GLOSSARY

absolute amounts Dollar totals reported on financial statements; using them in financial analysis comparisons can be misleading because they do not reflect materiality levels of the underlying companies. *p. 589*

absorption (full) costing Reporting method in which all product costs, including fixed manufacturing costs, are initially capitalized in inventory and then expensed when goods are sold. (Contrast with *variable costing.*) *p. 500*

accounts receivable turnover Financial ratio that measures how quickly accounts receivable are converted to cash; computed by dividing net credit sales by average net accounts receivable. *p. 595*

accrual accounting Accounting system that recognizes revenues when earned and expenses when incurred regardless of when the related cash is exchanged.

accumulated conversion factor Factor used to convert a series of future cash flows into their present value equivalent when applied to cash flows of equal amounts spread over equal interval time periods; this factor can be computed by adding the individual single factors applicable to each period. *p. 47*

acid-test ratio See *quick ratio. p. 595*

activities Measures an organization undertakes to accomplish its mission. *p. 207*

activity base Factor that causes changes in total variable cost; usually some measure of volume when used to explain cost behavior. *p. 65*

activity-based cost drivers Measures of activities that cause costs to be incurred, such as number of setups, percentage of use, and pounds of material delivered; using such measures as allocation bases can improve the accuracy of cost allocations in business environments where overhead costs are not driven by volume. *p. 205*

activity-based costing (ABC) A two-stage cost allocation process. First, costs associated with specific business activities are allocated or assigned to activity cost pools. Second, these pooled costs are allocated to designated cost objects by using a variety of appropriate cost drivers. The cost drivers chosen for each cost pool are those that most accurately reflect the demand placed on that cost pool by the cost object. *p. 207*

activity-based management (ABM) Managing organization activities to add the greatest value by developing products that satisfy the needs of the organization's customers. *p. 23*

activity centers Cost centers composed of operating activities with similar characteristics; pooling indirect costs into activity centers reduces record-keeping costs by allowing allocations based on a common cost driver for each center. *p. 207*

allocation Process of dividing a total cost into parts and assigning the parts to the relevant cost objects. *p. 153*

allocation base The factor used as the base for cost allocation; when possible, a driver of the allocated cost. *p. 155*

allocation rate The mathematical factor used to allocate or assign costs to a cost object, determined by dividing the total cost to be allocated by the appropriate cost driver or allocation base. *p. 155*

annuity Series of equal cash flows received or paid over equal time intervals at a constant rate of return. *p. 447*

applied fixed cost Total cost determined by multiplying the predetermined overhead rate times the actual volume of production. *p. 356*

applied overhead Amount of overhead costs assigned during the period to work in process using a predetermined overhead rate. *p. 491*

appraisal costs Costs of identifying nonconforming products produced regardless of prevention cost expenditures. *p. 216*

asset turnover ratio A measure of revenue dollars generated by the assets invested; calculated as net sales divided by average total assets. *p. 600*

average cost (per unit) The total cost of making products divided by the total number of products made. *p. 26*

average days to collect receivables (average collection period) Measure of how quickly, on average, a business collects its accounts receivable; calculated as 365 divided by the accounts receivable turnover. *p. 596*

average days to sell inventory (average days in inventory) Measure of how quickly, on average, a business sells its inventory; calculated as 365 divided by the inventory turnover ratio. *p. 596*

avoidable costs Potential future costs an organization can circumvent by choosing a particular course of action. To be avoidable, costs must differ among decision alternatives. For example, if materials cost for two different products is the same for each product, materials cost could not be avoided by choosing to produce one product instead of the other. The materials cost would therefore not be an avoidable cost. *p. 257*

balanced scorecard A management evaluation tool that uses both financial and nonfinancial measures to assess how well an organization is meeting its objectives. *p. 412*

batch-level activities Actions taken (e.g., materials handling, production setups) to produce groups of products, the cost of which is fixed regardless of the number of units produced in a batch. *p. 209*

batch-level costs The costs associated with producing a batch of products, most accurately allocated using cost drivers that measure activity levels. For example, the cost of setting up a press to print 500 copies of an engraved invitation is a batch-level cost. Classifying costs as batch-level is context sensitive. The postage to mail a single product would be classified as a unit-level cost. In contrast, the postage to mail a large number of products in a single shipment would be classified as a batch-level cost. *p. 257*

benchmarking Identifying best practices used by world-class competitors in a given industry. *p. 24*

best practices Identifiable procedures used by world-class companies. *p. 24*

book value per share An accounting measure of a share of common stock, computed by dividing total stockholders' equity less preferred rights by the number of common shares outstanding. *p. 602*

bottleneck A constraint that limits a company's capacity to produce or sell its products, such as a piece of equipment that cannot produce enough component parts to fully occupy employees in the assembly department. *p. 270*

break-even point Sales volume at which total revenue equals total cost; can be expressed in units or sales dollars. *p. 108*

budgeting Form of planning that formalizes a company's goals and objectives in financial terms. *p. 304*

budget slack Difference between inflated and realistic standards. *p. 360*

by-products Products that share common inputs with other joint products but have insignificant market values relative to the other joint products.

