

What is Cost Accounting?

Cost Accounting is a branch of accounting that deals with the process of recording and summarizing the amount of cost that is spent on the company's activities. It includes all cost of process, product or service used, provided, and sold.

Labor Refers to a process or industry that requires a large amount of **labor** to produce its goods or services.

Intensive

Capital Refers to business processes or industries that require large amounts of investment to produce a good or service and thus have a high percentage of **fixed assets**, such as *property*, *plant*, and *equipment*.

Financial Accounting vs Management Accounting

	Financial Accounting	Management Accounting
Definition	Accounting is an information system that identifies records and communicates the economic events of an organization to interested users.	Accounting system by which information are presented and supplied to management in appropriate manner to operate business smoothly and efficiently/
User	External persons who make financial decision	Managers who plan for and control an organization
Time Focus	Historical Perspective	Future Emphasis
Verifiability vs Relevance	Emphasis on verifiability	Emphasis on relevance for planning and control
Precision vs Timeliness	Emphasis on precision	Emphasis on timeliness
Subject	Primary focus on the whole organization	Focuses on segments of an organization
GAAP	Must follow GAAP and prescribed formats	No need to follow GAAP and prescribed formats
Requirement	Mandatory for external reports	Not mandatory

Organizational Strategy and Cost Information

⚡ A company formulates a **mission statement** - the reason for company's existence.

ex.: Jollibee - "To serve great tasting food, bringing the joy of eating for everyone"

⚡ The development of the organization's *strategy* roots from its mission statement.

⚡ **Organizational strategy** is the plan of action on how the entity will attain and realize its goals and objectives with the use of their own resource that will be able to contribute to the creation of value both to customers and shareholders.

⚡ One of the ways an entity can attain competitive advantage is through **cost leadership** - the ability of an entity to provide the lowest prices in the market through proper management of cost.

⚡ Cost leadership differs from product differentiation in the perspective of providing unique products to be offered to the market where prices are allowed to be relatively higher .



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Organizational Strategy and Cost Information (cont)

⚡ To become a cost leader, cost should be managed well.

⚡ In order for cost to be managed well, **Cost Accounting** information is now on paramount importance - the entity's cost accountants now play a vital role in the value creation process of the entity.

⚡ Properly managed cost > Lower costs of production > Lower prices > Cost leader > More people will buy > Added value to the entity.

What is Value Chain?

⚡ A value chain is a set of activities an entity applies to be able to deliver a valuable product to the customer.

⚡ Value chain is a set of activities or functions that allows the conversion of inputs into useful products and services.

Activities within the Value Chain

Research and Development	Analysing, testing, and studying of different methodologies of cost reduction or quality improvement.
Design	Creation and development of product and service design fit for the market.
Supply	Proper management of raw materials from suppliers.
Production	The process of acquisition and construction of company resources to create products and services.
Marketing	Promotions made by an entity to make the product attractive to the market.
Distribution	Process of delivery of products and services to customers.
Customer Service	After-sale support for customers.

FS Classification of Cost

Product Cost	Product cost are cost identified and incurred by an entity to manufacture a product.	⚡ <i>Material</i> All raw materials and other supplies used in the manufacturing process. Direct Materials: e.g Cost of glass in lightbulb manufacturing. Indirect Materials: Cost of glue, lubricating oils, nails, screws, and the like. ⚡ <i>Labor</i> Salaries and other benefits provided to all workers.
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FS Classification of Cost (cont)

Direct Labor: *e.g* Cost of salaries paid to laborers of furniture associated directly in the process.

Indirect Labor: Salaries paid to all other factory personell necessary in the manufacturing process but not directly related in the conversion process.

⚡ *Overhead*

All indirect cost necessary for product conversion that are not direct materials and direct labor.

examples: Indirect materials, Indirect labor, Depreciation of equipment in the factory, Insurance of factory plant, Maintenance and repairs of equipment, Factory utilities.

