Chapter
19

Managerial Accounting

Lecture 04: Managerial Accounting (Concepts & Principles)

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Cost Vs Expense

Cost is the amount of expenditure, i.e. sacrifice of resources (actual or notional) incurred on or attributable to acquisition of a specific objective

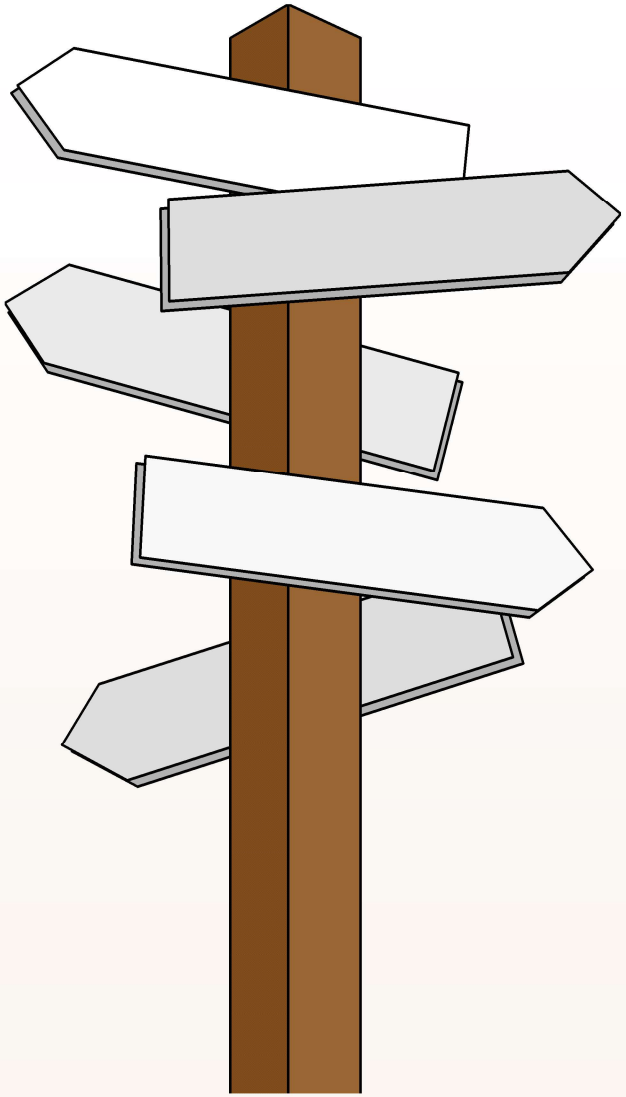
An Expense is a cost with expired benefits. Generally, costs are recognized as expenses on the income statement in the period that benefits from the costs

Cost Object Vs Cost Unit

A cost object is anything for which cost data are desired- including products, product line, customers, job etc

a cost unit is ‘a unit of product, service or time in relation to which costs may be ascertained or expressed’. In other words cost unit is unit of measurement of cost

Classification Of Costs



- By Traceability
- By association
- By Behavior
- By Function
- By controllability
- By relevance

Learning Objective

To classify costs by traceability with jobs, products, or services

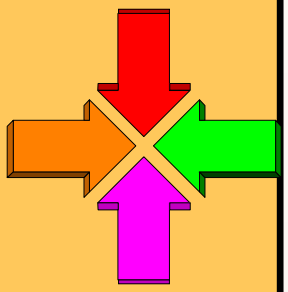


LO1

Cost Classifications by traceability

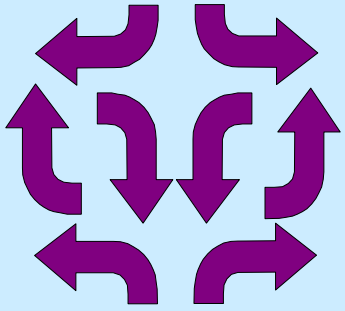
Direct costs

- Costs that can be easily and conveniently traced to a unit of product or other cost objective.
- Would not be incurred if the product or activity were discontinued.
- Examples: direct material and direct labor



Indirect costs

- Costs cannot be easily and conveniently traced to a unit of product or other cost object.
- Would be incurred even if the product or activity were discontinued.
- Example: indirect material and indirect labor



Learning Objective

To classify costs by
activity
to which they associate



LO2

Cost Classifications by association

costs are classified into four categories.

i) Manufacturing Costs

ii) Administrative Costs

iii) Selling Costs

iv) Distribution Costs

Manufacturing Costs

Manufacturing costs are those costs related to factory operations which are essential to the completion of the product.

