

Cost terms and concepts essay sample



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In this module you will have an opportunity to demonstrate your understanding of cost terms and their application in the aviation industry.

For this Case Study complete the four requirements below:

1. ABC Airlines has determined both the fixed and variable costs per flying hour associated with flying each of the 10 different types of aircraft in their fleet. How might this type of information be useful in determining the costs associated with flying different aircraft on specific routes?

Knowing the variable and fixed per flying hour costs associated with each of ABC's 10 airframes is extremely useful. Fixed costs are straight forward. Variable costs are defined as those costs that vary with aircraft usage. As the aircraft usage increases, the variable cost will increase as well. The cost per unit stays the same. For example, the more an airplane flies, the higher the total fuel cost will be. Therefore, fuel is a variable cost. Common examples of variable costs include: Fuel, Oil, Landing Fees, and Catering. Therefore, by being able to calculate the variable costs and adding them to the known fixed costs, ABC can select the most cost effective airframe solution for a given route.

For example, flying a large capacity plane on a lower demand traffic route proves to be quite inefficient, once all variable operational costs are calculated. 2. You are a management analyst for XYZ aircraft manufacturing company. Your company is considering either to purchase or lease manufacturing equipment. Identify, discuss, and be specific on five differential costs that might exist between the two options. You can develop

any assumptions you want for either alternative, but if you do, they should be explained.

Differential cost is the difference between the cost of two alternative decisions, or of a change in output levels. Additionally, the differential cost can be a fixed cost or variable cost. One differential cost between leasing or purchasing the equipment is depreciation. Accumulated depreciation needs to be taken into account when determining between the two options. The depreciation of leased equipment has no relevance to XYZ. At the end of the leased term, regardless the value of the equipment, XYZ has the option to simply walk away. If the equipment is purchased, XYZ has to consider the usable life of the equipment, coupled with its rate of depreciation.

Another differential cost between the two options is incurred repairs. With leased equipment, the leasing company is likely responsible for any scheduled maintenance costs or malfunctions with the equipment. If XYZ purchases the manufacturing equipment then they are responsible for those repair costs. Yet another differential costs is the associated cost of insurance required on the manufacturing equipment. If the equipment is leased, XYZ would likely not be responsible with paying insurance to safeguard the cost of the equipment in the event of a catastrophic loss. If XYZ choose to purchase the manufacturing equipment, this differential cost is their liability.

Despite these advantages to leasing, it does have its drawbacks, the biggest disadvantage of leasing is that your differential costs over the life of the asset are generally going to be higher than if you purchased the asset. This is because your leased payments must compensate the lessor not only for

acquisition and financing costs, but also for the lessor's retained risk of continuing ownership. Another potential disadvantage of leasing is losing the tax benefits of depreciation deductions that come with ownership. However, this differential cost may be insignificant, if the "lost" benefits are offset by your ability to deduct your rental payments or if you have insufficient income or tax liability to be offset by the lost deductions and credits.

3. List and discuss three costs that are likely to be controllable by a city's airport manager. List three costs that are likely to be uncontrollable by the manager. Controllable costs

Energy Consumption - The amount of energy, primarily electricity, used by an airport is one cost that has become increasingly controllable. By investing in energy efficient climate conditioning systems, areas of an airport that have become underutilized due to a reduction in traffic, can now be cordoned off to in a manner that preserves the area without wasting energy.

Operating Expenses - Fluctuations in passenger traffic is directly relational to fluctuation in the expenses incurred to support or not support that traffic.

The largest component of operating expenses is personnel costs, followed by contracted services. Knowing this, one way an airport can cushion for these differences is to increase its focus on generating more Non-Airline revenues.

Regardless of the amount of traffic that passes through the airport, that organization should be trying to get the most out of each passenger that passes through its gates. Preventative Maintenance Costs - The adoption of a through preventative maintenance program will provide tremendous cost savings to any organization. Such a program has a predictable cost that will

save the airport much more than if the program did not exist. Uncontrollable costs

Safety and Security Enhancements - There are the fixed costs of meeting regulatory requirements, such as safety and security. A large proportion of these costs are not really controllable in that they are imposed by the very nature of the business. Fuel Costs - At either \$100 a barrel or at \$50, the cost of fuel will always be out of the control of the airport manager. The revenues gained by the airport, through its supply are a factor of the margin at which that fuel can be provided. Unscheduled Maintenance - This cost is by definition uncontrollable, as well as unpredictable. While a stringent preventative maintenance program will reduce the amount unscheduled mishaps, this area is subject to large swings in costs. For example, an airport straddled with a record-breaking winter season, could expend a very large portion of its maintenance budget, clearing runways and taxiways from piling snow and ice. 4. Refer to Problem 2-43 at the end of Chapter 2. Build or use an existing Excel Spreadsheet and complete requirements 1 and 2. The spreadsheet must accompany the submission. 1. Prepare Laredo Luggage's schedule of cost of goods manufactured for the year.