

Cost accounting assignment

Business



These different bases of cost classification are summarized in the diagram below: Fixed/Variable Direct/indirect Cost Behavior Manufacturing/ Non-manufacturing incremental/sunk historic/opportunity?? y' If national Classification Avoidable/unavoidable Controllable/ uncontrollable Standard/actual

2. 2 Importance of cost classification Analysis of cost behavior is important to all organizations for effective management. This is because many organizations have a unique cost structure.

For example, fixed costs account for 60 -" of all hospital costs. However, unlike many organizations of this type, labor costs largely memories the hospital's fixed costs. Labor costs unlike depreciation require a cash outflow. This is characteristic of labor intensive organizations. Capital- intensive organizations, on the other hand, have low labor costs, e. G. Computerized manufacturing organizations. Some organizations e. G. Hospitals allocate 10 -" 15% of their space for standby emergency events giving them built in idle capacity.

This prevents them from enjoying advantages of higher profits that a capital-intensive organization realizes at higher volumes beyond the break-even volume. Thus the cost structure of healthcare institutions resents challenges to accountants because of their labor intensive and capital-intensive characteristics

2. 3. 1 Manufacturing Vs... Non Manufacturing costs: *

Elements of Man factoring costs: Manufacturing costs are the costs incurred to produce a product. Remember that a product refers to both goods and services.

The elements of manufacturing costs are : * Material costs, * Labor costs; and * Overhead costs. These elements make up the total cost of a product, as shown below: Total product cost = Material cost + Labor Cost + overhead cost These costs are discussed further in the following sections.) Material costs; Material refers to all the physical inputs into the production process. They include the following: * Raw material refers to bought in material which is used in the manufacture of the product.

According to the organization raw material may further be classified as steel, timber e. T. C. * Components and subassembly I. E. Bought in components and subassembly which are incorporated in the product * Work in progress I. E. Partly completed assemblies and products incorporating raw materials and or subassembly * Consumable materials I. E. Materials used in the operation of the factory and ruing production but do not appear in the product e. G. Detergents Maintenance materials I. E. Materials of all types used in maintaining machinery, buildings and vehicles e. . Spare parts, lubricating oil and grease ; k Office materials; materials used in operation of the office e. G. Stationery b) Labor costs What is labor? Labor costs could be direct or indirect labor costs. Direct labor cost refers to wages paid to workers who are directly involved in the conversion of raw materials into finished goods. These are called direct labor costs Indirect labor costs refers to the wages paid to workers whose efforts cannot be readily identified with specific product units or batches e. G. Bourse paid to maintain all the premises utilized for production of goods and services. C) Overhead costs: They are also called indirect production costs. They are those costs which can only be charged to a cost unit using some estimated basis. The estimating procedure

allows a share of the indirect costs to be charged to each cost unit. These costs cannot be identified specifically to the end product. * Elements of Non Manufacturing costs Non-Manufacturing costs are costs incurred by all activities that support the production of goods and services.

They are administration costs, selling costs and distribution costs. These are explained as follows: a) Administrative costs: Is the sum of costs associated with the overall management of the enterprise which cannot be readily identified with one of the major functional areas e. G. Salary of the factory manager would be seen as a production cost but the salary of the personnel officer will be viewed as administrative cost since the personnel function does work for all other functions of the enterprise. B) Selling Costs: Is the sum of costs associated with the securing of orders from customers?

Included in this area will be items such as the salaries paid to the salesmen and expenditure on advertising. C) Distribution costs: Is the sum of costs associated with warehousing the products and their delivery to customer? The cost of wooden pallets on which products are stacked for delivery to customers and the cost of delivery whether using the company's own vehicles or outside haulage firm are examples of distribution costs. D) Finance Costs: These are costs incurred to secure funds to finance the organization's activities.

These include interests on loans and overdrafts, dividends to shareholders, interests on debentures etc e) Research and development Costs: These are costs that are incurred to invent new products or to modify the existing ones, as well as costs incurred to acquire more information on such products. 2. 3.

2 Behavioral classification of costs Definition Cost behavior refers to the change in costs (increase or decrease) as the output level changes, I. E. As we increase output, are the costs rising, dropping or remaining the same.

Cost Behavior can be used to produce various classifications of costs such as: a) Variable Costs Vs... Fixed Costs) Variable costs: Are costs that increase or decrease proportionately with the level of activity , I. E. That portion of the cost of an activity that changes with the level of output. Costs Variable Costs Activity Level Note that with variable costs, the cost level is zero when production is zero. The cost increases in proportion to the increase in the activity level, thus the variable cost function IS represented by a straight line from the origin.

The gradient of the function indicates the variable cost per unit. 2) Semi variable costs Are costs with both a fixed and variable cost component. The fixed impotent is that portion which is constant irrespective of the level of activity. They are variable within certain activity levels but are fixed within other activity levels, as shown below: Variable cost Cost 3) Fixed Costs Are costs that do not change with of the level of output. It is also called autonomous cost, as it remains the same irrespective of the activity level as shown below.

Fixed Cost The classification of cost into fixed and variable costs would only hold within a relevant range beyond which all costs are variable. The relevant range is the activity limits within which the cost behavior can be predicted.) Semi Fixed Costs Variable component Semi Fixed component b) Direct Vs... Indirect costs Recall that direct costs are costs that can be traced

specifically to the end product of the production process while indirect costs cannot be so traced. * Direct costs consist of costs that can be directly attributed to a specific output, product or level of activity.

Direct costs include direct raw materials and direct labor also called prime costs in aggregate. $\text{PRIME COST} = \text{Direct Material Cost} + \text{Direct Labor Cost}$ *

Indirect costs are costs that will not be directly attributable to a specific product. They are regarded as overheads. Identification of overheads to specific products is done through cost allocation and apportionment. They include supervisors' salaries, rent, electricity, depreciation of building etc. C) Controllable Vs... Non Controllable costs Controllable costs can be influenced at the level of authority at which they are being analysed while non-controllable costs cannot. Controllable cost; Refers to the cost which can be influenced by the actions of a person in whom authority for such control is vested, for example control of labor cost will be influenced by the method of remuneration and the degree at management into which is exercised by a certain manager. * Non controllable cost: is cost which cannot be influenced by a person in whom authority for such control is vested for example if the trade union demands an increase in wages the increment is non controllable cost. Similarly, the depreciation of a building is a non-controllable cost to a manager as he does not have authority over depreciation!

In decision making, only controllable costs are considered because they can be changed by the decision maker. There is little or nothing that the decision maker can do about the non-controllable costs thus they are irrelevant in decision making. However, the facilities provided by the non-controllable costs should be efficiently used. 2. 3. 3 Functional Classification of costs:

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Under this classification, costs are classified according to the function they perform in an organization. Costs can functionally be classified as:

a) Production costs: Are all the costs incurred in production of units during a time period e. . Raw material costs, direct labor costs and production overheads.

B) Administration costs: These are all costs incurred in ensuring the smooth running of the organization so as to facilitate the production and sale of goods and services. These include: salaries for the managers, salaries for support employees (such as accountants, clerks and secretaries) etc

c) Selling and distribution costs: These are costs that are incurred to enable the delivery of products and services to the actual markets and promote or complete a sale.