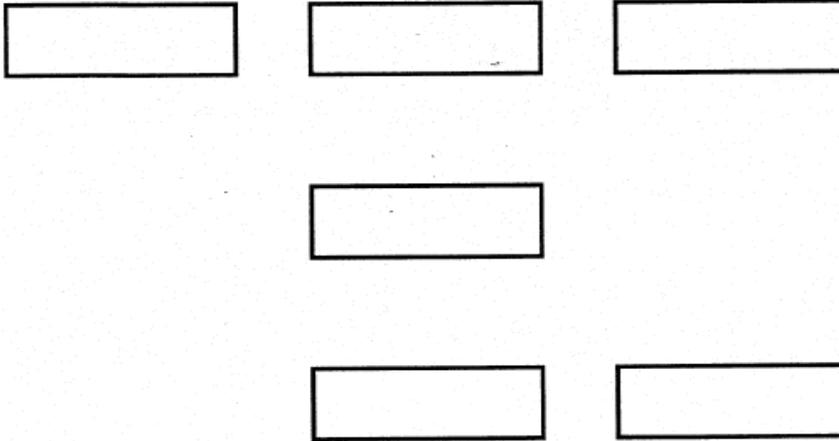


COST TERMS, CONCEPTS, AND CLASSIFICATIONS

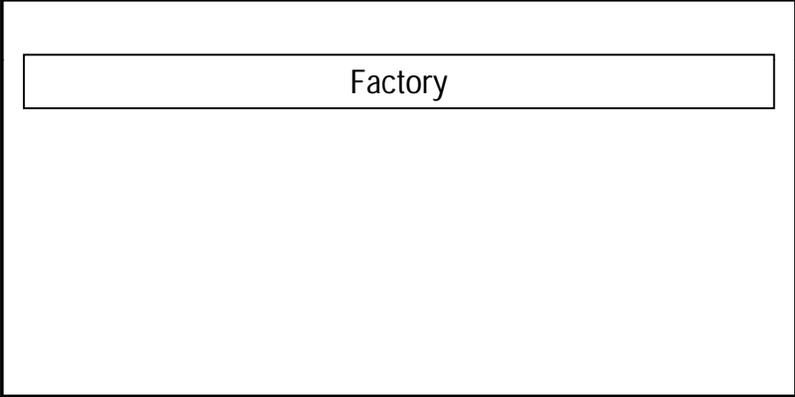
AN OVERVIEW OF COST TERMS

<i>Purpose of cost classification</i>	<i>Cost classifications</i>
Preparing an income statement and balance sheet	<ul style="list-style-type: none">• Product costs<ul style="list-style-type: none">• Direct materials• Direct labor• Manufacturing overhead• Period costs<ul style="list-style-type: none">• Nonmanufacturing costs<ul style="list-style-type: none">• Marketing and selling costs• Administrative costs
Predicting changes in cost due to changes in activity	<ul style="list-style-type: none">• Variable costs• Fixed costs
Assigning costs	<ul style="list-style-type: none">• Direct costs• Indirect costs
Making decisions	<ul style="list-style-type: none">• Differential costs• Sunk costs• Opportunity costs

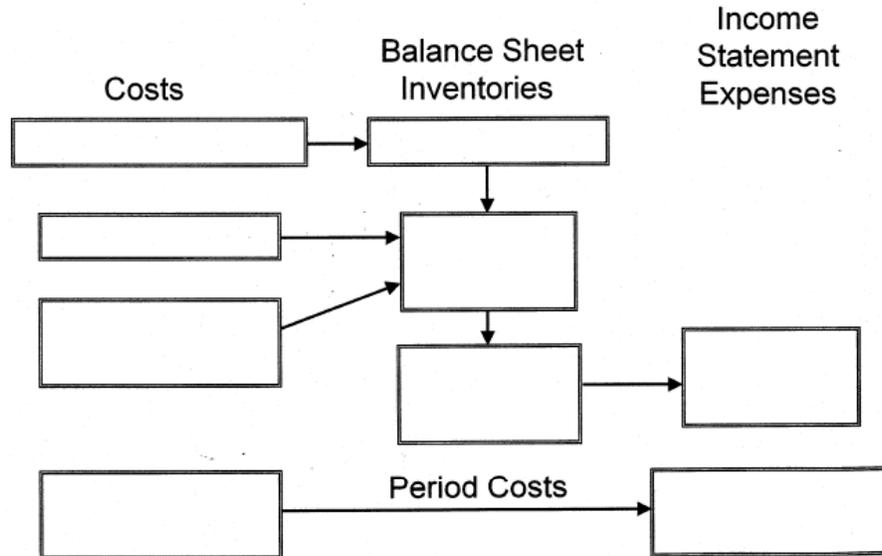
COST FLOWS IN A MANUFACTURING FIRM



PRODUCT vs. PERIOD COSTS



Manufacturing Cost Flows



COST FLOWS EXAMPLE

EXAMPLE: Ryder Company incurred the following costs last month:

