

Sixth Edition

Management Accounting for Decision Makers

Peter Atrill
Eddie McLaney



Management Accounting for Decision Makers



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6th
Edition

Management Accounting for Decision Makers

Peter Atrill
and
Eddie McLaney

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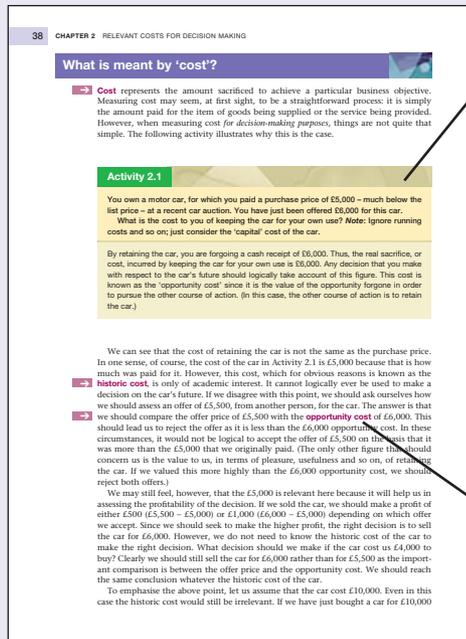
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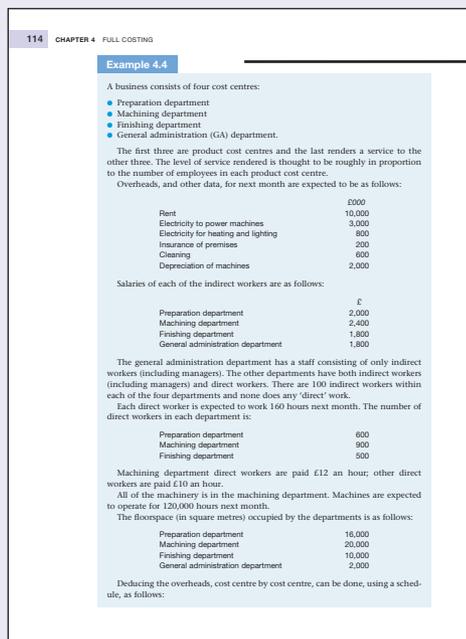
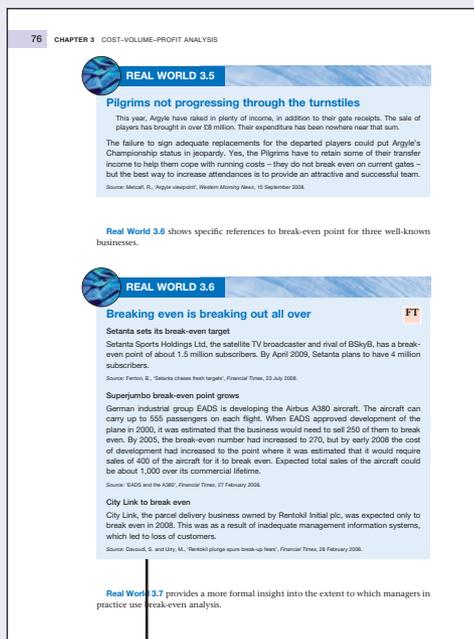
Guided tour of the book



Activities These short questions, integrated throughout each chapter, allow you to check your understanding as you progress through the text. They comprise either a narrative question requiring you to review or critically consider topics, or a numerical problem requiring you to deduce a solution. A suggested answer is given immediately after each activity.

Key terms The key concepts and techniques in each chapter are highlighted in colour where they are first introduced, with an adjacent icon in the margin to help you refer back to the most important points.

Learning outcomes Bullet points at the start of each chapter show what you can expect to learn from that chapter, and highlight the core coverage.



Examples At frequent intervals throughout most chapters, there are numerical examples that give you step-by-step workings to follow through to the solution.

'Real World' illustrations Integrated throughout the text, these illustrative examples highlight the practical application of accounting concepts and techniques by real businesses, including extracts from company reports and financial statements, survey data and other interesting insights from business.