Period Cost The entity's operating expenses. They are called as such since they are much more associated with time periods rather than the manufacturing process.

⚡ *Marketing and Advertising* Expenses incurred in promoting the entity's products and services.

⚡ *Selling and Distribution*

They include salaries of sale personnel, and delivery expenses.



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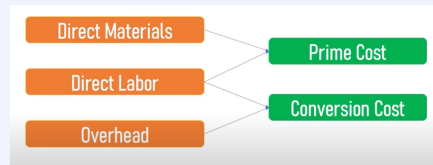
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FS Classification of Cost (cont)

⚡ Administrative Expenses

They include office utilities, depreciation of office PPE, repairs and maintenance of office PPE, and all other expenses in the office.

Components of Product Cost



Equation of Manufacturing Cost



Cost Behaviors

- Variable Cost** They are cost that change as the quantity of the goods produced changes. Total amount of variable costs is dependent on the level of production.
Examples:
- ♥ Cost of materials
 - ♥ Cost of direct labor computed per piece.
- Fixed Cost** At whatever level of production within the relevant range, this cost does not change. It is independent on the level of production.
Examples:
- ♥ Rent of facilities
 - ♥ Depreciation of equipment.
- Mixed Cost** Refers to cost that has both variable and fixed components.
Example: Utilities, since these are charged with a base amount and goes higher with any usage over the base amount.
- Step Cost** Costs that are constant on a certain level of activity but increases on another certain level of activity.
Example: Salaries and commission of agents that goes higher with different ranges of activity.

Concepts of Variable and Fixed Cost

Variable Costs

- Constant on a per-unit basis.
- Varies when presented as a total.

Fixed Costs

- Constant when presented as a total.
- Varies on a per unit basis.

Assume an entity's normal manufacturing process with a range of 5,000 to 7,000 units of goods with a variable cost per unit of P20 and P15,000 fixed costs.

	Units	Total variable costs	Per unit	Total fixed costs	Per unit	Total	Per unit
at 5,000 units	5,000	P100,000	P20	P15,000	P3.00	P115,000	P23.00
at 6,000 units	6,000	P120,000	P20	P15,000	P2.50	P135,000	P22.50
at 7,000 units	7,000	P140,000	P20	P15,000	P2.14	P155,000	P22.14

Cost Equation

$$y = a + bx$$

y = total cost
 a = total fixed cost
 b = variable cost per unit
 x = volume of activity

Sample Problem

How much is the total cost to manufacture products with a variable manufacturing cost per unit of P25 and total manufacturing fixed cost of P40,000 at the following production levels:

a. 2,000 units
b. 4,500 units
c. 7,250 units

$$y = a + bx$$

$$y = 40,000 + (25)(2,000)$$

$$y = 40,000 + 50,000$$

$$y = 90,000$$

$$y = a + bx$$

$$y = 40,000 + (25)(4,500)$$

$$y = 40,000 + 112,500$$

$$y = 152,500$$

$$y = a + bx$$

$$y = 40,000 + (25)(7,250)$$

$$y = 40,000 + 181,250$$

$$y = 221,250$$

Separating Mixed Cost

In separating mixed cost, there can be two methods to be used.

- ⚡ High-Low Method
- ⚡ Least Squares Regression Method

Other Cost Terminologies

Opportunity Cost Benefits forgone in choosing one action over another.



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Other Cost Terminologies (cont)

Sunk Cost	Cost incurred that will not affect a future decision.
Committed Cost	Cost resulting from organizational structure or use of facilities.
Discretionary Cost	Cost arising from managerial decision.
Controllable Cost	Cost that are able to be influenced on how much shall be spent.
Noncontrollable Cost	Cost that cannot be controlled or influenced,

What is Cost?

Cost reflects the amount of resources sacrificed in order for the company to achieve a certain objective such as creation of goods or rendering of services in order to earn revenues.



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