It includes direct material costs, direct labor costs and manufacturing overheads.

Administrative Costs

Administrative costs includes all those costs incurred on the general administration and control of the firm.

Examples of such costs are : salaries of the office staff, rent of the office building, depreciation and repairs of the office furniture etc.

Selling Costs

Selling costs are those costs which are incurred in connection with the sale of goods.

Some examples of such costs are : Cost of warehousing, advertising, salesmen salaries etc.

Distribution Costs

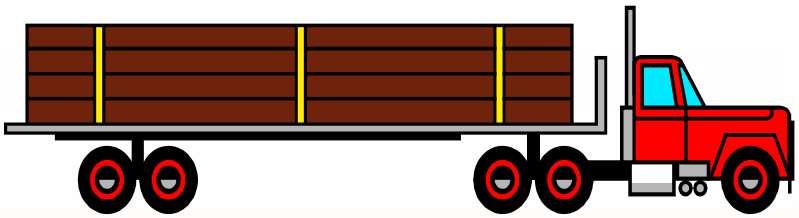
Distribution costs are those costs which are incurred on dispatch of finished products to customer including transportation.

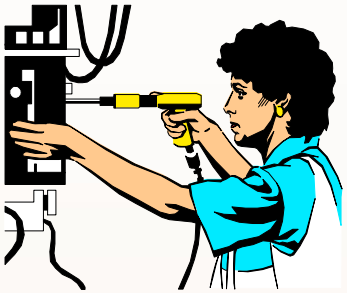
Examples of such costs are: packing, carriage, insurance, freight outwards, etc.

Components of Manufacturing Cost

The cost to produce a unit of product includes:

- **Direct material**
- **Direct labor**
- **Manufacturing overhead**





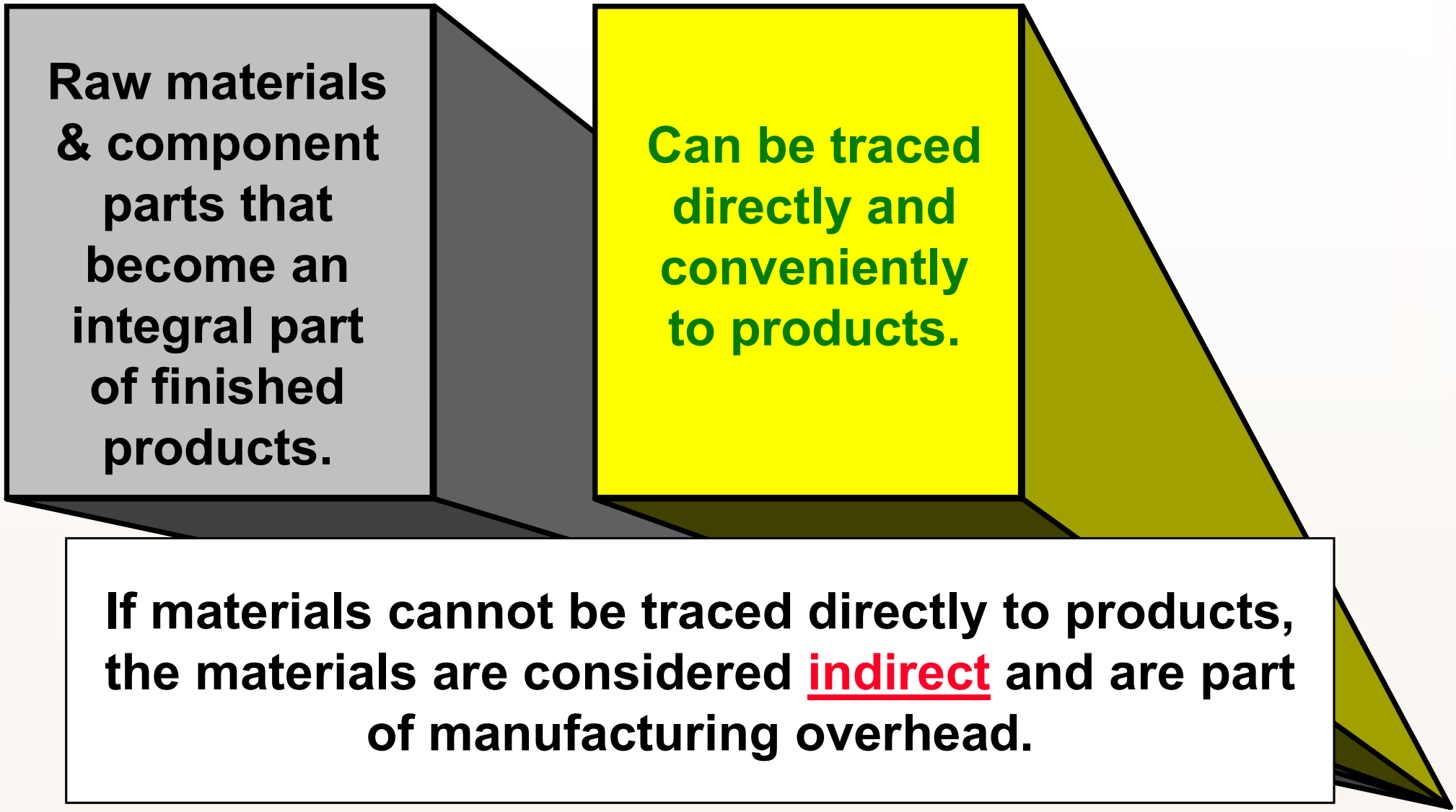


Supplies



Lightbulbs

Direct Materials



If materials cannot be traced directly to products, the materials are considered indirect and are part of manufacturing overhead.

Direct Labor

Includes the payroll cost of direct workers.

Direct labor hours × **Wage rate**

Those employees who work directly on the goods being manufactured.

The cost of employees who do not work directly on the goods is considered indirect labor and is part of manufacturing overhead.

Manufacturing Overhead

All manufacturing costs other than direct materials and direct labor.

Includes:

- Indirect materials.
- Indirect labor.
- Machinery and equipment costs.
- Cost of regulatory compliance.