capital budget Budget detailing the company's plans to invest in operational assets, new products, or lines of business for the coming year; influences many of the operating budgets and is a formal part of the master budget. *p. 308*

capital budgeting Financial planning for the intermediate time range involving decisions such as whether to buy or lease equipment, purchase additional assets, or increase operating expenses to stimulate sales. *p. 306*

capital investments Purchases of operational assets involving a long-term commitment of funds that can be critically important to the company's ultimate success; costs normally recovered through using the assets. *p. 444*

cash budget A budget detailing expected future cash receipts and payments. *p. 313*

cash inflows Cash receipts including cash generated from operating activities such as cash revenues or collections of accounts receivable; cash collected from investing activities such as selling investments; and cash collected from financing activities such as borrowing money or issuing stock. *p. 636*

cash outflows Cash disbursements including cash paid for operating activities such as cash expenses or payments to settle accounts payable; cash paid for investing activities such as buying investments; and cash paid for financing activities such as repaying long-term debt or purchasing treasury stock. *p. 636*

certified suppliers Suppliers who have demonstrated reliability by providing the buyer with quality goods and services at desirable prices, usually in accord with strict delivery specifications; frequently offer the buyer preferred customer status in exchange for guaranteed purchase quantities and prompt payment schedules. *p. 262*

common costs Costs that are incurred to support more than one cost object but cannot be traced to any specific object. *p. 154*

companywide allocation rate Factor based on a single measure of volume, such as direct labor-hours, used to allocate all overhead cost to the company's products or other cost objects. *p. 204*

constraints Conditions that limit a business's ability to satisfy the demand for its products. *p. 270*

continuous improvement An ongoing process through which employees learn to eliminate waste, reduce response time, minimize defects, and simplify the design and delivery of products and services to customers; a feature of total quality management (TQM). *p. 24*

contribution margin The difference between sales revenue and variable cost; the amount available to pay for fixed cost and thereafter to provide a profit. *p. 61*

contribution margin per unit The sales price per unit minus the variable cost per unit. *p. 109*

contribution margin ratio The contribution margin per unit divided by the sales price per unit; can be used in cost-volume-profit analysis to calculate in dollars the break-even sales volume or the level of sales required to attain a desired profit. *p. 110*

controllable costs Costs that can be influenced by a particular manager's decisions and actions. *p. 154*

controllability concept Evaluating managerial performance based only on revenue and costs under the manager's direct control. *p. 404*

cost Measure of resources used to acquire an asset or to produce revenue.

cost accumulation Measuring the cost of a particular object by combining many individual costs into a single total cost. *p. 152*

cost allocation Process of dividing a total cost into parts and assigning the parts to relevant objects. *pp. 12, 153*

cost averaging Measuring the cost per unit of a product or service by dividing the total production cost by the total activity base to which the cost pertains; average cost is often more relevant to pricing, performance evaluation, and control than actual cost. *p. 66*

cost-based transfer price Transfer price based on the historical or standard cost incurred by the supplying segment. *p. 416*

cost behavior How a cost changes (increase, decrease, remain constant) relative to changes in some measure of activity (e.g., the behavior of raw materials cost is to increase as the number of units of product made increases). *p. 54*

cost center A responsibility center that incurs costs but does not generate revenue. *p. 401*

cost driver Any factor, usually a volume measure, that causes cost to be incurred; sometimes described as *activity base* or *allocation base*. Changes in cost drivers, such as labor-hours or machine-hours, cause corresponding changes in cost. *p. 152*

cost objects Items for which managers need to measure cost; can be products, processes, departments, services, activities, and so on. *p. 150*

cost of capital Return paid to investors and creditors for supplying assets (capital); usually represents a company's minimum rate of return. *p. 445*

cost per equivalent unit Unit cost of product determined by dividing total production costs by the number of equivalent whole units; used to allocate product costs between processing departments (amount of ending inventory and amount of costs transferred to the subsequent department). *p. 550*

cost per unit of input Cost of material, labor, or overhead for one unit; determined by multiplying the price paid for one unit of material, labor, or overhead input by the usage of that input for one unit of product or service.

cost-plus pricing Strategy that sets the selling price at cost plus a markup equal to a percentage of the cost. *p. 112*

cost pool A collection of costs organized around a common cost driver. The cost pool, as opposed to individual costs, is allocated to cost objects using the common cost driver, thereby promoting efficiency in the allocation process. *p. 165*

cost structure The relative proportion of a company's variable and fixed costs to total cost. The percentage change in net income a company experiences for a given percentage change in sales volume is directly related to the company's cost structure. The greater a company's percentage of fixed to total costs, the more its net income will fluctuate with changes in sales. *p. 59*

cost tracing Assigning specific costs to the objects that cause their incurrence. *p. 153*

cost-volume-profit (CVP) analysis Management tool that reflects the interrelationships among sales prices, volume, fixed costs, and variable costs; used in determining the break-even point or the most profitable combination of these variables. *p. 107*

current ratio (working capital ratio) Measure of liquidity; calculated by dividing current assets by current liabilities. *p. 594*

decentralization Delegating authority and responsibility for business segment operation to lower-level managers. *p. 400*

deferral transactions Accounting transactions in which cash payments or receipts occur before the related expense or revenue is recognized.

