

Managerial Accounting and Cost Concepts

Chapter 1

Needs of Management

- **Financial accounting** is concerned with reporting financial information to external parties, such as stockholders, creditors, and regulators.
- **Managerial accounting** is concerned with providing information to managers within an organization so that they can formulate plans, control operations, and make decisions.

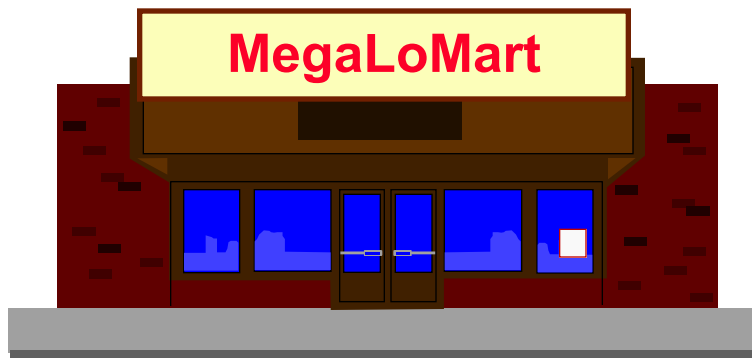
Purposes of Cost Classification

1. Assigning **costs** to **cost objects**
2. Accounting for costs in **manufacturing companies**
3. Preparing **financial statements**
4. **Predicting cost behavior** in response to changes in activity
5. Making **decisions**

Commercial vs manufacturing companies

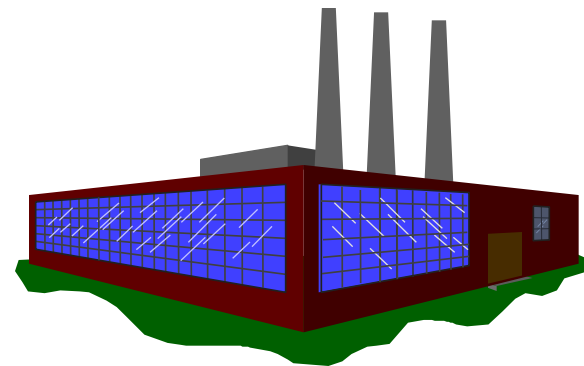
Commercial:

- **Buy finished goods.**
- **Sell finished goods.**



Manufacturing:

- **Buy raw materials**
- **Produce and sell finished goods.**



Purpose of Cost Classification	Cost Classifications
Assigning costs to cost objects	<ul style="list-style-type: none"> • Direct cost (can be easily traced) • Indirect cost (cannot be easily traced)
Accounting for costs in manufacturing companies	<ul style="list-style-type: none"> • Manufacturing costs <ul style="list-style-type: none"> • Direct materials • Direct labor • Manufacturing overhead • Nonmanufacturing costs <ul style="list-style-type: none"> • Selling costs • Administrative costs
Preparing financial statements	<ul style="list-style-type: none"> • Product costs (inventoriable) • Period costs (expensed)
Predicting cost behavior in response to changes in activity	<ul style="list-style-type: none"> • Variable cost (proportional to activity) • Fixed cost (constant in total) • Mixed cost (has variable and fixed elements)
Making decisions	<ul style="list-style-type: none"> • Differential cost (differs between alternatives) • Sunk cost (should be ignored) • Opportunity cost (foregone benefit)

Learning Objective 1

Understand cost classifications used for **assigning costs to cost objects: direct costs and indirect costs.**

Assigning Costs to Cost Objects

- **Direct costs**

- Costs that can be **easily** and **conveniently** traced to a unit of product or other cost object.
- Examples: direct materials and direct labor

- **Indirect costs**

- Costs that **cannot** be easily and conveniently traced to a unit of product or other cost object.
- Example: manufacturing overhead

- **Common costs**

- **Indirect costs** incurred to support a number of cost objects. These costs cannot be traced to any individual cost object.

Learning Objective 2

Identify and give examples of each of the three basic manufacturing cost categories.

Cost classifications for manufacturing companies

**Manufacturing
Costs**

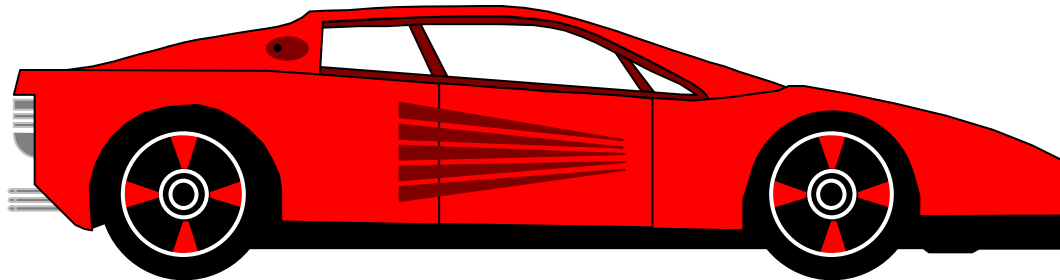
**NonManufacturing
Costs**

Classifications of Manufacturing Costs (direct and indirect)

