

GLOSSARY

A

Activity-based pricing Establishes a base price for a proposed customer order based on the estimated cost of producing and delivering the order.

Administered transfer price A transfer price set by some authority in the organization to price the exchange of a good or service between two organization units. For example, the general manager of a car dealership may set the price that the Service Department will bill other organization departments at 75% of the rate charged to external customers.

Applied indirect costs Indirect costs, such as the costs of capacity related resources, that are applied to a cost object.

Appraisal costs The costs related to inspecting materials or products to ensure that they meet both internal and external customer requirements.

Appropriations Planned and approved cash outflows, or spending plans, in government agencies.

Authoritative budgeting A budgeting process that occurs when a superior informs subordinates what their budget will be without requesting input.

Avoidable costs The costs that can be eliminated when a part, product, product line, or business segment is discontinued.

B

Balanced Scorecard A strategic management system that translates an organization's strategy into clear objectives, measures, targets, and initiatives organized by four perspectives.

Benchmarking The process of studying and adapting the best practices of other organizations to improve the firm's own performance and establish a point of reference by which internal performance can be measured.

Benchmarking (performance) gap The gap between actual performance and the performance level of the organization that established the benchmark level of performance.

Breakeven point The level of sales units or sales dollars at which the contribution from sales revenue less variable costs covers fixed costs. At the breakeven point, net income equals zero.

Breakeven time (BET) The length of time required for a new project to pay back its initial investment in research, development and engineering activities.

Budget A quantitative expression of the money inflows and outflows that reveal whether the current

operating plan will meet the organization's financial objectives.

Budgeting process The approach used to determine how to allocate financial resources to each part of an organization based on the planned activities and short-run objectives of that part of the organization.

C

Capacity cost rate The cost of supplying capacity for each group of similar resources, such as people and equipment; calculated by dividing the total cost of supplying the resources by their practical capacity, typically measured by the time available to perform productive work.

Capacity-related costs The costs associated with capacity-related resources.

Capacity-related resources Resources that are acquired and paid for in advance of when the work is done. Capacity-related resources provide the organization with the capacity to make or deliver goods and services.

Cash bonus A payment method that pays cash based on some measured performance. Also called lump-sum reward, pay for performance, or merit pay.

Certified suppliers A set of suppliers that are certified by a company because they are dependable and consistent in supplying high-quality items as needed.

Consultative budgeting A method of budget setting that occurs when managers ask subordinates to discuss their ideas about the budget but no joint decision making occurs.

Consumable resource A resource that is consumed as a result of some activity. Examples of consumable resources are wood used to make furniture and the time of an hourly paid worker who makes the furniture.

Continuous budget A budget that is continuously updated as the current period is dropped from the budget and a new period is added.

Contribution margin Sales less variable costs.

Contribution margin per unit The contribution margin per unit of consumption of a constraining factor of production. For example, the contribution per machine hour.

Contribution margin ratio The ratio of a product's contribution margin to its selling price. It is the fraction of each sales dollar that contributes to covering fixed cost and providing a profit.

Controllability principle States that the manager of a responsibility center should be assigned responsibility

only for the revenues, costs, or investments controlled by responsibility center personnel.

Conversion costs Costs of labor and support activities to convert the materials or product at each process stage.

Cooperative benchmarking The voluntary sharing of information through mutual agreements.

Cost-based transfer prices A cost-based transfer price occurs when the price of a good or service exchanged between two organization units is based on the costs incurred by the supplying (selling) organization unit. Cost based transfer prices reflect decisions about which elements of the product or services' cost should be included, such as fixed plus variable or just variable costs, standard or actual costs, and any mark-up over the transferred costs. For example, one cost-based transfer price might be standard variable cost plus a mark up of 34%.

Cost centers Responsibility centers in which employees control costs but do not control revenues or investment levels.

Cost driver A cost driver is an activity or variable that causes a cost. For example, increased production volume causes increased investment in production equipment and, in turn, higher levels of machine depreciation. The number of miles driven in a car is the cost driver for the cost of gasoline. The term *cost driver* is also used for the activity whose quantity is the denominator for a cost driver rate or predetermined overhead rate.

Cost driver rate The amount determined by dividing the activity expense by the total quantity of the activity cost driver.