120 CHAPTER 4 FULL COSTING

Full (absorption) cost as the break-even price

For decision-making purposes, it can be helpful to allocate non-manufacturing costs, as well as manufacturing costs, to products using some sensible basis of allocation. When this is done and everything goes according to plan (so that direct cost overheads prove to be as expected), selling the output for its full cost should cause the business to break even exactly. Therefore, whatever profit (in total) is loaded onto full cost to set actual selling prices will, if plans are achieved, result in that level of profit being earned for the period.

The forward-looking nature of full (absorption) costing

Through deducting full cost can be done after the work has been completed, it is often done in advance. In other words, cost is frequently predicted. Where, for example, full cost is needed as a basis on which to set selling prices, it is usually the case that prices need to be set before the customer will accept the job being done. Even where no particular customer has been identified, some idea of the ultimate price will need to be known before the business will be able to make a judgement as to whether potential customers will buy the product, and in what quantities. There is a risk, of course, that the actual outcome will differ from that which was predicted. If this occurs, corrections are subsequently made to the full cost originally calculated.

Self-assessment question 4.1

Hector and Co. Ltd has been invited to tender for a contract to produce 1,000 clothes hangers. The following information relates to the contract.

Materials
The clothes hangers are made of metal wire covered with a padded fabric. Each hanger requires 2 metres of wire and 0.5 square metres of fabric.

Direct labour
Skilled: 10 minutes per hanger
Unskilled: 5 minutes per hanger

The business already holds sufficient of each of the materials required to complete the contract. Information on the cost of the materials is as follows:

	Metal wire £ per metre	Fabric £ per sq metre
Historic cost	2.20	1.00
Current buying-in cost	2.50	1.10
Scrap value	1.70	0.40

The metal wire is in constant use by the business for a range of its products. The fabric has no other use for the business and is scheduled to be scrapped.

Unskilled labour, which is paid at the rate of £7.50 an hour, will need to be taken on specifically to undertake the contract. The business is fairly quiet at the moment, which means that a pool of skilled labour exists that will still be employed at full pay of £12.00 an hour to do nothing if the contract does not proceed. The pool of skilled labour is sufficient to complete the contract.

The business charges jobs with overheads on a direct labour hour basis. The production overheads of the entire business for the month in which the contract will be undertaken

Self-assessment questions Towards the end of most chapters you will encounter one of these questions, allowing you to attempt a comprehensive question before tackling the end-of-chapter assessment material. To check your understanding and progress, solutions are provided at the end of the book.

170 CHAPTER 5 COSTING AND PRICING IN A COMPETITIVE ENVIRONMENT

- Target costing attempts to reduce costs so that the market price covers the cost plus an acceptable profit.
- Ensuring quality output has costs, known as quality costs, typically divided into four aspects: prevention costs, appraisal costs, internal failure costs and external failure costs.
- Kaizen costing attempts to reduce costs at the production stage.
- Since most costs will have been saved at the pre-production phase and through target costing, only small cost savings are likely to be possible.
- Benchmarking attempts to emulate a successful aspect of, for example, another business or division.

Pricing output

- In theory, profit is maximised where the price is such that:
 - Marginal sales revenue = Marginal cost of production
- Elasticity of demand indicates the sensitivity of demand to price changes.
- Full cost (cost-plus) pricing takes the full cost and adds a mark-up for profit:
 - It is popular.
 - The market may not accept the price (most businesses are 'price takers').
 - It can provide a useful benchmark.
- Relevant/marginal cost pricing takes the relevant/marginal cost and adds a mark-up for profit:
 - It can be useful in the short term, but in the longer term it may be better to charge a full cost-plus price.
 - Target sales prices are those established as the first step in the target costing process. They are market-determined.
- Various pricing strategies can be used, including penetration pricing and price skimming.