differential costs Costs that differ among alternative business opportunities; usually relevant for decision making. Some differential costs, however, are not relevant. For example, although depreciation may differ between the alternatives, it is an unavoidable sunk cost and is therefore not relevant for decision making. *p. 259*

differential revenue Revenues that are relevant to decision-making because they differ among alternative courses of action. *p. 256*

direct cost Cost that is easily traceable to a cost object and for which it is economically feasible to do so. *p. 153*

direct labor Wages paid to production workers whose efforts can be easily and conveniently traced to products. *p. 9*

direct method (1) Allocation method that allocates service center costs directly to operating department cost pools; does not account for any relationships among service centers. (2) Method of reporting cash flows from operating activities on the statement of cash flows that shows individual categories of cash receipts from and cash payments for major activities (collections from customers, payments to suppliers, etc.). *pp. 171, 638*

direct raw materials Costs of raw materials used to make products that can be easily and conveniently traced to those products. *p. 9*

dividend yield Ratio for comparing stock dividends paid relative to the market price; calculated as dividends per share divided by market price per share. *p. 603*

downstream costs Costs incurred after the manufacturing process is complete, such as delivery costs and sales commissions. *pp. 14, 214*

earnings per share Measure of the value of a share of common stock based on company earnings; calculated as net income available to common stockholders divided by the average number of outstanding common shares. *p. 602*

economies of scale Reducing the unit cost of production by increasing an operation's size. Increasing size usually increases the volume of activity, reducing the per unit fixed cost and resulting in a lower total production cost.

efficient market hypothesis The proposition that creditors and investors evaluate the underlying substance of business events regardless of how those events are reported in financial reports.

equation method Cost-volume-profit analysis technique that uses the algebraic relationship among sales, variable costs, fixed costs, and desired net income before taxes to solve for required sales volume. *p. 108*

equipment replacement decisions Deciding whether to replace existing equipment with newer equipment based on comparing the avoidable costs of keeping the old or purchasing new equipment to determine which choice is more profitable. *p. 266*

equivalent whole units A quantity of partially completed goods expressed as an equivalent number of fully completed goods. *p. 549*

expense transactions Business events that decrease assets or increase liabilities in order to produce revenue in the course of operating a business.

external failure costs Costs resulting from delivering defective goods to customers. *p. 216*

facility-level activities Actions taken (e.g., insuring the facility, providing plant maintenance, employing a company president) that benefit the production process as a whole. *p. 211*

facility-level costs Costs incurred to support the whole company or a segment thereof, not related to any specific product, batch, or unit of production or service and unavoidable unless the entire company or segment is eliminated; they are so indirect that any allocation of facility-level costs is necessarily arbitrary. *p. 211*

failure costs Costs resulting from producing or providing nonconforming products or services. *p. 316*

favorable variance Variance indicating that actual costs are less than standard costs or actual sales exceed budgeted sales. *p. 351*

financial accounting Branch of accounting focused on the business information needs of external users (creditors, investors, governmental agencies, financial analysts, etc.); its objective is to classify and record business events and transactions to produce external financial reports (income statement, balance sheet, statement of cash flows, and statement of changes in equity). *p. 2*

Financial Accounting Standards Board (FASB) Private, independent standard-setting body established by the accounting profession that has been delegated the authority by the SEC to establish most of the accounting rules and regulations for public financial reporting. *p. 5*

financing activities Cash inflows and outflows from transactions with investors and creditors (except interest), including cash receipts from issuing stock, borrowing activities, and cash disbursements to pay dividends. *p. 639*

finished goods Completed products resulting from the manufacturing process; measured by the accumulated cost of raw materials, labor, and overhead. *p. 6*

Finished Goods Inventory Asset account used to accumulate the product costs (direct materials, direct labor, and overhead) associated with completed products that have not yet been sold. *p. 486*

first-in, first-out (FIFO) method Means of computing equivalent units in a process cost system that accounts for the degree of completion of both beginning and ending inventories; more complex than the weighted average method, and used when greater accuracy is desired.

fixed cost Cost that remains constant in total regardless of changes in the volume of activity; per unit amount varies inversely with changes in the volume of activity. *p. 550*

fixed cost spending variance The difference between the *actual* fixed manufacturing overhead costs and the *budgeted* fixed manufacturing overhead costs. *p. 356*

fixed cost volume variance The difference between the *budgeted* fixed manufacturing overhead costs and the *applied* fixed manufacturing overhead costs. *p. 350*

flexible budgets Budgets that show expected revenues and costs at a variety of different activity levels. *p. 350*

flexible budget variances Differences between budgets based on standard amounts at the actual level of activity and actual results; caused by differences between standard unit cost and actual unit cost at the volume of activity achieved.

