

**Management Accounting**  
**Spring 2006**  
**Course Outline, Timetable, and Grading Schedule**

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### **Course Outline**

This course emphasizes the use of accounting information for *internal* planning and control purposes. This orientation contrasts with financial accounting where the focus is on accounting disclosures for parties *external* to the firm. However, we hasten to note that *internal* and *external* uses of accounting information share many similar characteristics. To better integrate the class with the financial accounting core, we will make a special effort to highlight the commonalities.

The course is intended for individuals who will make business decisions and evaluate the performance of business units using data obtained from the accounting system. Note that this could be internal parties such as the CEO, or external parties such as a raider trying to acquire the firm, or an investment bank analyst analyzing the cost savings of a potential merger.

The first part of the course covers the vocabulary and mechanics of cost accounting, issues involved in the design of a cost accounting system, and the role of management accounting in decisions concerning resource allocation. Included in this are discussions of capacity costs, inter-departmental allocations, and activity-based management in both manufacturing and service environments. We will pay particular attention to various (unintended) dysfunctional consequences of traditional accounting systems, as well as possible solutions to these problems.

The second part of the course examines the process of evaluating the performance of individuals, business units and firms. We will study the optimal choice of performance metrics for incentive purposes, and analyze the rationale behind the balanced scorecard. Included in this are issues related to transfer prices and measures of productivity. Finally, we examine how to forecast future cash flow and decide which project to implement. After having chosen a project and running it for a year, we will also conduct a post-mortem of last year's performance and see why results did not meet budgetary expectations.

The third part of the course revisits all the issues in a rather pell-mell set of cases. We will explore nonprofit settings, quality measurement issues, etc. The objective here is to refresh all the concepts we explored over the four months of the class.

## A Guide to Management Accounting

1. **Cost Concepts**
2. **Using Relevant Cost Information for:**
  - a. **Short-run Decision Making**
  - b. **Long-run Decision Making**
3. **Understanding Costing Systems:**
  - a. **Actual Costing Systems**
    - **The flow of Costs in a Manufacturing Firm**
  - b. **Cost Allocations**
    - **Their role in product costing and performance evaluation**
  - c. **Activity-Based Costing (ABC) approaches to product costing**
    - **Application of the ABC for customer profitability analysis**
  - d. **An integrative approach to ABC, standard costing, and capacity issues.**
4. **Performance Measurement:**

**The use of performance metrics for:**

  - i) **Communicating strategy**
  - ii) **Motivating corporate and divisional managers**
  - iii) **Inducing optimal inter-divisional transfers**
5. **Project Selection and Evaluation**
  - i) **Use budgets and forecasts to choose the right project.**
  - ii) **Use budgets and variances to check why actual outcomes deviated from forecasts.**
  - iii) **Who is responsible for these deviations?**
6. **Wrap up by Revisiting All Issues Discussed So Far**

## Timetable

A majority of students thus far have indicated that they were able to complete the cases without a text. What really appears to help is discussing the case with one's group. So in this sense the course is very corporate-like!

The OPTIONAL text for the class is Maher, Lanen, and Rajan *Fundamentals of Cost Accounting*, McGraw-Hill. This the text the day MBAs are using in their managerial accounting core. Bill Lanen is an awesome professor at the Michigan Business School, and Madhav Rajan was my Ph.D. advisor at Wharton, so I have full faith in this book.

That said, I myself find few differences among various management accounting texts. I learnt cost accounting from Kaplan and Atkinson, *Advanced Management Accounting*, Prentice Hall (KA). If you are short of cash, just go to the Kresge Library and check out any management accounting text. Or use the Web. The standard managerial accounting text by Horngren, Foster, and Datar, *Cost Accounting: A Managerial Emphasis* is priced at \$2.18 and up at [www.abebooks.com](http://www.abebooks.com)!

How to use the book? My suggestion is to use it like a tour guide. Read the case, and it will become obvious what portion of the book to read. I don't have the MLR book in hand, so I will indicate the relevant chapters from KA for those students who need more specific guidance.

### **Part I: Vocabulary and Mechanics of Cost Accounting**

The week of Jan 9

1. Introduction

Read the three articles "Bruce Willis", "Google Synergies", and "The Perils of Numeracy".

Background Reading: "Accounting for Manufacturing Companies," by S. Datar.

**Objective:** To introduce the role of accounting in general and management accounting in particular and discuss its evolution. Define and illustrate cost objects, direct costs, and indirect costs. Understand the associations between cost drivers, variable costs, and fixed costs, and the major assumptions underlying the definitions of variable and fixed costs. Review the concepts of contribution margin, breakeven point, and cost-volume-profit analysis.

The week of Jan 16:

MLK Day

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The week of Jan 23

2. Forrest Gump (DUE)
3. Stalcup (DUE)

The week of Jan 30

4. Forrester (DUE)
5. Wendy's (DUE)

**Objective:** Examine cost accounting issues in legal decisions and contracts using a case study involving cost behavior, profitability analysis, and the interface of financial, managerial, and tax accounting. Understand the notion of relevant costs and their use in simplifying the analysis of decision problems.

Describe the mechanics of cost accounting systems and the way they map cost flows. Distinguish between job costing and process costing, and relate their value to the nature of the underlying production process. Introduce cost allocation and the computation of overhead rates. (KA Ch 1)

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The week of Feb 6

6. Destin Brass (DUE)
7. Data Services (DUE)

Background Reading: "Time-Driven ABC," by R. Kaplan and S. Anderson.