Key terms

Activity-based costing (ABC) p. 138	Benchmarking p. 153
Cost driver p. 138	Elasticity of demand p. 155
Cost pool p. 138	Full cost (cost-plus) pricing p. 163
Total life-cycle costing p. 150	Marginal cost pricing p. 166
Target costing p. 151	Penetration pricing p. 168
Quality costs p. 152	Price skimming p. 169
Kaizen costing p. 153	

Further reading

If you would like to explore the topics covered in this chapter in more depth, we recommend the following books:

Atkinson, A., Banker, R., Kaplan, R. and Young, S. M., *Management Accounting*, 5th edn, Prentice Hall, 2007, chapters 4, 5, 6 and 9.

Drury, C., *Management and Cost Accounting*, 7th edn, Cengage Learning, 2007, chapters 10 and 11.

Hilton, R., *Management Accounting*, 6th edn, McGraw-Hill Irwin, 2005, chapters 4, 5, 6 and 15.

Horngren, C., Foster, G., Datar, S., Bains, M. and Ittner, C., *Cost Accounting: A Managerial Emphasis*, 13th edn, Prentice Hall International, 2008, chapters 5 and 12.

Bullet point chapter summary Each chapter ends with a 'bullet point' summary. This highlights the material covered in the chapter and can be used as a quick reminder of the main issues.

Key terms summary At the end of each chapter, there is a listing (with page reference) of all the key terms, allowing you to easily refer back to the most important points.

Further reading This section comprises a listing of relevant chapters in other textbooks that you might refer to in order to pursue a topic in more depth or gain an alternative perspective.

EXERCISES 171

REVIEW QUESTIONS

Answers to these questions can be found in Appendix C at the back of the book.

- How does activity-based costing differ from the traditional approach? What is the underlying difference in the philosophy of each them?
- The use of activity-based costing in helping to deduce full costs has been criticised. What has tended to be the basis of this criticism?
- What is meant by elasticity of demand? How does knowledge of the elasticity of demand affect pricing decisions?
- According to economic theory, at what point is profit maximised? Why is it at this point?

EXERCISES

Exercises 5.6 to 5.8 are more advanced than 5.1 to 5.5. Those with a coloured number have answers in Appendix D at the back of the book. If you wish to try more exercises, visit the students' side of the Companion Website at www.pearsoned.co.uk/atrillmclanley.

- Woodner Ltd provides a standard service. It is able to provide a maximum of 100 units of this service each week. Experience shows that at a price of £100, no units of the service would be sold. For every £5 below this price, the business is able to sell 10 more units. For example, at a price of £95, 10 units would be sold, at £90, 20 units would be sold, and so on. The business's fixed costs total £2,500 a week. Variable costs are £20 per unit over the entire range of possible output. The market is such that it is not feasible to charge different prices to different customers.

Required:
What is the most profitable level of output of the service?
- It appears from research evidence that a cost-plus approach influences many pricing decisions in practice. What is meant by cost-plus pricing and what are the problems of using this approach?
- Kaplan plc makes a range of suitcases of various sizes and shapes. There are 10 different models of suitcase produced by the business. In order to keep inventories (stock) of finished suitcases to a minimum, each model is made in a small batch. Each batch is costed as a separate job and the cost for each suitcase deduced by dividing the batch cost by the number of suitcases in the batch.

At present, the business derives the cost of each batch using a traditional job-costing approach. Recently, however, a new management accountant was appointed, who is advocating the use of activity-based costing (ABC) to deduce the cost of the batches. The management accountant claims that ABC leads to much more reliable and relevant costs and that it has other benefits.

Required:
(a) Explain how the business deduces the cost of each suitcase at present.
(b) Discuss the purposes to which the knowledge of the cost for each suitcase, deduced on a traditional basis, can be put and how valid the cost is for the purpose concerned.

Review questions

These short questions encourage you to review and/or critically discuss your understanding of the main topics covered in each chapter, either individually or in a group. Solutions to these questions can be found at the back of the book in Appendix C.

Exercises

These comprehensive questions appear at the end of most chapters. The more advanced questions are separately identified. Solutions to some of the questions (those with coloured numbers) are provided at the end of the book, enabling you to assess your progress. Solutions to the remaining questions are available online for lecturers only at www.pearsoned.co.uk/atrillmclanley.

