

Cost accounting module assignment

Business



Several methods are developed to allocate joint costs to joint products. By-products are not usually allocated any of the joint costs. Instead, noncost methods are frequently used to account for by-products. This chapter concludes with the caution that allocated joint costs are not useful for output and pricing decisions. Further processing costs are used in management decision making.

I. General Characteristics of Joint Production

Joint products are two or more products produced simultaneously by the same process.

Joint products become separate and identifiable at the split-off point.

A. Cost Capability and the Need for Allocation

1. Joint costs are the total of the raw material, labor, and overhead costs incurred up to the initial split-off point.

A. Joint costs can be allocated to the final product only in some arbitrary manner because such costs cannot be traced directly to the products they benefit.

B. Joint cost allocation is performed to meet the requirements of financial reporting (GAAP) and federal income tax law for income measurement and inventory valuation.

In addition, joint cost allocation is useful in costing for government cost-type contracts and in justifying prices for legislative or administrative regulations.

C. Joint cost allocation is much less useful for cost control and managerial decision making.

2. Separable costs are those costs incurred after the split-off point; they can be easily traced to individual products.

B. Distinction and Similarity between Joint Products and By-Products

1. The distinction between joint products and by-products rests solely on the relative importance of their sales value.

. A by-product is a secondary product whose total sales value is relatively minor in comparison with the sales value of the main product (joint product).

3. Relationships between joint products and by-

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products change over time as technology and markets change. A. By-products may become more and more important, eventually becoming joint products. B. When the relative importance of individual products changes, the products need to be reclassified and the costing procedures need to be changed. II. Accounting for Joint Product Costs A. Introduction 1.

Joint cost allocations must be done for financial reporting purposes: to value inventory and to determine income. An allocation method must be found, though arbitrary, to allocate the joint costs as reasonably as possible. 2. The joint cost allocation approaches include the following: a. Benefits-received approaches, which include the following methods: Physical units method Weighted average method b. Allocation based on the relative market value, using the following methods: Sales-value-at-split-off method Net realizable value method Constant gross margin percentage method Sales-to-production-ratio method B.

Benefits-Received Approaches 1. Physical Units Method a. Under the physical units method, units of physical output, such as heat content, volume, or weight, that measure the benefits received are used to distribute joint costs. This method allocates to each joint product the same proportion of joint costs as the underlying proportion of units. Example: Manufacturers of forest products use the physical units method to apply the average conversion cost to all finished products, regardless of their type, grade, or market value. B.

Disadvantages of the physical units method include the following: It ignores the fact that not all costs are directly related to physical quantities. It may result in incorrect managerial decisions because high profit may be reflected

from the sale of high-grade products, with low profit or losses reflected from the sale of low-grade products. 2. Weighted Average Method The weighted average method uses the weight factors to include such diverse elements as amount of material used, difficulty to manufacture, time consumed, difference in type of labor used, and size of unit.

Weighted physical units Number of units x Weight factor Example: The canning industry uses weight factors to distinguish between can sizes or quality of product. The weighted average method allocates relatively more of the joint cost to the high-grade products because they represent more desirable and profitable products. C. Allocation Based on Relative Market Value The methods in this approach try to assign costs based on the product's ability to absorb joint costs. They are based on the assumption that the joint costs would not be incurred unless the products yield enough revenues to cover all costs plus a reasonable profit.

The relative market value approach of allocation is better than the physical units approach if (1) the physical mix of output can be altered by incurring more (or less) total joint costs, and (2) this alteration produces more (or less) total market value. 1. Sales-Value-at-Split-Off Method a. The sales-value-at-split-off method allocates joint cost based on each product's proportionate share of market or sales value at the split-off point. B. In this method, the higher the market value, the greater the joint cost signed to the product. 2. Net Realizable Value Method a.