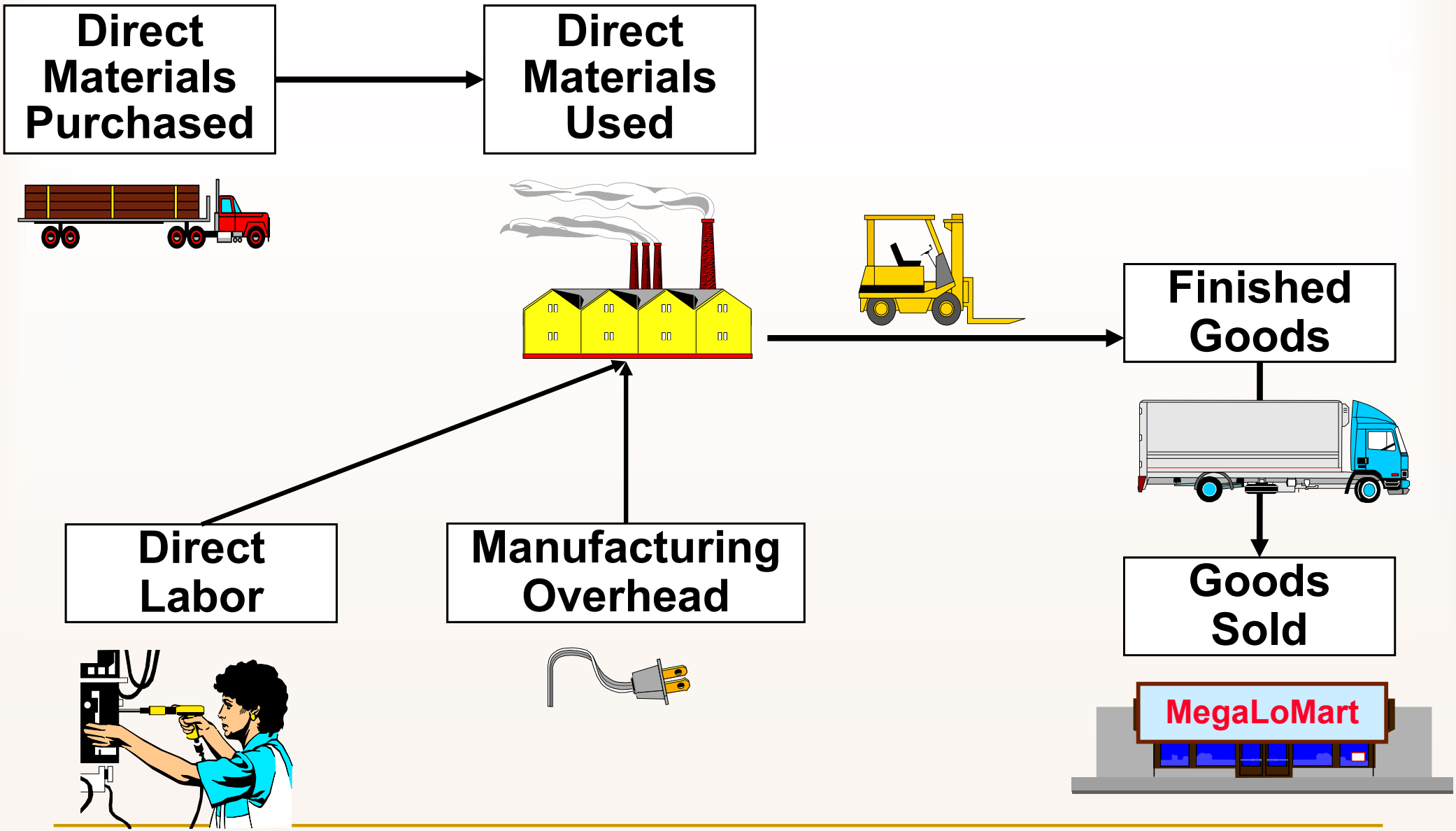
Supplies



Lightbulbs

Does not include selling or general and administrative expenses.