full costing See *absorption costing*. *p. 500*

generally accepted accounting principles (GAAP) Rules and practices that accountants agree to follow in financial reports prepared for public distribution. *p. 5*

high-low method Method of estimating the fixed and variable components of a mixed cost; the variable cost per unit is the difference between the total cost at the high- and low-volume points divided by the difference between the corresponding high and low volumes. The fixed cost component is determined by subtracting the variable cost from the total cost at either the high- or low-volume level. *p. 68*

horizontal analysis Financial analysis technique of comparing amounts of the same item over several time periods. *p. 589*

hybrid costing systems Cost systems that blend some features of a job-order costing system with some features of a process costing system. *p. 538*

ideal standard A measure of the highest level of efficiency attainable; assumes all input factors interact perfectly under ideal or optimum conditions. *p. 358*

incremental revenue Additional cash inflows from operating activities generated by using an additional capital asset. *p. 451*

indirect cost Cost that either cannot be easily traced to a cost object or for which it is not economically feasible to do so. See also *overhead*. *pp. 11, 153*

indirect method Method of reporting cash flows from operating activities on the statement of cash flows that starts with the net income from the income statement, followed by adjustments necessary to convert accrual-based net income to a cash-basis equivalent. *p. 638*

information overload Condition where so much information is presented that it confuses the user of the information. *p. 588*

interdepartmental service Service performed by one service department for the benefit of another service department. *p. 172*

internal failure costs Costs incurred to correct defects before goods reach the customer. *p. 216*

internal rate of return Rate at which the present value of an investment's future cash inflows equals the cash outflows required to acquire the investment; the rate that produces a net present value of zero. *p. 450*

inventory holding costs Costs associated with acquiring and retaining inventory including cost of storage space; lost, stolen, or damaged merchandise; insurance; personnel and management costs; and interest. *p. 14*

inventory turnover A measure of sales volume relative to inventory levels; calculated as the cost of goods sold divided by average inventory. *p. 598*

investing activities Cash inflows and outflows associated with buying or selling long-term assets and cash inflows and outflows associated with lending activities (loans to others—cash outflows; collecting loans to others—cash inflows). *p. 639*

investment center Type of responsibility center for which revenue, expense, and capital investments can be measured. *p. 401*

job cost sheet Record used in a job-order costing system to accumulate the materials, labor, and overhead costs of a job during production; at job completion, it summarizes all costs that were incurred to complete that job; also known as a *job-order cost sheet* or *job record*. *p. 538*

job-order costing system System in which costs are traced to products that are produced individually (e.g., custom-designed building) or in batches (e.g., an order for 100 wedding invitations); used to determine the costs of distinct, one-of-a-kind products. *p. 536*

joint costs Common costs incurred in the process of making two or more products. *p. 165*

joint products Separate products derived from common inputs. *p. 165*

just in time (JIT) Inventory management system that minimizes the amount of inventory on hand by avoiding inventory acquisition until products are demanded by customers, therefore eliminating the need to store inventory. The system reduces inventory holding costs including financing, warehouse storage, supervision, theft, damage, and obsolescence. It can also eliminate opportunity costs such as lost revenue due to the lack of availability of inventory. *p. 14*

labor efficiency variance Standard cost variance that indicates how the actual amount of direct labor used differs from the standard amount required.

labor price variance Standard cost variance that indicates how the actual pay rate for direct labor differs from the standard pay rate. *p. 365*

lax standards Easily attainable goals that can be reached with minimal effort. *p. 358*

least-squares regression A technique used to draw a line through a data set by minimizing the sum of the squared deviations between the line and the points in the data set. *p. 72*

liquidity ratios Measures of a company's capacity to pay short-term debt. *p. 593*

low-ball pricing Supplier practice of pricing a product below competitors' prices to attract customers and then raising the price once customers depend on the supplier for the product. *p. 262*

making the numbers Expression that indicates marketing managers attained the planned master budget sales volume. *p. 352*

management by exception The philosophy of focusing management attention and resources only on those operations where performance deviates significantly from expectations. *pp. 357, 403*

managerial accounting Branch of accounting focused on the information needs of managers and others working within the business. Its objective is to gather and report information that adds value to the business. Managerial accounting information is not regulated or reported to the public. *p. 2*

manufacturing overhead Production costs that cannot be easily or economically traced directly to products. *p. 11*

