

WILL SEAL | CARSTEN ROHDE  
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# MANAGEMENT ACCOUNTING

FIFTH  
EDITION

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# About the authors

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# Preface

Building on previous editions of *Management Accounting*, this fifth edition offers a comprehensive and balanced introduction to management accounting theory and practice and has been written specifically for courses across the UK and Europe. The text combines a solid grounding in technical material with a fresh look at emerging issues relevant to accounting practice. It is a clear and accessible book promoting practice as a method of learning through real-world and numerical examples, vignettes, and graded end of chapter exercises and problems. The text includes new research and developments in the discipline and has been specifically shaped to meet the needs of the market.

## Content

Each chapter has been updated to reflect the latest development in management accounting and the main changes and developments to this edition include:

- The introduction of a new end of chapter ‘Applying Excel’ feature that links the power of Excel with management accounting concepts by illustrating how Excel functionality can be used to better understand accounting data. The Excel feature provides the students with an opportunity to build their own Excel worksheets and formulas as a basis for analysing different ‘what if’ questions.
- Chapter 1 has been extended to include more focus on the roles of management accounting and the accountant for control, planning and decision making.
- Chapter 5 on cost behaviour has been moved up as a new Chapter 3 and aligned to the content of Chapter 2. This is done to tie the chapters together better and eliminate unnecessary overlap.
- The new Chapter 5 on process costing (previous Chapter 4) has been extended to also include the use of the FIFO method. In addition a short section on the use of standard costing as an additional method is added. This is done to tie Chapter 4 better to the discussion on standard costing in Chapter 12.
- Chapter 8 on activity based costing has been extended to include more



examples on activity based management and time-driven activity based costing.

- In Chapter 9 on relevant costs for decision making the section on optimal utilization of one constrained resource has been extended. In addition the section of multiple constrained resources has been moved from Chapter 19 and integrated in the chapter. Finally, the section on joint production has been extended and a new example added.
- Chapter 10 on capital investment decisions has been extended by adding a new Appendix 10A on present value concepts to increase the understanding of the time value of money.
- Chapter 15 on pricing and intra-company transfers has a new Focus on Practice example on how a single set of transfer prices used for both tax compliance and management control purposes can lead to conflicts.
- Chapter 17 on management control and corporate governance has been reorganized to focus more on those subjects. In addition two new Focus on Practice boxes have been added to make a better linkage to practice.
- In Chapter 18 the focus on the subject of business process management towards lean operation has been strengthened by reorganizing the contents of the chapter.
- Chapter 19 has been reorganized to focus more clearly on strategic cost management topics. In addition the section on target costing has been extended.
- Brand new end of chapter questions, exercises, problems and cases have been added to a number of chapters.
- A new and improved look and feel with a brand new four-colour design aiming to present the concepts clearly, to engage students and provide improved presentation of materials.
- More generally, references, key terms and learning objectives have been updated where appropriate.

## Superior pedagogy

The book includes a full suite of pedagogical learning tools designed to make teaching and learning stimulating and efficient, all presented in a visually impressive format. More detail is provided in the Guided Tour on pages xix to xxi.

## Resources

A wealth of online resources also provides support to both the instructor and student. Students can access content including quizzes and practice exercises. For instructors, solutions and other teaching resources ensure the book is as easy to use as possible. An exciting addition to the support package for this edition is *Connect™ Plus Accounting*. This excellent online assignment and assessment platform provides opportunities for additional interaction between students and instructors, allowing instructors to continually assess each student's individual progress through practice and assessment. More information on this can be found in the technology section on pages xxii–xxiv.

## Terminology

Accounting terminology differs in UK and US English. With the globalization of capital markets and accounting, the use of international English as applied by the International Accounting Standards IFRS offers a solution that will bridge the barriers across countries and provide uniform understanding. Therefore, for consistency, IFRS English has been predominantly applied in this book. IFRS international English applies UK English for grammar and spelling, but for terminology, the main emphasis is on US terms. Some examples are:

- IFRS *statement of profit or loss* = *income statement* (US + IFRS) = *profit and loss account* (UK)
- IFRS *revenue* (US) = *revenue, sales* (US) = *turnover* (UK).
- IFRS *operating profit* (UK) = *net operating income* (US) = *EBIT* (Earnings Before Interest and Taxes).
- IFRS *profit before tax* (UK) = *income before tax* (US) = *EBT* (Earnings Before Tax)
- IFRS *profit* (UK) = *net income* (US).
- IFRS + UK *balance sheet* = *statement of financial position* (IFRS + US).
- IFRS *inventory/inventories* (US) = *stock/stocks* (UK)
- IFRS *accounts receivable* (US) = *debtors* (UK)
- IFRS *accounts payable* (US) = *creditors* (UK)
- IFRS *work in progress* (UK) = *work in process* (US)

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We are grateful to the Association of Chartered Certified Accountants (ACCA) for permission to reproduce past examination questions. The suggested solutions in the exam answer bank have been prepared by us, unless otherwise stated.