**Objective:** Analyze a comprehensive problem set that offers a review of cost behavior, pricing and decision analysis. Understand the hierarchy of costs. Understand the differences between traditional cost systems and Activity-Based Costing (ABC). Apply ABC concepts in an actual decision-making context to understand the effect of cost accounting methods on perceived product profitability, and the use of ABC data in operational and marketing decisions. Extend the analysis to settings in which cash flows occur over multiple time periods. Understand the inability of most accounting systems to provide useful data for marketing or sales decisions. Examine the use of Activity-Based Costing for determining customer profitability. Discuss the application of customer profitability data to operational, marketing, and strategic decisions. (KA Ch 4)

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The Week of Feb 13

8. Bridgeton (DUE)
9. Chemical Bank: Balanced Scorecard (NOT DUE)

**Objective:** Complete our examination of techniques for analysis of long-run decisions by going through an illustrative case study. Further explore the nature of costs incurred by manufacturing firms. Finally, move to a discussion of using nonfinancial measures to measure firm operations. (KA Ch 2 and Ch 8)

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## Part II: Performance Evaluation and Control

The week of Feb 20

10. Lincoln Electric – expanding abroad (NOT DUE)  
Optional: Read “Lincoln’s Harsh Lessons from International Expansion
11. Western Chemical (DUE)

**Objective:** Understand how to design an organization. Introduce the reasons behind decentralization and understand the concept and various forms of responsibility accounting (i.e., your performance measure should reflect the job you are responsible for, i.e., you cannot compensate a janitor on firm-wide ROA). Analyze the determination of optimal provision of incentives. Examine more generally the nature of performance evaluation in business units and study some of its specific manifestations (ROI, EVA, etc.). (KA Ch 10)

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The week of Mar 6

12. Shuman Automobiles (DUE)
13. Chemical Bank: Allocation of Profits (DUE)

**Objective:** Look at various prevailing methods of transfer price determination, as well as the special import of transfer prices in the context of minimizing overall tax burdens. Study a decision-making setting in which responsibility accounting and performance measurement issues interact. Analyze the operation of business units using aspects of the variance framework. (KA Ch 9, but just the sections on Transfer Pricing)

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The week of Mar 13:

14. Project Selection and Investment (Lecture Notes attached)
15. McDonalds (DUE), Citibank Performance Evaluation (NOT DUE)  
Read: Notes on Executive Compensation (especially the GE proxy statement)

**Objective:** Understand how to forecast future cash flows from a project and decide whether to invest in that project or not. Note: Since we need some time to digest the lecture material, the case is assigned for next week. (KA Ch. 13)

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The week of Mar 20:

16. Purdue Pharma (DUE) plus Variance Analysis  
Background Reading: “The Mechanics of Variance Analysis,” by Bill Lanen.
17. Spiffy (DUE)

The week of Mar 27:

- 18. Mile High Bicycles (DUE)
- 19. Purity Steel (DUE)

**Objective:** Project planning requires forecasts. Once time passes, we need to understand why actual outcomes deviated from forecasts. Understand the functioning of standard costing systems. Introduce flexible budgets and standard costs as aids for planning and control. Learn how variances between actual and standard costs can be broken into price and efficiency variances to assist in assigning responsibility and examining the variances' causes. (KA Ch. 10 for Purity Steel)

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### Part III: Wrap up

The week of April 3:

- 20. Allied Stationery (DUE)
- 21. Texas Instruments (A&B) NOT DUE

**Objective:** Gain an appreciation for the issues involved in implementing an integrated system for costing, decision making, performance measurement and control. (KA Ch. 11)

### Exam and Grading Schedule

Each case counts for 15 marks. Cases are to be done in groups of 3-5 people, and turned in at the *beginning* of the class. I would like to receive printed answers in class rather than emails. Needless to say, I am happy to work around the rules should some unforeseen contingencies arise in your life. Many Asian students have both a Catholic name and an Asian name. Please make sure your name on your writeups matches the official records.

I will not be involved in the process of group selection. You can fire any member of your group at will. If you feel a group member has not contributed to a particular case, you can specify the number of marks to be deducted for that person from that case. Just note the penalty information in front of the case.

Given the large number of cases that you have to turn in, I have not yet thought of an exam schedule. We will go over this on the first day of class.

### Useful Books and Sources

1. *The Visible Hand* by Alfred Chandler (Business history professor at Harvard): Describing the rise and the structure of large corporate organizations in America, this book explains how professional managers came into being and gained influence over other people's money. Won the Pulitzer prize.

2. *Decentralization: Managerial Ambiguity by Design* by Richard Vancil. Remarkably insightful and informative book by an (old) HBS professor on how firms design and implement accounting and control systems.
3. *The New York Times Business Section*: Best to read it daily; short, yet comprehensive.
4. *Cost Accounting: A Managerial Emphasis* by C. Horgren, G. Foster, and S. Datar: Everything you wanted to know about cost accounting, especially terms and definitions, is in here, somewhere.
5. *Principles of Corporate Finance* by R. Brealy and S. Myers. Unbeatable for information on how to finance the firm's operations discussed in this class.