Manufacturing Overhead account Temporary account used during an accounting period to accumulate the actual overhead costs incurred and the amount of overhead applied to production. A debit balance in the account at the end of the period means overhead has been underapplied and a credit balance means overhead has been overapplied. The account is closed at year-end in an adjusting entry to the Work in Process and Finished Goods Inventory accounts and the Cost of Goods Sold account. If the balance is insignificant, it is closed only to Cost of Goods Sold. *p. 491*

margin Ratio that measures control of operating expenses relative to sales; computed as operating income divided by sales. Along with *turnover*, a component of return on investment. *p. 401*

margin of safety Difference between break-even sales and budgeted sales expressed in units, dollars, or as a percentage; the amount by which actual sales can fall below budgeted sales before incurring losses. *p. 119*

market-based transfer price Transfer price based on the external market price less any cost savings; it offers the closest approximation to an arm's-length price possible for intersegment transactions. *p. 413*

master budget The combination of the numerous separate but interdependent departmental budgets that detail a wide range of operating and financing plans including sales, production, manufacturing expenses, and administrative expenses. See also *static budget*. *p. 308*

material variance A variance sufficiently significant that its investigation could influence decision making. *p. 359*

materiality The point at which knowledge of information would influence a user's decision; can be measured in absolute, percentage, quantitative, or qualitative terms. *p. 589*

materials price variance Standard cost variance that indicates how the actual price paid for raw materials differs from the standard price for the materials. *p. 363*

materials quantity variance Standard cost variance that indicates the actual amount of raw materials used to make products differs from the standard amount required.

materials requisition form A form, either paper or electronic, used to request the materials needed for a specified job. The accounting department summarizes all materials requisitioned for a job on a job cost sheet. *p. 538*

minimum rate of return Minimum rate of profitability required for a company to accept an investment opportunity; also called *desired rate of return, required rate of return, hurdle rate, cutoff rate,* and *discount rate*. *p. 445*

mixed costs (semivariable costs) Costs that have both fixed and variable components. *p. 64*

multiple regression analysis A statistical tool that permits analysis of how a number of independent variables simultaneously affect a dependent variable.

negotiated transfer price Transfer price established through mutual agreement of the selling and buying segments. *p. 416*

net margin Profitability ratio that measures the percentage of sales dollars resulting in profit; calculated as net income divided by net sales. *p. 599*

net present value Capital budgeting evaluation technique in which future cash flows are discounted, using a desired rate of return, to their present value equivalents and then the cost of the investment is subtracted from the present value equivalents to determine the net present value. A zero or positive net present value (present value of cash inflows equals or exceeds the present value of cash outflows) means the investment opportunity provides an acceptable rate of return. *p. 449*

noncash investing and financing activities Certain business transactions, usually long-term, that do not involve cash, such as exchanging stock for land or purchasing property by using debt; reported separately on the statement of cash flows. *p. 640*

nonvalue-added activities Tasks undertaken that do not contribute to a product's ability to satisfy customer needs. *p. 15*

operating activities Cash inflows from and outflows for routine, everyday business operations, normally resulting from revenue and expense transactions including interest.

operating budgets Departmental budgets that become a part of the company's master budget; typically include a sales budget, an inventory purchases budget, a selling and administrative expense budget, and a cash budget. *p. 638*

operating departments Departments that perform tasks directly related to accomplishing the organization's objectives. (Contrast with *service departments*.) *p. 170*

operating leverage Cost structure condition that produces a proportionately larger percentage change in net income for a given percentage change in revenue; measured by dividing the contribution margin by net income. The higher the proportion of fixed cost to total costs, the greater the operating leverage. *p. 56*

operations budgeting Short-range planning activities such as the development and implementation of the master budget. *p. 306*

opportunity cost Cost of lost opportunities such as revenue forgone because of insufficient inventory. *pp. 15, 254*

ordinary annuity Annuity in which cash flows occur at the end of each accounting period. *p. 448*

outsourcing Buying goods and services from an outside company rather than producing them internally. *p. 260*

overapplied or underapplied overhead The difference between the amount of overhead costs actually incurred and the amount of overhead costs allocated to work in process. *p. 491*

overhead Costs associated with producing products or providing services that cannot be traced directly to those products or services in a cost-effective manner; includes indirect costs such as indirect materials, indirect labor, utilities, rent, depreciation on manufacturing facilities and equipment, and planning, design, and setup costs related to the product or service. *p. 6*

overhead costs Indirect costs of operating a business that cannot be directly traced to a product, department, process, or service, such as depreciation. *p. 153*

participative budgeting Technique in which upper-level managers involve subordinates in setting budget objectives, thereby encouraging employee cooperation and support in attaining the company's goals. *p. 308*

payback method Capital budgeting evaluation technique in which the length of time necessary to recover the initial net investment through incremental revenue or cost savings is determined; the shorter the period, the better the investment opportunity. *p. 458*

percentage analysis Financial analysis technique of comparing numerical relationships between two different financial statement items to draw conclusions; circumvents difficulties caused by differing materiality levels. *p. 590*

period costs General, selling, and administrative costs that are expensed in the period in which the economic sacrifice is incurred. (Contrast with *product costs*.) *p. 10*

perpetual (continuous) budgeting Maintaining a budget that always reflects plans for the coming 12 months by adding a new monthly budget to the end as the current month's expires; keeps management constantly involved in the budget process to allow timely recognition of changing conditions. *p. 306*

