

And discuss the differences between variable and fixed costs and provide examples...



Fixed and variable costs: The total overhead expense of a company comprises mainly of two components. They are the fixed and the variable components. The fixed components of the expense are the ones which remains fixed at all levels of the production. Such costs, which are called as fixed costs, do not vary with the change in production level or sales volume such as rent, insurance, dues and subscriptions, equipment leases, payments on loans, depreciation, management salaries, and advertising. On the other hand, the variable components of the expense, in other words, called as the variable costs, are those that vary accordingly to the changes in production level or volume. Such costs become directly proportional to the change in activity level such as raw materials, hourly wages and commissions, utilities, inventory, office supplies, and packaging, mailing, and shipping costs. (TaHERi et al. 2000; Besanko et al. 2010)

Fixed costs are said to be fixed irrespective of the change in production level. But they might change overtime. Hence, they are sometimes referred to be as Period costs. Sometimes it happens that fixed costs are incurred at the discretion of the management of a company, such as advertising and promotional expense, while other costs are not incurred in such situations. It is important to remember that all non-discretionary fixed costs will be incurred even if production or sales volume falls to zero. Although production and sales volume are the main factors determining the level of variable costs incurred by a company, these costs also may vary in relation to other factors, such as changes in prices fixed by the suppliers or seasonal promotional efforts. Some expenses may have both fixed and variable elements. As for example, a company may pay a sales person a monthly salary, which is considered to be as a fixed cost, plus a percentage

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commission for every unit sold above a certain level, which is considered to be as a variable cost. (Seo, 1991; Aryasri, 2007)

One must take into note the different type of costs incurred as there happens to be an increase in the production or sales volume. Total fixed costs remain unchanged as volume increases, while fixed costs per unit falls. On the other hand, variable costs behave differently. Total variable costs increase proportionately as volume increases, while variable costs per unit remain unaltered. (Seo, 1991)

As for instance, in the healthcare industry, allocation of various elements of cost to the trauma service are based on applying various cost accounting standards and statistics to data from the general ledger, billing, and payroll systems. Costs are categorized as variable direct, fixed direct and indirect costs. The total cost of a patient care encounter is defined as variable direct plus fixed direct plus indirect cost. Hospital overhead is defined as the sum of fixed and indirect costs. Variable direct costs are those that vary with patient activity, such as laboratory tests, medications, surgical supplies, and nursing expenses. Fixed direct costs can be identified with the trauma service but do not vary with patient activity like trauma nurse coordinator, data registrar, and administrative salary of the trauma surgeon. Examples of a fixed direct expense are the salaries of some office and administrative staff, such as the head nurse. Equipment and maintenance-related expenses can be allocated as a fixed cost. In addition, facilities, building lease expense, utilities, and off-site leasehold expense can be taken as fixed costs. (Taheri et al. 2000)

Indirect costs are hospital costs that cannot be recognized with a particular patient or a particular unit of the hospital. Indirect costs are those costs that <https://assignbuster.com/and-discuss-the-differences-between-variable-and-fixed-costs-and-provide-examples-of-both/>

are incurred by non-revenue-producing areas of the hospital that must be allocated over all clinical revenue-producing departments. Examples of indirect expenses that are allocated over the various departments are hospital financial services, information technology, and plant operations maintenance expense. All these services are charged back to the various departments which depend on the respective services provided. (Taheri et al. 2000; Besanko et al. 2010)

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