Cost classifications persuasive essay

Business, Management

Management accounting basically consists of conveying financial information to management. Classification of costs, which are an integral and frequently used term in such discipline, is ideal because it helps in the analysis and presentation of such information. To be valuable information has to be understandable, relevant and reliable. By dividing and defining costs one can comprehend more the expenditure that ought to be included and examined in the situation at hand. Product Costs These are costs identifiable to the product purchased or manufactured.

Indeed in manufacturing enterprises product costs form part of the production cost of goods completed and are included in the stock value for finished products or work in progress. For example, the product costs for a paint sprayer would include metal frame and head bolts costs. Period Costs Unlike product costs, period costs as their name imply are expenses that once sustained will not render any future economic benefits. Therefore they are written off in the income statement in the period when incurred. They are thus not included in the stock valuation.

Examples of period costs that come to mind are electricity paid and factory cleaning costs. Variable Costs Variable costs are costs that vary in direct proportion with the units manufactured. In management accounting variable costs are frequently measured on a per unit basis due to their behavior with the units produced. Two main variable costs that are normally incurred in the production process are direct material and direct labor costs. There are two types of costs that fall under the category variable costs, which are direct and indirect expenditure.

Direct costs are costs which vary in direct proportion with output and which can be traced to the particular product manufactured, like direct materials and labor. Indirect costs behave also in direct proportion to units produced but cannot be allotted to a particular product. Examples of this type of cost are electricity and indirect wages. Fixed Costs Fixed costs are not influenced by the production of goods. In fact fixed costs are incurred even if no production is performed.

For example, if the company is paying factory rent per month, such rent has to be paid irrespective of the number of units produced during the month. Stepped Fixed Costs Such costs tend to remain fixed in the short-term, but in the long run they may change in response to movement in certain variables and then set at another fixed rate. For instance, the supervisor’s salary is fixed for the first year in accordance to the contract signed. However, after one year the supervisor may attain an increment leading to an increase in his wage, stepping up such fixed expenditure. Semi-variable Costs

Semi-variable costs consist of expenses that comprise both a fixed and a variable element in them. A typical example of a semi-variable cost is telephone expenditure. The telephone cost comprises a rental cost, which is fixed in nature and never changes. This is however added up with charges made in line with the number of calls undertaken. Such charges fall under the category of variable costs because they behave in line with the calls made. In cost and management accounting these two elements are frequently separate in business evaluations by adopting techniques like the high low method.

Relevant Costs One of the main aims of management accounting is provide valuable financial information to management to aid them in their decisions. Due to such importance certain costs where classified in line with their effect on the decision-making process. Relevant costs are costs that can be affected by the decision taken and are thus applicable and have to be included in the decision appraisal. In accountancy, relevant costs are commonly also referred to as differential cost. Both have the same meaning and application.

For example, if management is faced with the decision of either buying the product or manufacturing it, they should include the material and labor manufacturing costs as relevant costs because they will be affected by the decision taken. Sunk Costs Sunk costs are past costs which are not relevant for the decision and should be excluded in the valuation because they cannot be altered. For example, consultancy fees charged on an evaluation are sunk costs in the decision between the optimal alternative because they have already been incurred and cannot be changed.

Opportunity Cost This is the cost of the foregone alternative and is adopted in management accounting, especially when one is facing mutually exclusive projects. For instance, if an organization is appraising two projects and project B entails the disposal of the equipment at the end of its life. When assessing project A one should include the opportunity cost of the disposal proceeds lost if project A is chosen. Final Thought – Utility of Cost Information

The application of appropriate terms to different types of costs aid management in utilizing effectively the dual role ofmoneyfor business

operations. Such dual role comprises money as an economic factor of production and as a measure of economic performance. 838 WORDS

References: ACCA Study Text (1999). Information for Control and Decision Making. Seventh Edition. London: BPP Publishing Limited. Drury C. (1996). Management and Cost Accounting. Fourth Edition. London: International Thomson Business Press. Lucey T. (2003). Management Accounting. Fifth Edition. Great Britain: Biddles Ltd.