Guided tour of MyAccountingLab

MyAccountingLab puts students in control of their own learning through a suite of study and practice tools tied to the online e-book and other media tools. At the core of **MyAccountingLab** are the following features:

Practice tests

Practice tests for each section of the textbook enable students to test their understanding and identify the areas in which they need to do further work. Lecturers can customise the practice tests or leave students to use the two pre-built tests per chapter.

There are several accounting conventions which underpin the preparation of balance sheets. Match the accounting convention shown in the lefthand column with the corresponding description shown in the righthand column, choosing the appropriate letter in the drop-down list.

<input type="checkbox"/>	1. Business entity	A. This assumes that the business will continue operations for the foreseeable future.
<input type="checkbox"/>	2. Money measurement	B. Each transaction has two aspects, both of which will affect the balance sheet.
<input type="checkbox"/>	3. Historic cost	C. This seeks to reduce personal bias in financial statements.
<input type="checkbox"/>	4. Going concern	D. Assets are usually shown at the acquisition cost rather than their current value.
<input type="checkbox"/>	5. Dual aspect	E. Only those items that can be expressed in monetary terms can be accounted for
<input type="checkbox"/>	6. Prudence	F. The business and its owners are treated as separate and distinct.
<input type="checkbox"/>	7. Stable monetary unit	G. Accountants should be cautious when deciding on valuations.
<input type="checkbox"/>	8. Objectivity	H. This assumes that the value of money does not change over time.

Choose from any drop-down list, then click "Next Question" or "Previous Question."

Time Limit: No Time Limit
Time Spent: 00:03:37
Progress: 5 out of 12 questions complete
Current question: Worth 1 point

Personalised study plan

Based on a student's performance on a practice test, a personal study plan is generated that shows where further study needs to focus. This study plan consists of a series of additional practice exercises.

McLaney: Accounting, An Introduction 4e - STUDY PLAN

Study Plan

Click a chapter below to start practicing, or follow these steps to create a personalized study plan.

- 1 Take a [sample test](#) or an [assigned test or quiz](#). Then return to this page.
- 2 Practice the topics you need to study.
- 3 To prove mastery, take another [sample test](#) or an [assigned test or quiz](#).

Jump to where I worked last

Book Contents	Correct	Worked	Available Questions	Time Spent
Ch 1: Introduction to accounting and finance			0	
Ch 2: Measuring and reporting financial position				
2.1 The major financial statements	15	17	52	1h 57m 21s
2.1.1 The major financial statements	1	1	7	22s
2.2 Assets and Claims	3	3	11	1h 1m 8s
2.3 Balance sheet formats	2	4	17	26m 52s
2.4 Accounting conventions	5	5	13	26m 48s
2.5 The basis of valuation of assets	4	4	4	2m 11s
Total: All Chapters	15	17	52	1h 57m 21s

Show results that created this study plan

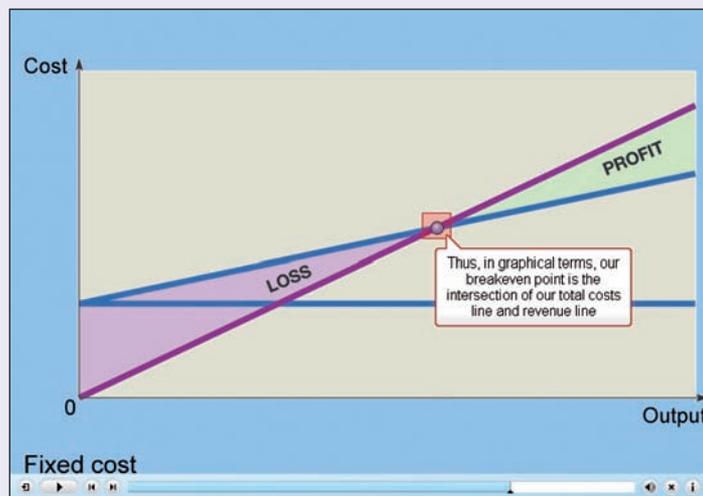
This course is based on McLaney: Accounting, An Introduction 4e (DEMO)
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Additional practice exercises

Generated by the student's own performance on a practice test, additional practice exercises are keyed to the textbook and provide extensive practice and link students to the e-book and to other tutorial instruction resources.

