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Managerial Accounting

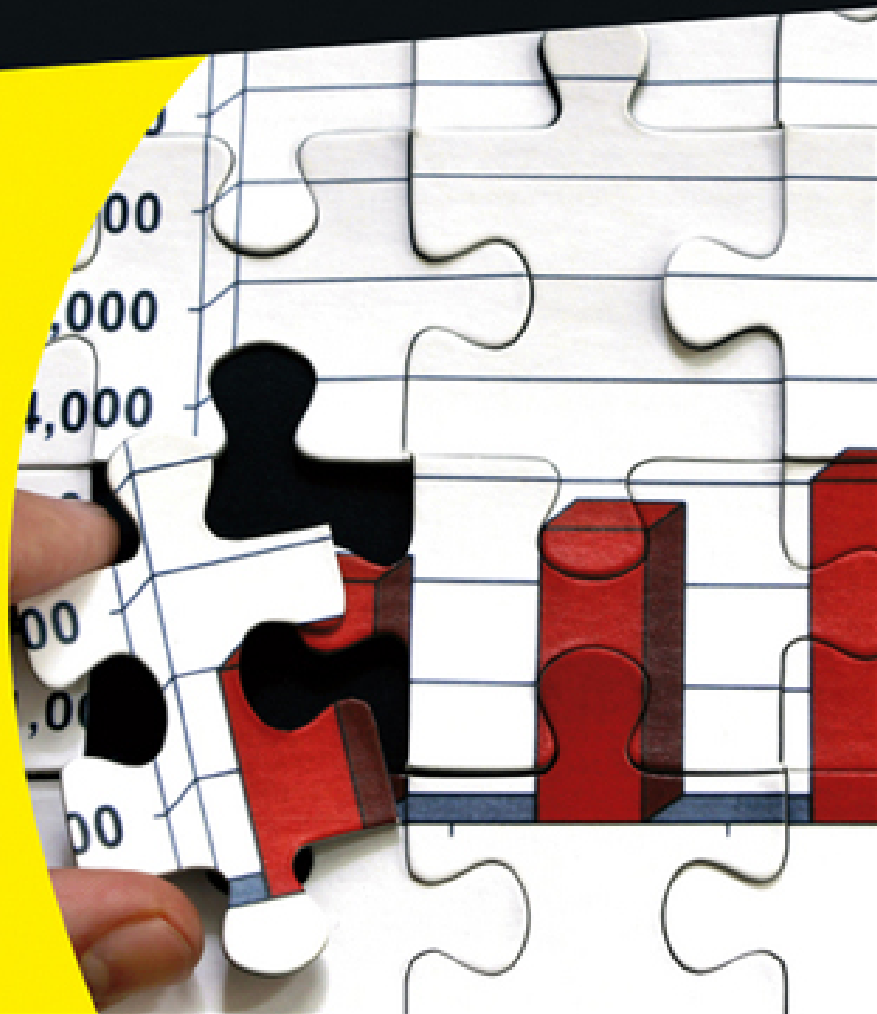
FOR
DUMMIES®

Learn to:

- Interpret accounting information for managerial decision-making
- Discover the basic concepts, terminology, and methods in managerial accounting
- Score your highest in a managerial accounting course

Mark P. Holtzman, CPA

*Chair of the Department of Accounting
and Taxation, Seton Hall University*



***Managerial
Accounting***
FOR
DUMMIES®

by Mark P. Holtzman



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About the Author

Mark Holtzman is chair of the Department of Accounting and Taxation at Seton Hall University in South Orange, New Jersey. After earning his bachelor's degree in Accounting from Hofstra University in Hempstead, Long Island, New York, he joined the New York office of Touche Ross & Co., now part of the accounting firm Deloitte. After attaining certification as a CPA and reaching the level of Senior Auditor, Mark joined the Accounting PhD program at The University of Texas at Austin, where he authored his doctoral dissertation on earnings management in the oil and gas industry. After completing his PhD, Mark joined the accounting faculty at Hofstra University and subsequently moved to Seton Hall, where he teaches financial accounting and managerial accounting courses to both graduate and undergraduate students.