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# Guided tour

## Learning Objectives

Each chapter opens with a set of learning objectives, summarizing what you should learn from each chapter.

**Cost-volume-profit relationships**

**LEARNING OBJECTIVES**

After studying Chapter 7, you should be able to:

- LO1** Explain how changes in activity affect contribution margin and profit.
- LO2** Compute the contribution margin ratio (CM ratio) and use it to compute changes in contribution margin and profit.
- LO3** Show the effects on contribution margin of changes in variable costs, fixed costs, selling price, and volume.
- LO4** Compute the break-even point by both the equation method and the contribution margin method.
- LO5** Prepare a cost-volume-profit (CVP) graph and explain the significance of each of its components.
- LO6** Use the CVP formulas to determine the activity level needed to achieve a desired target profit.
- LO7** Compute the margin of safety and explain its significance.

## Concepts in Context

These concepts in context boxes introduce you to the topics to follow and ground the chapter concepts in real life terms.

**CONCEPTS IN CONTEXT**

Since CVP analysis shows that levels of activity can have a big effect of compensating salespersons must be chosen with a great deal of care. Digital Equipment Corporation's founder believed that salespersons sell something they do not need and, accordingly, Digital paid them salaries. This approach worked fine for many years because Digital's products were expensive mainframe computers, and because they were cheaper, they were sold. When competition arrived, the Digital sales staff was hopelessly out of control. In an attempt to stem the tide, the new system backfired. little or no profit to pump up volume – and their commission.<sup>14</sup>

CVP analysis is one of the most powerful tools that managers have at their disposal to understand the interrelationship between cost, volume and profit in an organization. The following interactions between the following five elements:

## Focus on Practice

These mini-examples accompanied by an exercise illustrate precisely how management accounting theory affects companies, using topical examples of management accounting in well-known companies and industry sectors.

To summarize, if sales are zero, the company's loss would equal its fixed expenses. Each unit reduces the loss by the amount of the unit contribution margin. Once the break-even point has been reached, each additional unit sold increases the company's profit by the amount of the unit contribution margin.

**FOCUS ON PRACTICE**

**Green regulation and fixed costs**

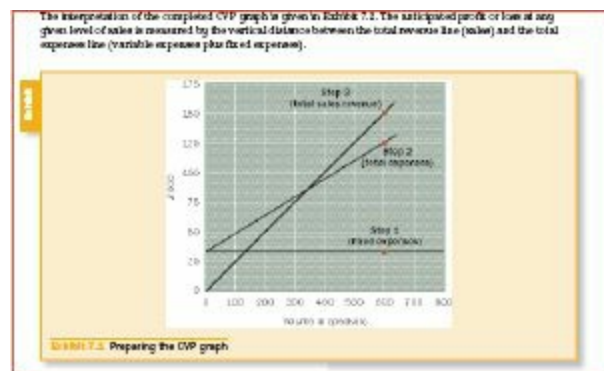
The recent alliance between Renault/Nissan and Daimler was driven by the high fixed costs of new low-emission technology and rules about average carbon emissions within car groups: 'The technologies are utterly expensive and almost impossible to shoulder alone for carmakers like BMW,' said Gregor Matthias, partner with the consultancy Bain & Co. Clearly the strategy for Daimler is to spread the higher fixed costs of new technology over higher volumes of cars.

**Exercise:** What might be a strategic risk for Daimler in this sort of deal?

Source: Reed, J. and Schafer, D. 2010. Carmakers join forces in green new world, *Financial Times* 10 April, p. 15.

## Exhibits and Tables

Each chapter includes 4-colour exhibits and tables, illustrating the concepts you need to know and the techniques you need to learn.



## Management Accounting in Action

These dialogues follow different management accounting issues through chapters to demonstrate them in practice in the real world.