Free cost of production, interaction of sales-costs and classification of control...

Business, Management

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Computation of Variable and Fixed Cost Elements

For performing the managerial accounting analysis to compute the variable and fixed cost elements by using a high-low method, the following table is considered which reveals that the actual quantity of units produced and the total cost incurred to produce them:

Variable Cost per Unit = Change in the total cost of the two production activities

Change in the total production activity

Variable Cost per Unit = Total Cost Higher Activity - Total Cost Lower Activity

Units Produced Higher Activity - Units Produced Lower Activity

= ($14, 940 - $11, 200) / (10, 000 - 7, 100) = $3, 740 / 2, 900

Variable Cost per Unit = $1. 289 per unit

Total Fixed Cost is calculated as follows:

Total Cost Higher Activity – (Variable cost per unit × Units Produced Higher Activity) = Total Cost Lower Activity – (Variable cost per unit × Units Produced Lower Activity)

= $14, 940 – ($1. 289 × 10, 000) = $11, 200 – ($1. 289 × 7, 100)

= ($14, 940 – $12, 890) = ($11, 200 – $9, 152)

Total Fixed Cost = $2, 050

Cost Volume Formula = $2, 050 + $1. 289x

Estimation of the Total Cost

Cost Volume Formula = $2, 050 + $1. 289x

= $2, 050 + ($1. 289 × 8, 000) = $2, 050 + $10, 312

Total Cost= $12, 362

Issues and Problems Created By Revenue and Cost Interaction

For any successful organization to operate, it is necessary to mention the level at which it will witness no profit and no loss situation in financial statements . Such a situation is normally known as a breakeven point which is an actual interaction of sales revenue generated by an organization and the total cost of production . Problems and issues arise when the produced and sold number of items is less than such a no profit and no loss point. In such circumstances, organizations would have to bear the burden of increasing operating losses and has to cover fixed as well as variable costs without generation of any additional revenue . The management of every organization faces numerous issues and problems to achieve a point where its revenue is somehow equivalent to its costs that no loss is incurred for which financial managers perform Cost-Volume-Profit (CVP) Analysis.

Classification of Control Systems

In any organization, particularly manufacturing concerns, there are numerous cost controls effective to keep operations running smoothly and costs at an optimal level to earn sustainable profits. The management of any business entity should implement an effective cost control system which is tailored to achieve organizational objectives and vision. At the production floor, one of the effective control systems is the introduction of strict cost control due to costs and their drivers are divided into variable and fixed costs. They are further distinguished among categories like direct, indirect and overheads. This way, production managers determine and classify different costs and determine if they are affordable and reasonable.

Apart from this, production managers employ inventory management control systems (like Just-in-Time) concept to order inventories the time when a certain level is reached to place a new order with suppliers . Third kind of effective cost control is the use of proper pricing system (e. g. Activity Based or Traditional Costing) where strict cost controls are implemented to maximize the earning capacity.

In addition to the control systems mentioned above, managers in other departments also employ some tight internal control systems which definitely not only affect the production floor but at the bottom line of financial statements as well. One type of such an effective internal control is the segregation of duties where every employee is designated a specific responsibility whose execution is confirmed by other personnel. Not a single employee is given multiple managerial powers or responsibilities at the same time. This is particularly important in case of finance and accounting department to discourage fraudulent activities (e. g. theft), avoid human errors and any sort of wrongdoing etc .

In every organization, there are basically four areas where effective control systems should be implemented. These include management of physical, human, financial and information resources. Control systems can be implemented at different levels like strategic, financial, structural and operational levels. The classification of control systems mentioned in this section are tailored to limit the accumulation of any error, minimize costs, adopt the changing business environment and dealing with different organizational complexities.

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