In addition to authoring articles and other research materials in the CPA Journal, Journal of Accountancy, Accounting Historians Journal, Research in Accounting Regulation, Financial Executive, Strategic Finance, the Corporate Controller's Manual, and Bank Accounting and Finance, Mark is coauthor of *Interpreting and Analyzing Financial Statements* with Karen Schoenebeck, now in its 6th edition (Pearson).

Always enthusiastic and eager to share his irreverent and irrelevant opinions, Mark regularly blogs as the accountinator (www.accountinator.com), freaking accountant (www.freakingaccountant.com), and freaking important (www.freakingimportant.com). His Twitter handle is @accountinator.

In his spare time, Mark enjoys spending time with his family, hiking, camping, and studying ancient Hebrew texts.

Dedication

To my family: Rikki, who stoically endures living with a curmudgeon accounting professor, and my astonishing kids, Dovid, Aharon, Levi, and Esther.

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Introduction

If accounting is the language of business, then managerial accounting is the language inside a business. Accountants establish very specific definitions for terms such as *revenue*, *expense*, *net income*, *assets*, and *liabilities*. Everyone uses these same definitions when they announce and discuss these attributes, so that when a company reports sales revenue, for example, investors and other businesspeople understand how that figure was calculated. This way, companies, investors, managers, and everyone else in the business community speak the same language, a language for which accountants wrote the dictionary.

Managerial accounting allows a company's managers to understand how their business operates and gives them information needed to make decisions. It helps them plan their business's activities and control its operations. For example, suppose a marketing executive needs to set a price for a new product. To set that price, the executive needs to understand how much the product costs; that's where managerial accounting comes in. Furthermore, the price needs to be set at such a level that at the end of the year, when the company sells all the products it's supposed to sell at whatever prices it sets, it earns the profit and cash flow that it has projected for itself. That, too, is where managerial accounting comes in.

When I teach managerial accounting, I always take care to point out who the users of managerial accounting information usually are. They're the managers, marketing professionals, financial analysts, and information systems professionals working within a company. All have a role not only in developing

managerial accounting information but also, more importantly, in using it to make better decisions.

About This Book

If managerial accounting is the language inside a business, then running a business without understanding that topic would be pretty hard. Therefore, I wrote this book for businesspeople — both present and future — who want to better understand how to use managerial accounting to make decisions and how managerial accountants actually develop information.

That said, I have a confession to make: Much to the dismay of my wife and the embarrassment of my children, I really love to do accounting, especially managerial accounting. And better yet, I love to teach it. I believe that contribution margin is the greatest thing since sliced bread (see [Chapter 9](#)) and that the theory of constraints can solve most of life's problems (see [Chapter 19](#)). And I often think about and admire the legends of managerial accounting that I introduce in [Chapter 22](#).

For all the bad rap that accounting gets for being boring (and for all that financial accountants, of all people, trash their poor managerial brethren for being the most boring of all accountants), I felt a special calling to commit to writing — and share with you — what I believe makes managerial accounting engaging and (yes) exciting, right here in this book.

Therefore, when you start reading this book and soon find that you can't put it down, don't blame me and my lame little puns. Instead, appreciate that after you start discovering accounting, it can be quite difficult to stop.

What You're Not to Read

I tried to write this book so that it spellbinds you, the reader, such that you feel you can't put it down until you read the whole thing. Others may be tempted to peek at the last few pages to see how it ends.

That said, if you're very busy, feel free to focus on the most important stuff that you need to know and skip some of these less important elements:

- ✓ **Technical stuff:** Anything marked with the Technical Stuff icon is especially interesting to managerial accounting geeks like me. However, if you're in a rush, you can skip these paragraphs.
- ✓ **Sidebars:** These fascinating little gray-shaded boxes include factoids and information that I thought you may like, but you can pick up managerial accounting just fine without reading them.