- Direct materials
- Direct labor
- Manufacturing overhead

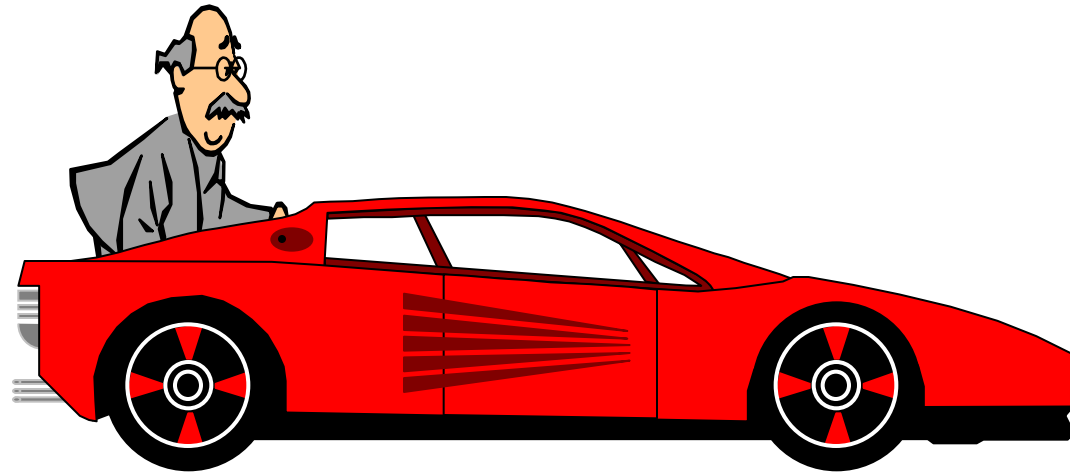
Direct Materials (direct)

- **Direct materials** are raw materials that become an integral part of the product and that can be conveniently traced directly to it.
- **Example: A radio installed in an automobile**



Direct Labor (direct)

- **Direct labor** consists of labor costs that can be easily traced to individual units of product.
- **Example: Wages paid to automobile assembly workers**



Manufacturing Overhead (indirect)

- **Manufacturing overhead** includes *all manufacturing costs except direct material and direct labor.*
- These costs **cannot be readily traced** to finished products.
 - Includes **indirect materials** that cannot be easily or conveniently traced to specific units of product
 - (*lubricants and cleaning supplies used in the automobile assembly plant*)
 - Includes **indirect labor** that cannot be easily or conveniently traced to specific units of product
 - (*maintenance workers and security guards.*)

Manufacturing Overhead – Examples

- Examples of manufacturing overhead:
 - Depreciation of manufacturing equipment
 - Utility costs
 - Property taxes
 - Insurance premiums incurred to operate a manufacturing facility
- **Only those indirect costs associated with *operating the factory* are included in manufacturing overhead.**

Nonmanufacturing Costs

- **Selling costs**
 - The costs incurred to secure customer orders and get the finished product to the customer. Selling costs can be **either direct or indirect costs**.
- **Administrative costs**
 - The costs associated with the *general management* of an organization rather than with manufacturing or selling. Administrative costs **can be either direct or indirect costs**.

Learning Objective 3

Understand cost classifications used to prepare financial statements: product costs and period costs.

Product Costs

- **Product costs include all the costs involved in acquiring or making a product.**
- Product costs “attach” to a unit of product as it is purchased or manufactured and they stay attached to each unit of product **as long as it remains in inventory awaiting sale.**
- **-> inventoriable costs**

Manufacturing Product Costs

For manufacturing companies, product costs include:

- **Raw materials** include any materials that go into the final product.
- **Work in process** consists of units of product that are only partially complete and will require further work before they are ready for sale to the customer.
- **Finished goods** consist of completed units of product that have not yet been sold to customers.

Transfer of Product Costs

- When *direct materials* are used in production, their *costs are transferred from Raw Materials to Work in Process*.
- *Direct labor and manufacturing overhead costs are added to Work in Process* to convert direct materials into finished goods.
- Once units of product are *completed*, their costs are *transferred from Work in Process to Finished Goods*.
- When a manufacturer *sells* its finished goods to customers, *the costs are transferred from Finished Goods to Cost of Goods Sold*.

Cost Classifications for Preparing Financial Statements (1 of 2)

Product costs include direct materials, direct labor, and manufacturing overhead.