Cost object Something for which a cost is computed. Examples of cost objects are a product, a product line, a department, a division, and a geographical area.

Cost of nonconformance (CONC) to quality standards The cost incurred when the quality of products and services does not conform to quality standards.

Cost of unused capacity The cost of unused capacity-related resources.

Cost-of-quality (COQ) report A report that details the cost of maintaining quality production processes and products. The report details prevention, appraisal, internal failure, and external failure costs.

Cost pool Each subset of total support costs that can be associated with a distinct cost driver.

Cost-volume-profit (CVP) analysis A study of how costs and profits vary with changes in volume.

Cross-functional product teams Made up of individuals representing the entire value chain, both inside and outside the organization, to guide the target-costing process.

Customer lifetime value (CLV) The total profits earned over all time periods of a customer's relationship

with the company; measured by subtracting the initial cost of acquiring the customer from the discounted sum of annual net profits during the years that the customer maintains a relationship with the company; often, CLV is estimated prospectively for newly-acquired customers.

Customer loyalty A measure of the ability of the company to retain existing customers; loyalty can be measured in multiple ways, such as percentage of repeat customers, year-to-year growth in sales with existing customers, and a customers' willingness to recommend the company to other potential customers.

Customer management processes Processes that select, acquire, retain, and deepen relationships with targeted customers.

Customer perspective The Balanced Scorecard perspective that identifies objectives and measures for the targeted customer segments, and for the value proposition for customers in these segments.

Customer satisfaction A measure of how a customer views its current relationship with the company, usually evaluated on a scale where one end represents "extremely satisfied with the relationship," and the other end is "extremely dissatisfied."

Cycle time The chronological time taken to complete an activity. For example, manufacturing cycle time is the time from start to finish taken to produce a product.

D

Data falsification The process of knowingly altering company data in one's favor.

Database benchmarking A policy in which companies usually pay a fee and in return gain access to information from a database operator.

Death spiral The process by which a company goes out of business through calculating unit cost by allocating overhead to a diminished volume of business, raising prices to cover the high unit costs, losing more business because of higher prices, calculating higher unit costs, setting higher prices to cover them, and, eventually, having no business and very high unit costs.

Decentralization The process of delegating decision-making authority to front line decision makers.

Diagnostic control systems Formal information systems that managers use to monitor organizational outcomes and correct deviations from standard measures of performance.

Direct cost A cost of a resource or activity that is acquired for or used by a single cost object. An example is the cost of leather used to make a leather coat.

Direct labor cost Direct labor cost refers to the wages paid to workers whose time can be traced reasonably

and accurately to a single cost object, usually a product.

Direct materials cost The cost of materials that can be traced reasonably and accurately to a single cost object, usually a product.

Direct method (for service department allocations) A method of allocating service department costs that only considers service units provided to production departments (thereby ignoring service units provided to other service departments).

Dysfunctional behavior Occurs when employees knowingly manipulate or falsify performance measures.

E

Earnings management Methods by which managers knowingly manipulate the reporting of income.

Economic value added (EVA®) An estimate of the wealth increment to owners from the current years' operations; measured as adjusted accounting income minus estimated cost of capital for the investment level.

Efficiency (quantity) variance The difference between the amount of a resource used and the amount allowed, given the level of production, costed at the standard cost of the resource.

Employee self-control A managerial method in which employees monitor and regulate their own behavior and perform to their highest levels.

Environmental costing A costing system that calculates the costs that an organization imposes on the environment.

Equivalent unit of production In process costing, calculated by multiplying the number of partially completed units by the percentage of completion.

Ethical control system A management control system to ensure and provide evidence that the organization's stated and practiced ethics are the same.

External failure costs The costs incurred when customers discover a defect.

Extrinsic rewards Rewards that are given by one person to another to recognize a job well done. Examples include: money, recognition in a corporate newsletter, stock options, or congratulations.

F

Financial accounting The process of producing financial statements for external constituencies—such as shareholders, creditors, and governmental authorities.

Financial budgets Budgets that identify the expected financial consequences of the activities summarized in the operating budgets.

Financial control A process used to assess an organization's success by measuring and evaluating its financial outcomes.

Financial perspective The Balanced Scorecard perspective that focuses on financial measures of an organization's success, such as return on investment and operating income.

Finished goods inventory The costs of the resources for completed units that are not yet sold.