Tutorial instruction

Launched from the additional practice exercises, tutorial instruction is provided in the form of solutions to problems, detailed differential feedback, step-by-step explanations, and other media-based explanations, including key concept animations.



Additional MyAccountingLab tools

- 1 Interactive study guide
- 2 Electronic tutorials
- 3 Glossary – key terms from the textbook
- 4 Glossary flashcards
- 5 Links to the most useful accounting data and information sources on the Internet.

Lecturer training and support

We offer lecturers personalised training and support for [MyAccountingLab](#). We have a dedicated team of Technology Specialists whose job it is to support lecturers in their use of our media products, including [MyAccountingLab](#). To make contact with your Technology Specialist please email feedback-cw@pearson.com

For a visual walkthrough of how to make the most of [MyAccountingLab](#), visit www.MyAccountingLab.com

To find details of your local sales representatives go to www.pearsoned.co.uk/replocator



Preface

Management accounting is concerned with ensuring that managers have the information they need to plan and control the direction of their organisation. This book is directed primarily at those following an introductory course in management accounting. Many readers will be studying at a university or college, perhaps majoring in accounting or in another area such as business studies, IT, tourism or engineering. Other readers, however, may be studying independently, perhaps with no qualification in mind.

The book is written in an 'open learning' style, which has been adopted because we believe that readers will find it to be more 'user-friendly' than the traditional approach. Whether they are using the book as part of a taught course or for personal study, we feel that the open learning approach makes it easier for readers to learn.

In writing this book, we have been mindful of the fact that most readers will not have studied management accounting before. We have therefore tried to write in an accessible style, avoiding technical jargon. Where technical terminology is unavoidable, we have tried to give clear explanations. At the end of the book (in Appendix A) there is a glossary of technical terms, which readers can use to refresh their memory if they come across a term whose meaning is in doubt. We have tried to introduce topics gradually, explaining everything as we go. We have also included a number of questions and tasks of various types to try to help readers to understand the subject fully, in much the same way as a good lecturer would do in lectures and tutorials. More detail of the nature and use of these questions and tasks is given in the section 'How to use this book'.

The book covers all the areas required to gain a firm foundation in the subject. Chapter 1 provides a broad introduction to the nature and purpose of management accounting. Chapters 2, 3, 4 and 5 are concerned with identifying cost information and using it to make short-term and medium-term decisions. Chapters 6 and 7 deal with the ways in which management accounting can be used in making plans and in trying to ensure that those plans are actually achieved. Chapter 8 considers the use of management accounting information in making investment decisions, typically long-term ones. Chapter 9 deals with 'strategic management accounting'. This is an increasingly important area of management accounting that focuses on factors outside the organisation but which have a significant effect on its success. Chapter 10 deals with the problems of measuring performance where the business operates through a divisional organisational structure, as most large businesses do. It also considers the use of non-financial measures in measuring performance. Finally, Chapter 11 looks at the way in which management accounting can help in the control of short-term assets, such as inventories (stock) and cash.

In this sixth edition, we have taken the opportunity to improve the book. We have continued to increase the emphasis on the need for businesses to operate within a framework of strategic planning and decision making. This includes greater focus on the business environment and, in particular, on the crucial importance of creating and

retaining customers. We have continued to highlight the changing role of management accountants to enable them to retain their place at the centre of the decision-making and planning process. We have also added more examples of management accounting in practice.

We should like to thank those at Pearson Education who were involved with this book, for their support and encouragement. Without their help it would not have materialised.

We hope that readers will find the book readable and helpful.

Peter Atrill
Eddie McLaney