postaudit After-the-fact evaluation of an investment project; the capital budgeting techniques employed in originally deciding to accept the project are used to calculate the results of the project using actual data; provides feedback regarding whether the expected results were actually achieved. *p. 461*

practical standard A measure of efficiency in which the ideal standard has been modified to allow for normal tolerable inefficiencies. *p. 358*

predetermined overhead rate Allocation rate calculated before actual costs or activity are known; determined by dividing the estimated overhead costs for the coming period by some measure of estimated total production activity for the period, such as the number of labor-hours or machine-hours. The base should relate rationally to overhead use. The rate is used throughout the accounting period to allocate overhead costs to work in process inventory based on actual production activity. *pp. 356, 490*

present value index Present value of cash inflows divided by the present value of cash outflows. Higher index numbers indicate higher rates of return. *p. 454*

present value table Matrix of factors to use in converting future values into their present value equivalents; composed of columns that represent alternative rates of return and rows that represent alternative time periods. *p. 446*

prestige pricing Strategy that sets the selling price at a premium (more than average markup above cost) under the assumption that customers will pay more for the product because of its prestigious brand name, media attention, or some other reason that has piqued the interest of the public. *p. 112*

prevention costs Costs incurred to avoid making nonconforming products. *p. 216*

price-earnings ratio Measure that reflects the values of different stocks in terms of earnings; calculated as market price per share divided by earnings (net income) per share. *p. 602*

pro forma financial statements Budgeted financial statements that reflect the master budget plans. *p. 308*

process costing system System in which costs are distributed evenly across total production of homogeneous products, such as chemicals, foods, or paints; the average cost per unit is determined by dividing the total product costs of each production department by the number of units of product made in that department during the accounting period. The total costs in the last production department include all costs incurred in preceding departments so that the unit cost determined for the last department reflects the final unit cost of the product. *p. 536*

product costs All costs related to obtaining or manufacturing a product intended for sale to customers; accumulated in inventory accounts and expensed as cost of goods sold at the point of sale. For a manufacturing company, product costs are direct materials, direct labor, and manufacturing overhead. (Contrast with *period costs*.) *p. 5*

product costing Classifying and accumulating the costs of individual inputs (materials, labor, and overhead) to determine the cost of making a product or providing a service. *p. 5*

product-level activities Actions taken (e.g., holding inventory, developmental engineering) that support a specific product or product line. *p. 210*

product-level costs Costs incurred to support specific products or services; allocated based on the extent to which they sustain the product or service, and avoidable by eliminating the product line or type of service. *p. 257*

productive assets Assets used to operate the business. May also be called *long-term assets.*

profit center Responsibility center for which both revenues and costs can be identified. *p. 401*

profitability ratios Measures of a company's capacity to generate earnings. *p. 599*

qualitative characteristics Features of information such as company reputation, employee welfare, and customer satisfaction that cannot be quantified but may be relevant to decision making. *p. 256*

quality The degree to which products or services conform to their design specifications. *p. 216*

quality cost report Accounting report that typically lists the company's quality costs both in absolute dollars and as a percentage of total quality cost. *p. 218*

quantitative characteristics Features of information that can be mathematically measured, such as the dollar amounts of revenues and expenses, often relevant to decision making. *p. 256*

quick ratio (acid-test ratio) Measure of immediate debt-paying ability; calculated by dividing highly liquid assets (cash, receivables, and marketable securities) by current liabilities. *p. 592*

ratio analysis Same as *percentage analysis*. *p. 592*

raw materials Physical commodities (e.g., wood, metal, paint) transformed into products through the manufacturing process. *p. 9*

Raw Materials Inventory Asset account used to accumulate the costs of materials (such as lumber, metals, paints, chemicals) that will be used to make the company's products. *p. 486*

reciprocal method Allocation method that uses simultaneous linear equations to account for two-way relationships among service centers (service centers both provide services to and receive services from other service centers); the resultant cost distributions are difficult to interpret. *p. 175*

reciprocal relationships Two-way relationships in which departments provide services to and receive services from one another. *p. 175*

recovery of investment Recovery of the funds used to acquire the original investment. *p. 460*

reengineering Business practices companies design to improve competitiveness in world markets by eliminating or minimizing waste, errors, and costs in production and delivery systems. *p. 24*

regression analysis See *least-squares regression. p. 73*

relaxing the constraints Opening bottlenecks that limit the profitable operations of a business. *p. 271*

relevant costs Future-oriented costs that differ among alternative business decisions; also known as *avoidable costs. p. 254*

relevant information Decision-making information about costs, cost savings, or revenues that: (1) is future-oriented and (2) differs among the available alternatives; decision specific (information relevant to one decision may not be relevant to another decision). *Relevant costs* are also called *avoidable* or *incremental costs* and *relevant revenues* are also called *differential* or *incremental revenues. p. 254*

relevant range Range of activity over which the definitions of fixed and variable costs are valid. *p. 65*

residual income Performance measure that evaluates managers based on how well they maximize the dollar value of earnings above some targeted level of earnings. *p. 409*