First-level variance Difference between the actual costs and the master budget costs for individual cost items.

Fixed cost The cost that is associated with capacity-related resources. The amount of fixed costs is related to the planned rather than the actual level of activities.

Fixed manufacturing overhead Fixed manufacturing overhead refers to the cost of providing production capacity in a factory. Depreciation on factory equipment is an example of fixed manufacturing overhead.

Flexible budget Reflects a cost budget or forecast based on the level of volume that is actually achieved.

Flexible budget variances Differences between actual costs and the budget level of costs adjusted for the actual level of activity.

Flexible resources Resources whose use is proportional to the amount of the resource used. An example of a flexible resource is steel in a steel mill.

Floor price The floor price is the minimum price that a party to a negotiation will accept.

G

Gain sharing A system for distributing cash bonuses from a pool when the total amount available is a function of performance relative to some target.

Gaming the performance indicator An activity in which an employee may to ensure and provide evidence that the organization's stated and practiced ethics are the same.

Goal congruence The outcome when managers' and employees' goals are aligned with organizational goals.

Group benchmarking A business alternative in which participants meet openly to discuss their methods.

Group technology A type of facility layout in which a manufacturing plant is divided into cells. Within each cell all machines required to manufacture a group of similar products are arranged in proximity to each other. This approach is sometimes called cellular manufacturing.

H

Human relations movement A managerial movement that recognizes that people have needs well beyond performing a simple repetitive task at work and that financial compensation is only one aspect of what workers desire.

Human resources model of motivation (HRMM) A contemporary managerial view that introduces a high level of employee responsibility for and participation in decisions in the work environment.

I
Improshare A gain sharing program that determines its bonus pool by computing the difference between the target level of labor cost given the level of production and the actual labor cost.

Incentive compensation A reward system that provides monetary rewards based on measured results. Also called a pay-for-performance systems.

Incremental budgeting A budgeting process that bases a period's expenditure level for a discretionary item on the amount spent for that item during the previous period.

Incremental cost The amount by which the total costs of production and sales increase when one additional unit of a product is produced and sold.

Indirect cost The cost of a resource that organizations acquire to be used by more than one cost object. An example is the wage paid to a supervisor in a factory that makes different products when the cost object is a product.

Indirect materials Indirect materials are consumable resources that are too costly to trace to individual cost objects. Examples of indirect materials are lubricants used in a factory and office supplies used in a consultancy.

Indirect/third-party benchmarking A technique that uses an outside consultant to act as a liaison among firms engaged in benchmarking.

Innovation processes Processes that develop new products, processes, and services.

Interactive control systems Formal information systems managers use to involve themselves regularly and personally in the decision activities of subordinates.

Internal failure costs The costs incurred when the manufacturing process detects a defective component or product before it is shipped to an external customer.

Internal financial control Application of financial control tools to evaluate organization units, with the resulting information used internally and not distributed to outsiders.

Intrinsic rewards Those rewards that come from within an individual and reflect satisfaction from doing the job and the opportunities for growth that the job provides.

Investment The monetary value of the assets that the organization gives up to acquire a long-term asset.

Investment centers Responsibility centers in which the managers and other employees control revenues, costs, and the level of investment in the responsibility centers.

J
Job order costing A process that estimates the costs of manufacturing products for different jobs required for specific customer orders.

Just-in-time (JIT) manufacturing A production process method in which products are manufactured only as needed.

K
Kaizen costing A costing system that focuses on reducing costs during the manufacturing stage of the total life cycle of a product.

L
Lean manufacturing An approach to manufacturing in which any resource spending that does not create value for the end customer is considered wasteful and should therefore be modified or eliminated.

Learning and growth perspective The Balanced Scorecard perspective that identifies the objectives for employee capabilities, information systems, and organizational climate that will create long-term growth and improvement.

M
Make-or-buy decision A decision in which managers must decide whether their companies should manufacture some parts and components for their products in-house or subcontract with another company to supply these parts and components.

Management accounting The process of supplying managers and employees with financial and nonfinancial information for making decisions and allocating resources, consistent with the strategy, and monitoring, evaluating, and rewarding performance.

