion on the links.

Preface

During their professional careers, managers in all organizations, profit and nonprofit, rely on their accounting systems. Sometimes managers use the accounting system to acquire information for decision making. At other times, the accounting system measures performance and thereby influences their behavior. The accounting system is both a source of information for decision making and part of the organization's control mechanisms—thus, the title of the book, *Accounting for Decision Making and Control.*

The purpose of this book is to provide students and managers with an understanding and appreciation of the strengths and limitations of an organization's accounting system, thereby allowing them to be more intelligent users of these systems. This book provides a framework for understanding accounting systems and a basis for analyzing proposed changes to these systems. The text demonstrates that managerial accounting is an integral part of the firm's organizational architecture, not just an isolated set of computational topics.

Changes in the Ninth Edition

Feedback from reviewers and instructors using the prior editions and my own teaching experience provided the basis for the revision. In particular, the following changes have been made:

- Each chapter has been revised to further enhance readability and remove redundancy.
- References to actual company practices have been updated.
- Users were uniform in their praise of the problem material. They found it challenged their students to critically analyze multidimensional issues while still requiring numerical problem-solving skills.
- The end-of-chapter problem material was revised by adding 45 new problems—including some related to health care and knowledge-based service firms—and removing outdated problems.
- The ninth edition is a more concise revision that presents the same fundamental concepts, learning objectives, and challenging critical thinking end-of-chapter materials as in prior editions.

Overview of Content

Chapter 1 presents the book's conceptual framework by using a simple decision context regarding accepting an incremental order from a current customer. The chapter describes why firms use a single accounting system and the concept of economic Darwinism, among other important topics. This chapter is an integral part of the text.

Chapters 2, 4, and 5 present the underlying conceptual framework. The importance of opportunity costs in decision making, cost–volume–profit analysis, and the difference between accounting costs and opportunity costs are discussed in Chapter 2. Chapter 4 employs the economic theory of organizations and organizational architecture as the conceptual foundation to understand the role of the accounting system as part of the organization's control mechanism. Chapter 5 describes the crucial role of accounting as part of the firm's organizational architecture. Chapter 3 on capital budgeting extends opportunity costs to a multiperiod setting. This chapter can be skipped without affecting the flow of later material. Alternatively, Chapter 3 can be assigned at the end of the course.

Chapter 6 applies the conceptual framework and illustrates the trade-off managers face between decision making and control in a budgeting system. Budgets are a decision-making tool to coordinate activities within the firm and are a device to control behavior. This chapter provides an in-depth illustration of how budgets are an important part of an organization's decision-making and control apparatus.

Chapter 7 presents a general analysis of why managers allocate certain costs and the behavioral implications of these allocations. Cost allocations affect both decision making and incentives. Again, managers face a trade-off between decision making and control. Chapter 8 continues the cost allocation discussion by describing the "death spiral" that can occur when significant fixed costs exist and excess capacity arises. This leads to an analysis of how to treat capacity costs—a trade-off between underutilization and overinvestment. Finally, the chapter describes several specific cost allocation methods such as service department costs and joint costs.

Chapter 9 applies the general analysis of overhead allocation in Chapters 7 and 8 to the specific case of absorption costing in a manufacturing setting. The managerial implications of traditional absorption costing are provided in Chapters 10 and 11. Chapter 10 analyzes variable costing, and activity-based costing is the topic of Chapter 11. Variable costing is an interesting example of economic Darwinism. Proponents of variable costing argue that it does not distort decision making and therefore should be adopted. Nonetheless, it is not widely practiced, probably because of tax, financial reporting, and control considerations.

Chapter 12 discusses the decision-making and control implications of standard labor and material costs. Chapter 13 extends the discussion to overhead and marketing variances. Chapters 12 and 13 can be omitted without interrupting the flow of later material. Finally, Chapter 14 synthesizes the course by reviewing the conceptual framework and applying it to various organizational innovations, such as total quality management, just in time, six sigma, lean production, and the balanced scorecard. These innovations provide an opportunity to apply the analytic framework underlying the text.

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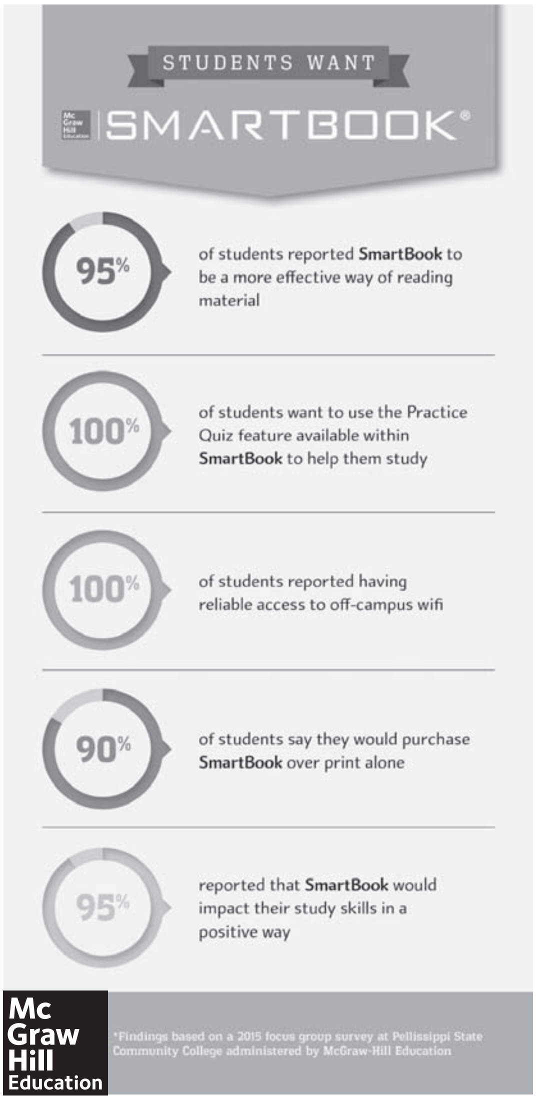

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William Vatter and George Benston motivated my interest in managerial accounting. The genesis for this book and its approach reflect the oral tradition of my colleagues, past and present, at the University of Rochester. William Meckling and Michael Jensen stimulated my thinking and provided much of the theoretical structure underlying the book, as anyone familiar with their work will attest. My long and productive collaboration with Ross Watts sharpened my analytical skills and further refined the approach. He also furnished most of the intellectual capital for Chapter 3, including the problem material. Ray Ball has been a constant source of ideas. Clifford Smith and James Brickley continue to enhance my economic education. Three colleagues, Andrew Christie, Dan Gode, and Scott Keating, supplied particularly insightful comments that enriched the analysis at critical junctions. Valuable comments from Anil Arya, Ron Dye, Andy Leone, Dale Morse, Ram Ramanan, K. Ramesh, Shyam Sunder, and Joseph Weintrop are gratefully acknowledged.

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Jerold L. Zimmerman
University of Rochester

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