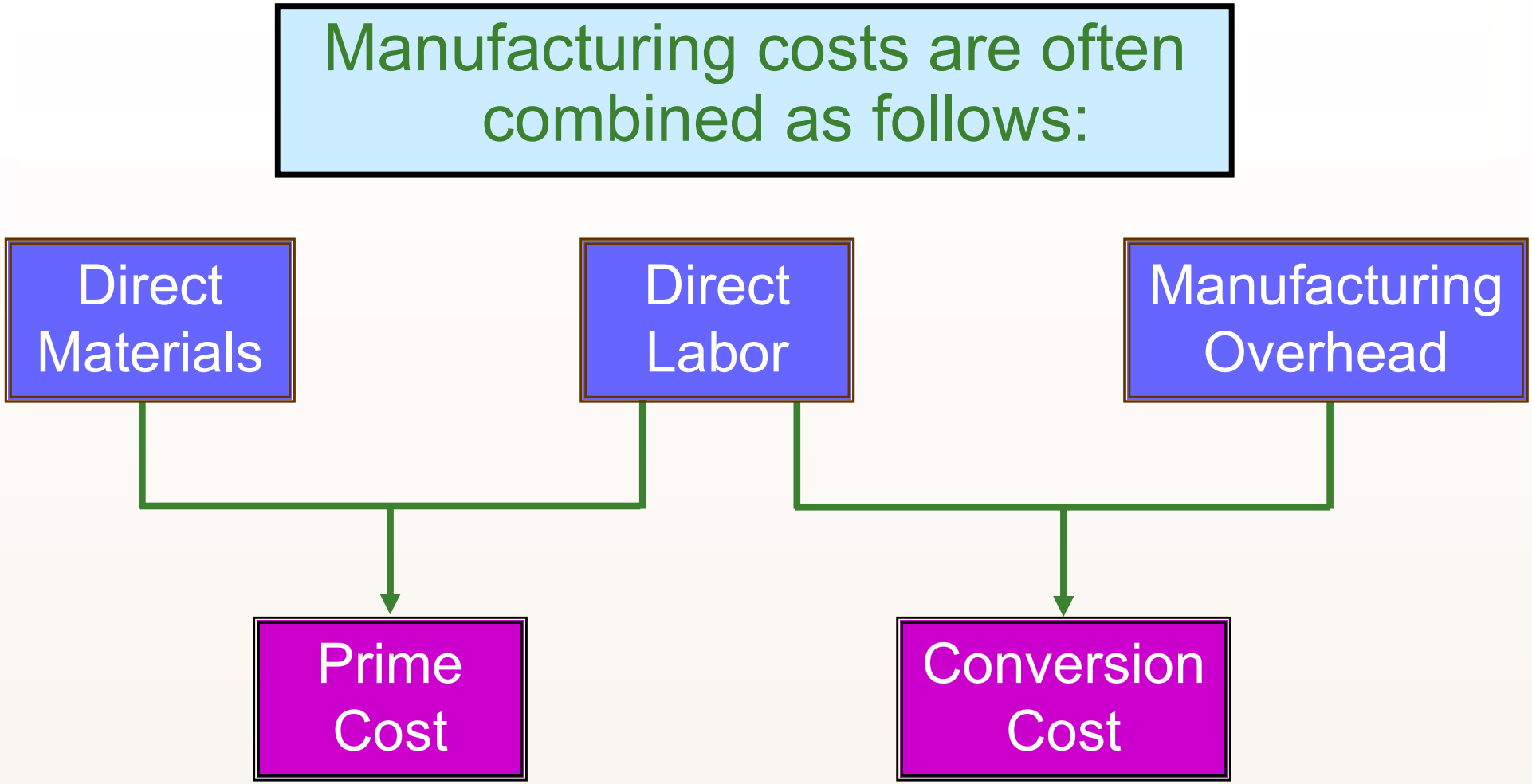
Flow of Physical Goods in Production



Conversion Cost

The costs of converting the materials into finished products consists of direct labor and factory overhead. These two costs combined are often referred to as ***conversion costs.***

Accounting for Manufacturing Operations



Learning Objective

To classify costs by behavior with activity level



LO3

Cost Classifications by Behavior

Cost Behavior

How a cost will react to changes in the level of business activity.

- **Total variable costs change when the level of activity changes.**
- **Total fixed costs remain unchanged when the level of activity changes.**

Typical Examples

Typical variable costs

- Raw materials
- Direct labor
- Factory utilities
- Sales commissions
- Shipping costs

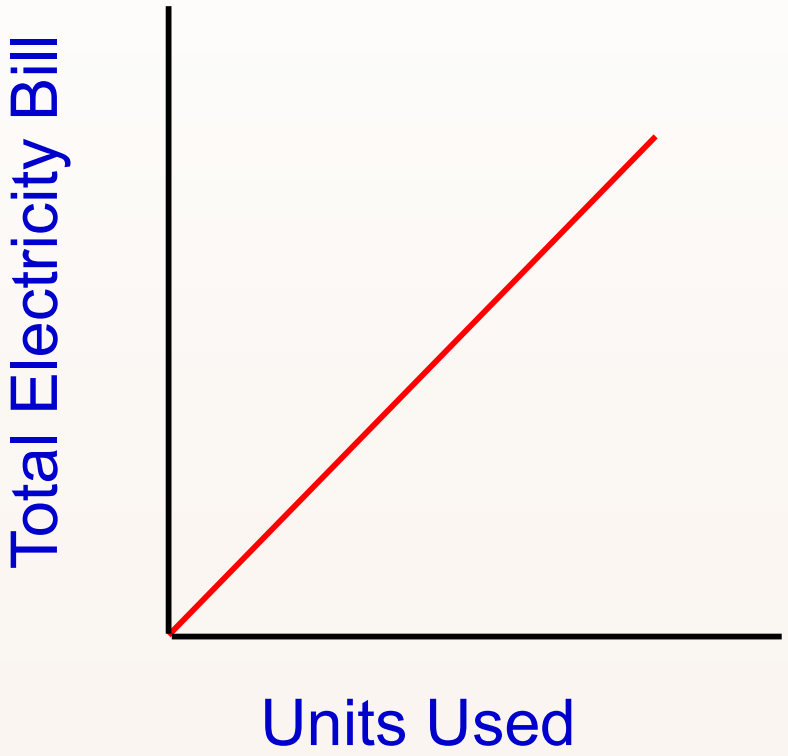
Typical fixed costs

- Real estate taxes
- Factory rent
- Supervisory salaries
- Workers' welfare cost
- Depreciation

Total Variable Cost

A variable cost is one that changes *in total* in proportion to changes in the volume of activity.

Total electricity bill
is based on how many units you use.