Management accounting and control system (MACS) A system that generates and uses information that helps decision makers assess whether an organization is achieving its objectives. The system includes the set of procedures, tools, performance measures, systems, and incentives that organizations use to guide and motivate all employees to achieve organizational objectives. The system also incorporates the plan-do-check-act cycle.

Managing customer relationships The process by which companies choose to improve a customer's profitability by changing policies with it on pricing, discounting, promotions, minimum order size, degree of customization, packaging, and delivery.

Manufacturing overhead cost Manufacturing overhead costs refers to all factory costs that are not considered direct materials or direct labor. Examples of manufacturing overhead costs include depreciation on factory equipment, supervision, utilities, and the cost of supplies such as lubricants.

Manufacturing stage The time periods when a product is produced and distributed to customers; in contrast to the research, development, and engineering stage or the post-sales service and salvage stages.

Market-based transfer prices Transfer prices that are set based on the market price of the good or service transferred between two organization units.

Marketing, selling, distribution, and administrative (MSDA) expenses Generally one or more line items in a standard income statement, below the gross margin line, that include the cost of resources devoted to marketing and selling to customers, distributing products and services to them, and for order handling, credit, invoicing and collections.

Master budget A budget, typically prepared on a yearly basis, that includes operating budgets (for example, sales, purchasing, and production) and financial budgets (for example, balance sheets, income statements, and cash flow statements) that identify the expected financial consequences of the activities reflected in the operating budgets.

Measures Descriptions of how success in achieving Balanced Scorecard objectives will be determined.

Mixed cost A cost that includes fixed and variable components. A mobile telephone bill that includes a basic fixed amount each month and a variable amount that reflects the amount of use is an example of a mixed cost to the consumer.

Monitoring Inspecting the work or behavior of employees while they are performing a task.

Motivation An individual's interest or drive to act in a certain manner.

N

Negotiated transfer price A negotiated price for a good or service transferred between two organization units. For example, after some discussion, the manager of the used car department in an automobile dealership might agree to pay the manager of the new car department \$10,000 for a car that was traded in during a new car purchase.

Net promoter score (NPS) A popular customer loyalty metric, measured by the percentage of customers highly willing to recommend the company's product or service less the percentage of customers unwilling to make such a recommendation.

Nonfinancial information Information about a process (such as percent good units produced), a product (such as time taken to fill order), or a customer (such as customer satisfaction) that is not based on information developed in the financial accounting system and is relevant in monitoring the organization's performance on objectives.

Nonfinancial measures of innovation Measures such as number of new products introduced, number of

new products co-created with customers, time-to-market, breakeven time, and % of product development milestones achieved, that evaluate the performance of a company's innovation process.

O

Objectives Concise statements in each of the four Balanced Scorecard perspectives that articulate what the organization hopes to accomplish.

Operating budget The document that forecasts revenues and expenses during the next operating period, including monthly forecasts of sales, production, and operating expenses.

Operating costs Costs, other than direct materials costs, that are needed to produce a product or service.

Operations management processes The basic, day-to-day processes by which companies produce their products and services and deliver them to customers.

Opportunity cost The maximum value sacrificed when a course of action is chosen.

Outsourcing The process of buying resources from an outside supplier instead of manufacturing them in-house.

P

Participative budgeting A method of budget setting that uses a joint decision-making process in which all relevant parties agree about setting the budget targets.

Pay-for-performance system Reward system that provides monetary rewards based on measured results. Also called incentive compensation.

Periodic budget A budget that is prepared for a given period, such as a quarter or a year.

Plan-do-check-act cycle A method of budget setting that uses a joint decision-making process in which all relevant parties agree about setting the budget targets.

Planning variance The difference between the planned and flexible budget amount.

Postsale service and disposal stage The portion of the life cycle that begins after the customer has received the product.

Practical capacity The maximum amount of work that can be performed by resources supplied for production or service.

Predetermined overhead rate A predetermined overhead rate, sometimes called a normal overhead rate, is computed by dividing an expected amount of overhead by the quantity of the cost driver that will be used to apply overhead to cost objects. For example, if expected overhead is \$1,000,000, the cost driver is machine hours, and the quantity of machine hours is 10,000, then the predetermined overhead rate is \$100 per machine hour.

Prevention costs The costs incurred to help ensure that companies produce products according to quality standards (that is, prevent poor quality).

Preventive control An approach to control that focuses on preventing an undesired event.