Foolish Assumptions

To write this book, I had to make certain assumptions about you. I assume that you're one of the following people:

- ✓ A college student taking a managerial accounting course who needs some help understanding the topics you're covering in class
- ✓ A businessperson or entrepreneur who wants to know more about how to collect accounting information to make decisions
- ✓ A recent college graduate interested in pursuing a career in managerial accounting, perhaps as a certified management accountant

- ✓ A professional accountant or bookkeeper looking for a straightforward refresher in the basics of managerial accounting

How This Book Is Organized

Each of the six parts of this book tackles a different aspect of managerial accounting. The following sections explain how I organized the information so that you can find what you need quickly and easily.

Part I: Introducing Managerial Accounting

Part I gives you a basic taste of what managerial accounting is and why it's important. It also reviews some important aspects of accounting that every businessperson needs to know. I hit profitability, efficiency, productivity, and continuous improvement especially hard.

Part II: Understanding and Managing Costs

At its very crux, managerial accounting is all about costs — be they direct, indirect, overhead, or whatever — and how those costs behave. What drives costs up, down, or sideways? Part II explores the world of costs.

Part III: Using Costing Techniques for Decision-Making

When you understand how costs work, you're ready to make decisions, and that's what Part III deals with. After a brief spiel about my favorite topic — contribution margin — I explain about how to use cost information to

make decisions. I cover such areas as whether to buy equipment, which products to make, and how to price.

Part IV: Planning and Budgeting

An important part of managing an organization is planning for the future, and managerial accountants play a critical role in this process by preparing budgets, the topic of Part IV. These budgets integrate information from every part of an organization to develop a plan to meet managers' goals. To make things even more interesting, I explain how managers can *flex* their budgets — prepare budgets that can adapt to changing facts and circumstances.

Part V: Using Managerial Accounting for Evaluation and Control

Accountants have a reputation for being control freaks, but it's part of the job. Managers and managerial accountants not only plan but also need to control. This duty means that they carefully monitor a company's performance and compare that performance to their budgets. That way, managers can quickly identify and address problems before the problems become crises. Part V explains how to evaluate and control the activities throughout an organization, including using responsibility accounting, variance analysis, and two techniques managers utilize to run their companies: the balanced scorecard and the theory of constraints.

Part VI: The Part of Tens

The chapters in this part provide you with a quick reference to the most important formulas in the book. I also share some career options for managerial accountants and profile inspirational role models.

Icons Used in This Book

Throughout the margins of this book, certain symbols emphasize important points, examples, and warnings. Watch for these icons:



This icon highlights facts that are especially important to keep in mind. Tucking these facts away helps you keep key concepts at your fingertips.



This icon pops up alongside examples that show you how to apply an idea to real-life accounting problems.



Like building the Titanic II, not every idea is a good idea. This icon alerts you to situations that require caution. Look out!



This icon marks simple hints that can help you solve problems on tests and in real-life managerial accounting situations.



I couldn't resist sharing these interesting tidbits with you. However, if you're in a hurry, don't panic; just skip them.

Where to Go from Here

All the chapters in this book are modular, so you can study and understand them without reading other chapters. Just go through the table of contents and pick out a topic that you want to know more about. I provide cross-references to topics in other chapters where appropriate, so if you've skipped a foundational concept crucial to what you're reading about, you know where to find what you need.

If you're looking to discover managerial accounting from scratch, or to unlearn some part of managerial accounting that you fear you learned wrong, start with Part I to get the basics. When writing this book, I took special care to explain all the fundamentals that some managerial accounting texts skip. Students with little or no background in accounting should make a point to read [Chapter 2](#).

Managerial accounting itself is built on a few basic principles. In my experience, most students who have trouble learning managerial accounting usually improve their performance after becoming more familiar with these basic principles. Therefore, to better understand these foundations, take a look at [Chapter 3](#) (basic cost principles), [Chapter 5](#) (cost behavior), and [Chapter 9](#) (contribution margin).



If you're studying for a college exam, make sure you know the relevant key formulas in [Chapter 20](#).