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

available 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
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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
Glossary

**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. 803

**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. 802

**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 variance  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

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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.
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

Glossary
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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
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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 (R²) statistic The R² 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
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**Glossary**

**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. 356*

**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. *p. 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