Price (rate) variances The difference between the amount paid for a resource and the amount that would have been paid if the resource had been purchased at its standard price.

Pricing waterfall A visual representation of all the subtractions, due to discounts, promotions, and allowances, from the list price of a product or service. The pricing waterfall equals the difference between the list price and the cash the company actually receives from the customer for the product or service.

Pro forma financial statements The projected statement of cash flows, balance sheet, and income statement.

Process costing A costing system that computes the cost of each manufacturing process used to make a product.

Process layout A production design in which all similar equipment or functions are grouped together.

Process perspective The Balanced Scorecard perspective that describes how a strategy will be executed. It identifies the operating, customer management, innovation, and regulatory and social processes that are most important to meet the expectations of shareholders and customers.

Processing cycle efficiency (PCE) A measure used to assess the efficiency of a process, the ratio of actual processing time to total elapsed time for the process.

Processing time The time expended to complete a processing activity.

Product layout A production design in which equipment is organized to accommodate the production of a specific product.

Productivity The ratio of outputs produced to inputs consumed.

Profit centers Responsibility centers in which managers and other employees control both the revenues and the costs of the product or service they deliver.

Profit sharing A cash bonus calculated as a percentage of an organization unit's reported profit; a group incentive compensation plan focused on short-term performances.

Project funding A proposal to spend discretionary expenditures with a specific time horizon or sunset provision.

Q

Quality costs The costs incurred on quality-related processes, including *prevention, appraisal, internal failure, and external failure*.

Quality function deployment (QFD) matrix A tool that is typically used for systematically arraying

information about the variables of features, functions, and competitive evaluation in a matrix format.

Quantity (efficiency) variances The difference between the amount of a resource used and the amount allowed, given the level of production, costed at the standard cost of the resource.

R

Rate (price) variance The difference between the amount paid for a resource and the amount that would have been paid if the resource had been purchased at its standard price.

Reciprocal method (for service department allocations) A method of allocating service department costs that considers the services provided both to other service departments and to production departments.

Regulatory and social processes Processes that promote meeting or exceeding standards established by regulations and facilitate achievement of desired social objectives.

Relevant cost A cost that changes as a result of making a decision, or a cost that differs between two decision alternatives. For example, the cost of a new piece of production equipment and its operating costs are relevant costs when considering whether to replace an existing piece of equipment with the new one. When considering which of two pieces of production equipment to purchase, the difference between their purchase prices and their operating costs are relevant costs.

Remediation The end-of-life cycle cost to restore a resource, such as water or land, to its original condition after using it for a production process.

Research, development, and engineering (RD&E) stage The first stage of a product's life-cycle in which market research, product design, and product development are performed.

Residual income An accounting-based measure of the increase in shareholder wealth resulting from current operations. Measured as accounting income minus the economic cost of the investment used to generate that income.

Responsibility center An organization unit for which a manager is made responsible.

Results control The process of hiring qualified people who understand the organization's objectives, telling them to do whatever they think best to help the organization achieve its objectives, and using the control system to evaluate the resulting performance, thereby assessing how well they have done.

Return on investment The ratio of net income to invested capital.

Revenue centers Responsibility centers whose members control revenues but do not control either the manufacturing or the acquisition cost of the product

or service they sell or the level of investment made in the responsibility center.

Rucker plan A form of gainsharing program.

S

Sales mix variance A difference between planned and actual revenue caused by a difference between planned and actual product mix.

Sales price variance A difference between planned and actual revenue caused by a difference between planned and actual prices for one or several products.

Sales quantity variance A difference between planned and actual revenue caused by a difference between planned and actual quantity levels.

Salesperson incentives The contingent payments awarded to salespeople based on actual sales performance, such as quantity or dollars of sales they generated, or the profits earned from their selling activities to customers.

Scanlon plan A form of gain-sharing program.

Scientific management school A management movement with the underlying philosophy that most people find work objectionable, that people care little for making decisions or showing creativity on the job, and that money is the driving force behind performance.

Second-level variances Variances that include both a planning variance and a flexible budget variance that sum to the first-level variance.

Segment margin report An accounting-based measure of the profit contribution of an organization unit to the overall organization.

Sensitivity analysis The process of selectively varying a plan's or a budget's key estimates for the purpose of identifying over what range a decision option is preferred.