responsibility accounting Performance evaluation system in which accountability for results is assigned to a segment manager of the business based on the amount of control or influence the manager has over those results. *p. 398*

responsibility center Identifiable part of an organization where control over revenues or expenses can be assigned. *p. 400*

responsibility reports Performance reports for the various company responsibility centers that highlight controllable items; show variances between budgeted and actual controllable items. *p. 401*

retained earnings Portion of stockholders' equity that represents the amount of net income kept in the business since inception (revenues minus expenses and distributions for all accounting periods). *p. 656*

return on assets The ratio of net income divided by average total assets. See also *return on investment*. *p. 600*

return on equity Profitability measure based on earnings a company generates relative to its stockholders' equity; calculated as net income divided by average stockholders' equity. *p. 601*

return on investment Profitability measure based on earnings a company generates relative to its asset base; calculated as net income divided by average total assets. ROI can be viewed as the product of net margin and asset turnover. Also called *return on assets* or *earning power. pp. 405, 600*

revenue transactions Business events that increase assets or decrease liabilities by providing services or products to customers in the course of operating a business.

R Square (R^2) statistic The R^2 Statistic represents the percentage of change in a dependent variable that is explained by a change in an independent variable. *p. 73*

sales price variance Variance attributable to the actual sales price differing from the standard sales price; calculated as the difference between actual sales revenue and flexible budget sales revenue (the standard sales price per unit times the actual number of units sold). *p. 354*

sales volume variance Variance attributable to the actual volume of sales differing from the budgeted volume of sales; calculated as the difference between the static budget (standard sales price times standard level of activity) and the flexible budget (standard sales price times actual level of activity). *p. 352*

Sarbanes-Oxley Act of 2002 A federal law that regulates corporate governance. *p. 21*

scattergraph Method of estimating the variable and fixed components of a mixed cost by plotting cost data on a graph and visually drawing a regression line through the data points so that the total distance between the points and the line is minimized. *p. 69*

schedule of cost of goods manufactured and sold Internal accounting report that summarizes the manufacturing product costs for the period; its result, cost of goods sold, is reported as a single line item on the company's income statement. *p. 499*

Securities and Exchange Commission (SEC) Government agency authorized by Congress to regulate financial reporting practices of public companies; requires companies that issue securities to the public to file audited financial statements with the government annually. *p. 5*

segment Component part of an organization that is designated as a reporting entity. *p. 263*

selling, general, and administrative costs (SG&A) All costs not associated with obtaining or manufacturing a product; sometimes called *period costs* because they are normally expensed in the period in which the economic sacrifice is incurred. *p. 5*

semivariable costs See *mixed costs. p. 54*

sensitivity analysis Spreadsheet tool used to answer "what-if" questions to assess the sensitivity of profits to simultaneous changes in fixed cost, variable cost, and sales volume. *p. 121*

service departments Departments such as quality control, repair and maintenance, personnel, and accounting that provide support to other departments. (Contrast with *operating departments*.) *p. 170*

single-payment (lump-sum) A one-time future cash flow that can be converted to its present value using a conversion factor. *p. 446*

solvency ratios Measures of a company's capacity to pay long-term debt. *p. 597*

special order decisions Deciding whether to accept orders from customers who offer to buy goods or services at prices significantly below selling prices regular customers pay. If the order's differential revenues exceed its avoidable costs, the order should be accepted unless qualitative factors, such as the order's effect on the existing customer base, could lead to unfavorable consequences. *p. 258*

split-off point Stage in the production process where products made from common inputs become separate and identifiable. *p. 165*

standards Budgeted per-unit selling prices or costs that are based on anticipated circumstances; multiplying the per-unit standards for cost and quantity produces the per-unit standard cost. *p. 358*

start-up (setup) costs Costs of activities performed to prepare to make a different product or batch of products, such as resetting machinery, changing the production configuration, and conducting inspection. *p. 205*

statement of cash flows The financial statement that classifies and reports a company's sources and uses of cash during an accounting period. *p. 636*

static budget A budget based solely on the planned level of activity, such as the master budget; not adjusted for changes in activity volume. *p. 350*

step method Two-step allocation method that accounts for one-way interdepartmental service center relationships by allocating costs from service centers to service centers as well as from service centers to operating departments; does not account for reciprocal relationships between service centers. *p. 173*

strategic cost management Newer techniques managers can use to more accurately measure and control costs; implemented as a response to the complex modern automated business environment. These strategies include eliminating nonvalue-added activities, designing more efficient manufacturing processes, and developing more effective ways, like activity-based costing, to trace overhead costs to cost objects. *p. 216*

strategic planning Long-range planning activities such as defining the scope of the business, determining which products to develop, deciding whether to discontinue a business segment, and determining which market niche would be most profitable. *p. 306*

suboptimization Condition in which the best interests of the organization as a whole are in conflict with managers' own self-interests. *p. 409*

sunk costs Costs that have been previously incurred; not relevant for decision making. For example, in an equipment replacement decision, the cost paid for the existing machine presently in use is a nonavoidable sunk cost because it has already been incurred. *p. 254*