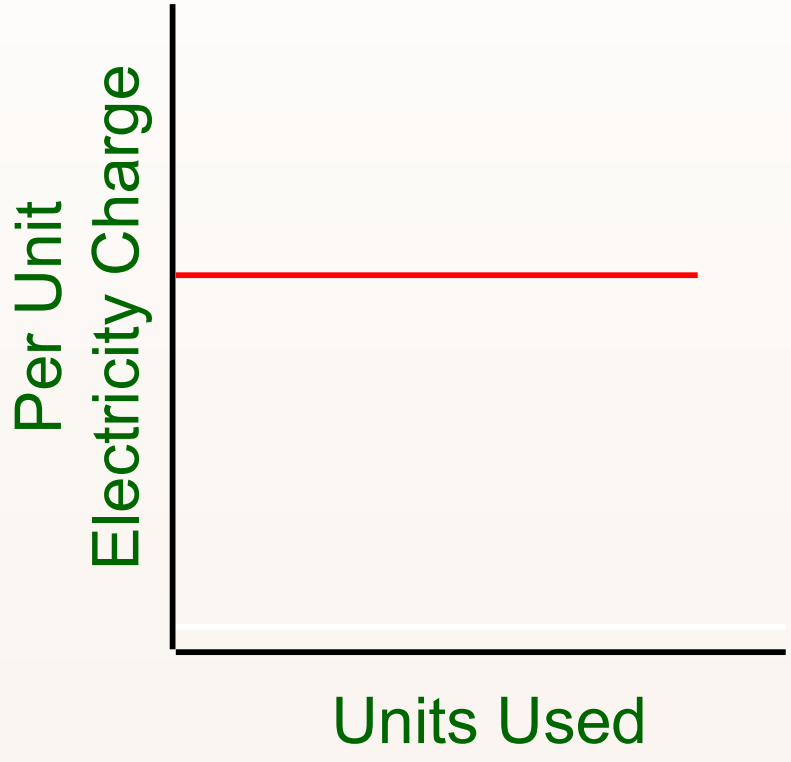


Variable Cost Per Unit

On a per unit basis, a variable cost remains constant over a wide range of activity.

The **cost per unit electricity** used is constant.
For example, Tk 10 per unit .

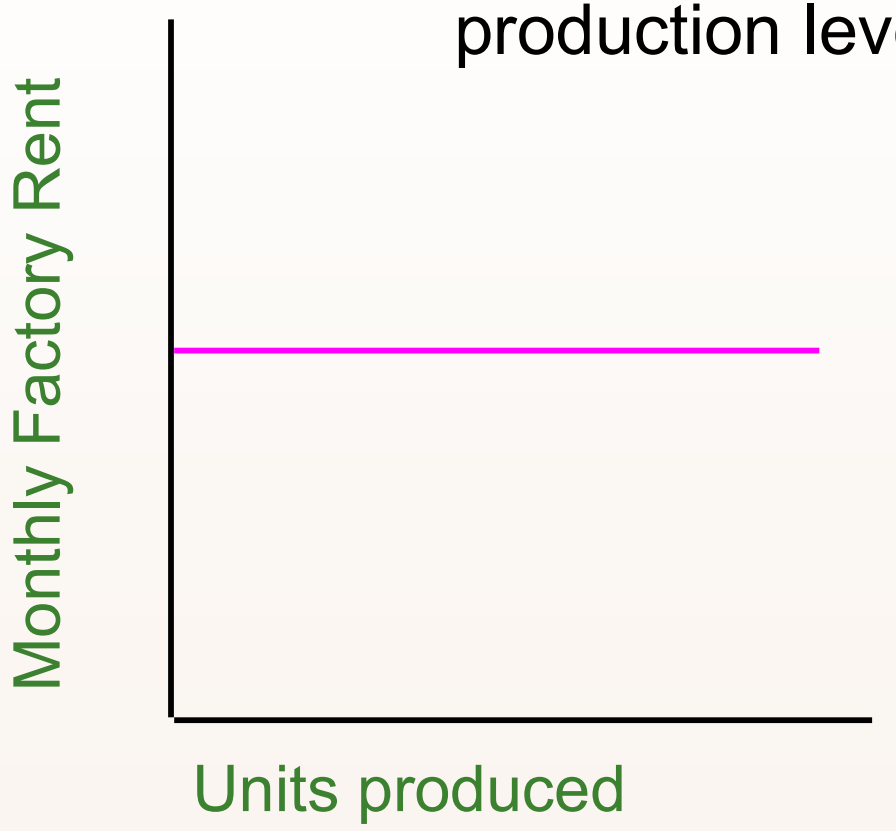




Total Fixed Cost

A fixed cost is one that remains constant *in total* even when the volume of activity changes.

Monthly **factory rent** does not change when production level is more or less.