Sequential method (for service department allocations) A method of allocating service department costs that proceeds by choosing the order in which the service departments will allocate their costs and then proceeding sequentially through the chosen order.

Share of wallet Percentage of a customer's spending in a given product or service category that a company captures; for example, a retail clothing store could measure that percentage of a customer's wardrobe that it sells to her, a bank could measure the percentage of a customer's assets it holds or credit sales that it processes.

Smoothing The act of affecting the preplanned flow of information without altering the organization's activities.

Step variable cost A step variable cost is a cost that changes in steps as some underlying volume of activity changes. For example the cost of a train of freight cars will increase in steps as the capacity of each car is exceeded and another car gets added to the train.

Stock option The right to purchase a unit of the organization's stock at a specified price, called the option price.

Strategy Describes how a company will gain competitive advantage by being different or better than its competitors. Examples of strategies include low cost, complete customer solutions, and product leadership.

Strategy map A comprehensive visual representation of the linkages among objectives and measures in the four perspectives of the Balanced Scorecard.

Sunk cost phenomenon The sunk cost phenomenon refers to decision making that is influenced or driven by a previous expenditure or decision. For example, an investor who refuses to sell a share which was purchased for \$10 and is now selling for \$5 solely because the current price is less than the purchase price is exhibiting the sunk cost phenomenon. From an economic perspective, decision making behavior driven by the sunk cost phenomenon is irrational.

Sunk costs The costs of resources that already have been committed and cannot be changed by any current action or decision; contrast with *incremental costs*.

Supply chain management A management system that develops cooperative, mutually beneficial, long-term relationships between buyers and sellers.

T

Target The level of performance or rate of improvement required for a Balanced Scorecard measure.

Target cost The difference between the target selling price and the target profit margin.

Target costing A method of cost planning used during the research, development, and engineering stage to reduce manufacturing costs to targeted levels.

Task control The process of developing standard procedures that employees are told to follow.

Theory of constraints (TOC) A management approach that maximizes the volume of production through a bottleneck process.

Third-level variances Variances that include quantity and price variances that sum to, and therefore explain, the flexible budget variances.

Throughput contribution The difference between revenues and direct materials for the quantity of product sold.

Time-driven activity-based costing (TDABC) A new ABC variant that is simple and more powerful since it requires estimating only two parameters: the cost of supplying resource capacity and the quantity of capacity consumed by each transaction, product, and customer. It enables a much simpler ABC model to capture even highly complex operations through the use of time equations.

Time equation An algebraic representation that predicts the quantity of processing time based on specific order and activity characteristics.

Total-life-cycle costing (TLCC) Describes the process of managing all costs during a product's lifetime.

Transfer pricing The set of rules an organization uses to assign prices to products transferred between internal responsibility centers in order to allocate jointly earned revenue among responsibility centers.

U

Unilateral (covert) benchmarking A process in which companies independently gather information about one or several other companies that excel in the area of interest.

V

Value engineering process The process of examining each component of a product to determine whether its cost can be reduced while maintaining functionality and performance.

Value index The ratio of the value of a component to a customer and the percentage of total cost devoted to the component.

Value proposition Clear and short statement of competitive value that the organization will deliver to its target customers—how it will compete for, or satisfy, customers.

Variable costs The costs of flexible resources.

Variable overhead In a manufacturing context, the cost of items that are actually direct costs but are too immaterial (in relation to total product cost) to

trace to individual cost objects. Examples include the cost of glue used to make each piece of furniture, thread for a garment, machine electricity usage, and machine supplies.

Variance The difference between an actual amount and a target or planned amount.

Variance analysis A set of procedures managers use to help them understand the source of variances.

W

Whale curve A plot of cumulative profitability versus the percentage of customers, where customers are ranked from the most profitable to the least profitable. In a typical whale curve, the most profitable 20 percent of customers generate between 150 and 300 percent of the company's profits. The unprofitable customers incur losses that cumulatively bring the company's profits down to 100 percent.

What-if analysis A process of exploring the effects of changes in estimates on predictions in a financial model.

Work-in-process inventory The costs of the resources for production not yet completed.

Z

Zero-based budgeting (ZBB) A budgeting process that requires proponents of discretionary expenditures to continuously justify every expenditure.