T-account method Technique for determining the cash inflows and outflows for the period by analyzing changes in balance sheet accounts from the beginning to the end of the period; infers the period's transactions from income statement and other data.

target pricing (target costing) Strategy that sets the selling price by determining the price at which a product that will satisfy market demands will sell and then developing that product at a cost that results in a profit. *pp. 112, 214*

theory of constraints (TOC) A management practice used to increase profitability by identifying bottlenecks or resource limitations that restrict operations and then removing them by relaxing the constraints. *p. 271*

time value of money The concept that the present value of one dollar to be exchanged in the future is less than one dollar because of interest, risk, and inflation factors. *p. 444*

times interest earned Ratio that measures a company's ability to make its interest payments; calculated by dividing the amount of earnings available for interest payments (net income before interest and income taxes) by the amount of the interest payments. *p. 497*

total quality management (TQM) Management strategy that focuses on (1) continuous systematic problem-solving by personnel at all levels of the organization to eliminate waste, defects, and nonvalue-added activities; and (2) managing quality costs in a manner that leads to the highest level of customer satisfaction. *pp. 24, 218*

transferred-in costs Costs transferred from one department to the next; combined with the materials, labor, and overhead costs incurred in the subsequent department so that when goods are complete, the total product cost of all departments is transferred to the Finished Goods Inventory account. *p. 537*

transfer price Price at which products or services are transferred between divisions or other segments of an organization. *p. 413*

trend analysis Study of business performance over a period of time. *p. 589*

turnover Measure of sales in relation to operating assets; calculated as sales divided by operating assets. Along with *margin*, a component of return on investment. *p. 407*

turnover of assets ratio See *asset turnover ratio*. *p. 407*

unadjusted rate of return (simple rate of return) Measure of profitability computed by dividing the average incremental increase in annual net income by the average cost of the original investment (original cost divided by 2); does not account for the *time value of money*. *p. 449*

unfavorable variance Variance indicating that actual costs exceed standard costs or actual sales are less than budgeted sales. *p. 351*

unit-level activities Actions taken (e.g., using direct materials or direct labor) each time a unit of product is produced. *p. 208*

unit-level costs Costs incurred with each unit of product made or single service performed; exhibit variable cost behavior; avoidable by not producing the unit of product or providing the service. Similarly, unit-level costs increase with each additional product produced or service provided. *p. 257*

upstream costs Costs incurred before beginning the manufacturing process, such as research and development costs. *pp. 13, 214*

value-added activity Any part of business operations that contributes to a product's ability to satisfy customer needs. *p. 24*

value-added principle The benefits attained (value added) from a process should exceed the cost of the process. *p. 5*

value chain Linked sequence of activities that create value for the customer. *p. 24*

variable cost Cost that in total changes in direct proportion to changes in volume of activity; remains constant per unit regardless of changes in activity volume. *p. 54*

variable cost volume variance The difference between a variable cost calculated at the planned volume of activity and the same variable cost calculated at the actual volume of activity. *p. 352*

variable costing Costing method in which only variable manufacturing costs are capitalized in inventory; all fixed costs, including fixed manufacturing overhead, are expensed in the period incurred. On a variable costing income statement, all variable costs are subtracted from revenue to determine contribution margin, then all fixed costs are subtracted from the contribution margin to determine net income. Under variable costing, production volume has no effect on the amount of net income. (Contrast with *absorption costing*.) *p. 501*

variances Differences between standard (budgeted) and actual amounts. *p. 351*

vertical analysis Financial analysis technique of comparing items within financial statements to significant totals. *p. 592*

vertical integration Maintaining control over the entire continuum of business activity from production to selling, such as a company owning both a grocery store and a farm. *p. 262*

visual fit line Line drawn by visual inspection on a scattergraph of data points to minimize the total distance between the data points and the line; used to estimate fixed and variable cost. *p. 70*

volume-based cost drivers Measures of volume such as labor-hours, machine-hours, or quantities of materials that are highly correlated with unit-level overhead cost; serve as appropriate bases for allocating unit-level overhead costs. *p. 204*

voluntary costs Discretionary quality costs incurred for prevention and appraisal activities. *p. 216*

weighted average method Means of computing equivalent units in a process cost system that accounts for the degree of completion of ending inventory only; ignores the state of completion of items in beginning inventory, accounting for them as if complete. *p. 550*

Work in Process Inventory Asset account used to accumulate the product costs (direct materials, direct labor, and overhead) associated with incomplete products that have been started but are not yet completed. *p. 486*

work ticket Mechanism (paper or electronic) used to accumulate the time spent on a job by each employee; sometimes called a *time card*. It is sent to the accounting department where wage rates are recorded and labor costs determined. The amount of labor costs for each ticket is summarized on the appropriate job-order cost sheet. *p. 538*

working capital A measure of the adequacy of short-term assets; computed as current assets minus current liabilities. *pp. 451, 594*

working capital ratio See *current ratio*. *p. 594*