

Cost descriptors essay



Introduction This paper will clarify the various terms used to describe costs, such as fixed, variable, direct, indirect, and sunk, giving examples of each to help a good understanding of current budget discussions. These concepts will help HR Management with an understanding of making effective budget decisions for its company, since they need to have clear and full knowledge of basic accounting language to grasp the concepts of the various accounting terms.

The term cost can be defined as the amount to be paid for products or services or a required payment for purchasing products and services used as a constant during a period. Costs can have different definitions, based on what kind of use it is required. They can be considered fixed or variable, direct or indirect, sunk costs, incremental or opportunities costs, as described below with the specific definition and example. Fixed and Variable Costs Fixed costs are the ones that do not vary with the number of goods produced, that do not change in proportion to the activity of a business within range of productivity, in an accounting period. They are known as the costs that a business must pay regardless of their sales or production levels. These costs do not grow or decrease and must be paid each month or year without exceptions.

Examples of these costs are electricity, water, telephone, rent, lease, or mortgage, not related to the production. Normally, they are the costs related to the offices and places that keep running, not depending of having production or not. In opposition of the fixed costs, the variable costs are the costs related to the production of goods and services, like raw materials, fuel for cars and machinery, labor and maintenance. Variable costs are the

uncontrolled expenses that are decided by the productivity, material distribution and necessary business expenses. They change as the conditions change, in the same proportion.

As the time is extended, more costs become variable. If more demand exists for a product or service, then the production will increase, more raw materials will be necessary and the costs will change. Direct or Indirect Costs
Direct Costs are the costs that can be allocated accordingly with the right account without hesitation, precisely. They can be easily identified with a particular project. Examples are office supplies, salaries, and travel costs of individuals involved in a specific project. Indirect Costs are the ones that represent the expenses that are not readily identified with a project, function, or activity, however, necessary for the general operation of the business and the conduct of its activities.

They are officially referred as facilities and administrative by the Federal Government, or simply called overhead expenses. As examples, food and lodging, taxes, personnel, and administration costs. Sunk Costs Those are the costs incurred, before certain activity takes place, which cannot be recovered by the possible sale of the asset produced, and represents barriers to exit. A company that is incurred in sunk costs has difficulties in deciding to exit the market, even if good opportunities outside are visualized. When analyzing a business decision, the sunk costs are relevant and should be considered and pre-determined to minimize risks to the company. One good example for these kinds of costs occurs when an order is taken, and when delivering it, the buyer will decide that the products are not the way they order and everything needs to be replaced.

No other buyer will accept this special order and no function for those products will be found, becoming sunk costs. Incremental (Marginal) and Opportunity Costs Incremental or Marginal Costs are the encompassing change that a company experiences within its balance sheet due to one additional unit of production. They are the overall change that a company experiences by producing one additional unit of good. The price wars done by companies analyze these costs to see where they can go on their prices to win the competition. As an example, in the travel business market, when the resorts and hotels have available rooms in large scale, they promote their product with low cost, so they will sell it and still have profitability with them. The profitability is not high, but at least, the fixed costs will be paid and maybe some profitability will be achieved.

Opportunity Costs are used to measure the costs of the resources. They can be defined as the cost of an alternative that must be forgone in order to pursue a certain action, or the benefits received by taking an alternative action, or, still, the difference in return between a chosen investment and one that was passed up. As example, the benefit of studying a MBA and spending money on it or save the money for future expenses, or better saying, using the money to pay expenses in daily basis. Conclusion Various terms are used to describe costs. Having an understanding of these terms will provide a better insight to managers and companies on making budget decisions, efficiently. Not only the ones described above should be considered, but also all types of costs related to the decision in effect.

Efficient managers will considered all aspects related to the analyses in question. References Answers. com. Investment Dictionary. Copyright ©2000, Investopedia. com – Owned and Operated by Investopedia Inc.

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