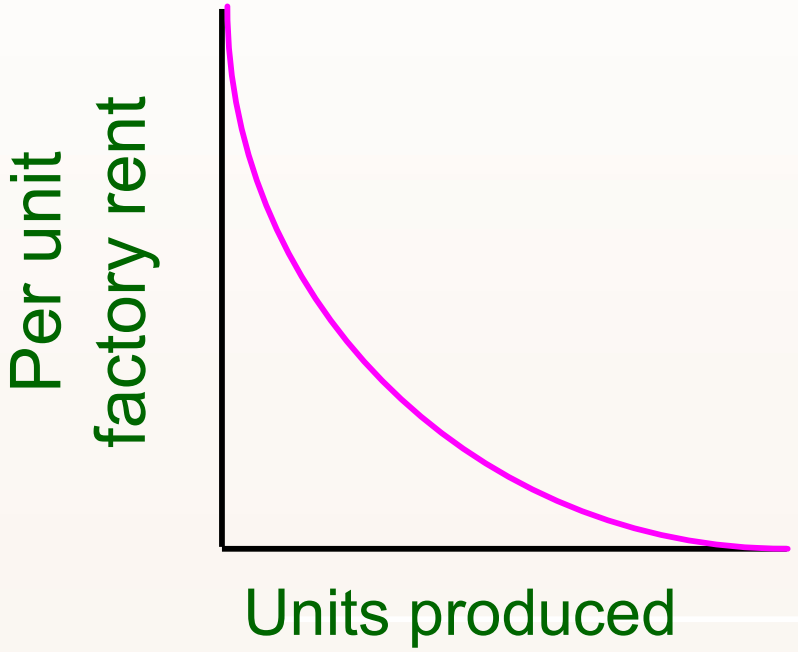


Fixed Cost Per Unit

On a per unit basis, a fixed cost changes as the volume of activity changes.

Factory rent **per unit produced** declines as more units are produced .





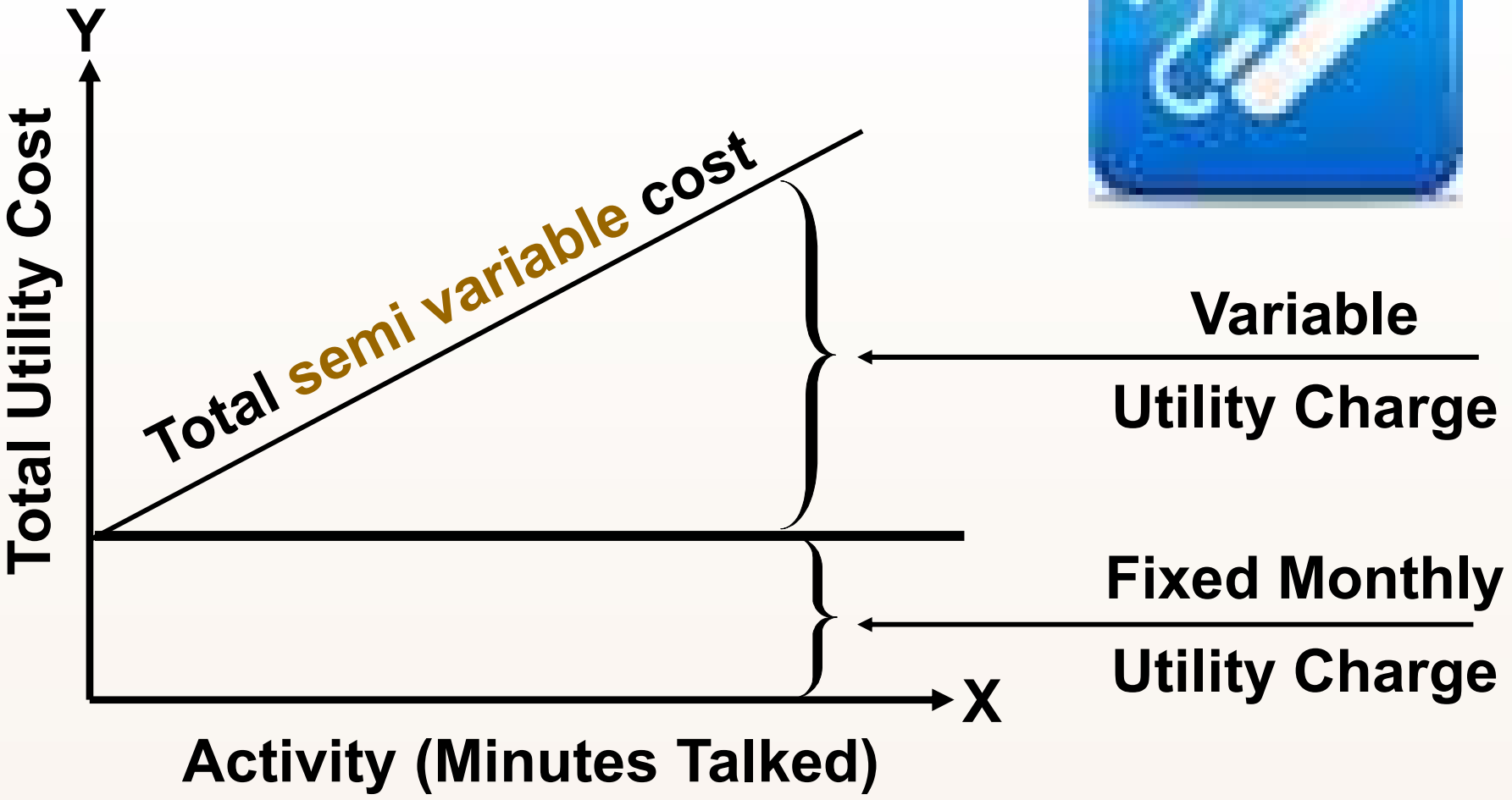
Semi variable Cost

A semi variable or mix cost has both fixed and variable components.



Consider Land Phone Bill example.

Semi variable Cost



Cost Classifications for Predicting Cost Behavior

Behavior of Cost (within the relevant range)		
Cost	**In Total**	**Per Unit**
Variable	**Total variable cost changes as activity level changes.**	**Variable cost per unit remains the same over wide ranges of activity.**
Fixed	**Total fixed cost remains the same even when the activity level changes.**	**Fixed cost per unit goes down as activity level goes up.**

Learning Objective

To classify costs by function



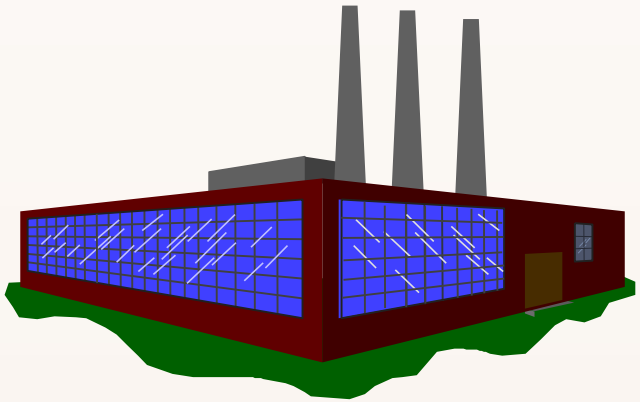
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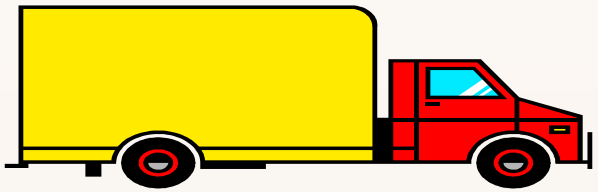
Cost Classifications by Function

Product Costs

- Direct materials
- Direct labor
- Overhead

- Period Costs
  Administrative Costs
- Selling Costs
- Distribution Costs





Learning Objective

To classify costs
by controllability



LO5

Cost Classifications by controllability

Controllable costs are those costs which can be controlled by a specified person or a level of management

Example: Material cost

Uncontrollable costs are those costs which cannot be controlled or influenced by a specified person of an enterprise

Example: Factory rent

Learning Objective

To classify costs by relevance to decision-making

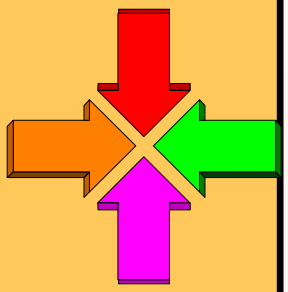


LO6

Cost Classifications by relevance

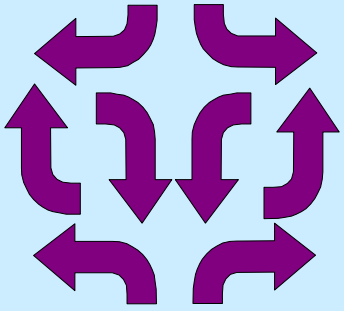
Sunk costs

- Costs already incurred that can not be avoided or changed.
- Irrelevant to future decision making.
- Examples: Equipment previously purchased.



Out-of-pocket costs

- Costs require a future outlay of cash.
- Relevant for future decision making.
- Example: Future purchase of equipment



End of Lecture 4

THANK YOU ALL…