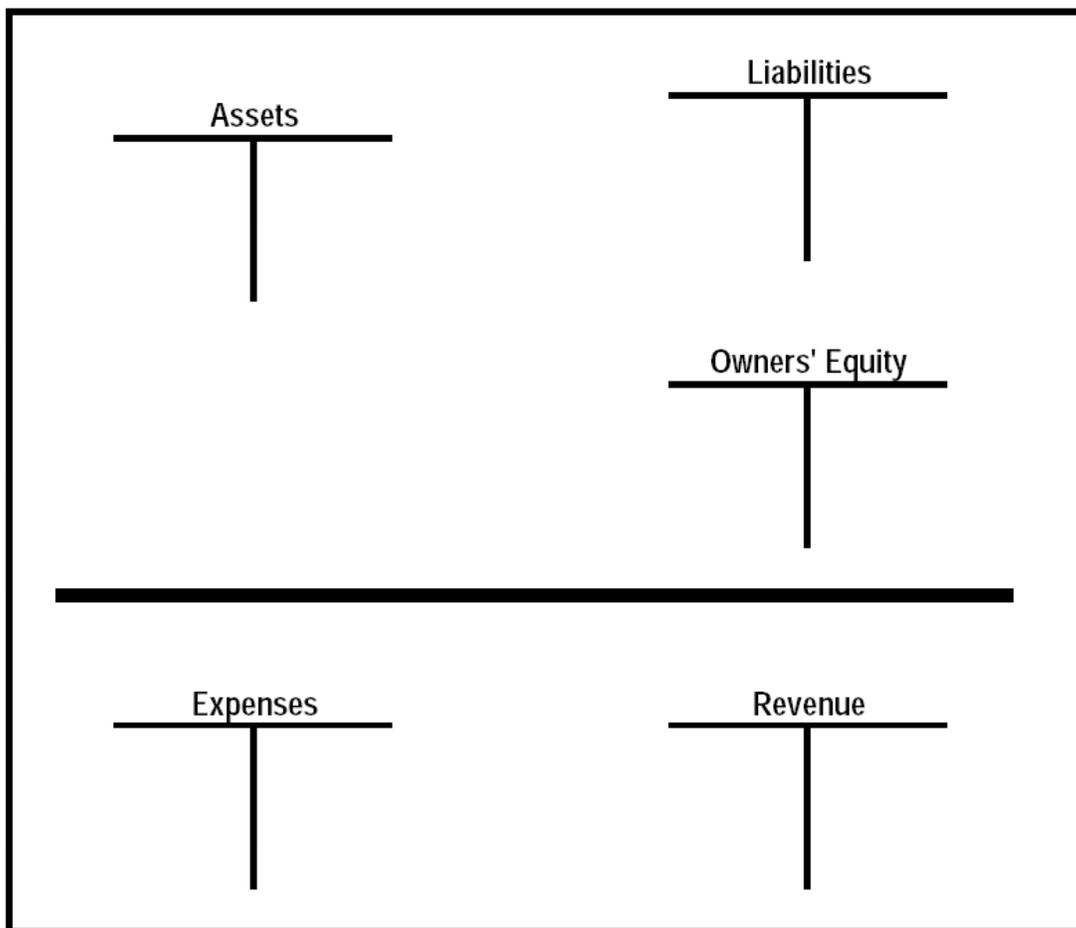
Purchases of raw materials		\$200,000
Direct labor		\$270,000
Manufacturing overhead		
Indirect materials	\$ 5,000	
Indirect labor	100,000	
Utilities, factory	80,000	
Property taxes, factory	36,000	
Insurance, factory	9,000	
Equipment rental	70,000	
Depreciation, factory	<u>120,000</u>	\$420,000

But:

- Some of the goods sold this month were produced in previous months.
- Some of the costs listed above were incurred for goods that were not sold this month.

Therefore:

- Cost of goods sold does not equal the sum of the above costs.
- We need to determine the values of the various inventories.



COST FLOWS EXAMPLE (cont'd)

Additional data for Ryder Company:

Raw materials inventory:

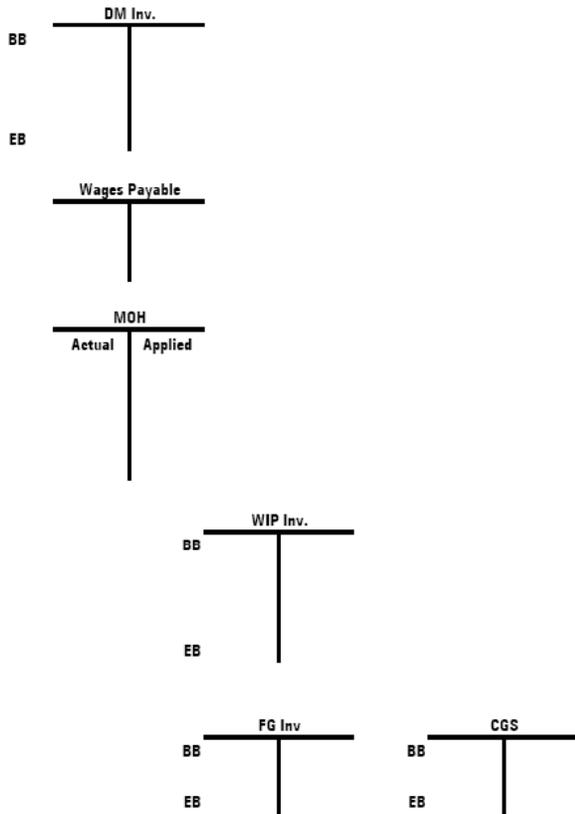
Beginning raw materials inventory	\$10,000
Purchases of raw materials	\$200,000
Ending raw materials inventory.....	\$30,000
Raw materials used in production	?

Work in process inventory:

Beginning work in process inventory.....	\$40,000
Total manufacturing costs.....	?
Ending work in process inventory	\$60,000
Cost of goods manufactured (i.e., finished).....	?

Finished goods inventory:

Beginning finished goods inventory.....	\$130,000
Cost of goods manufactured (i.e., finished).....	?
Ending finished goods inventory	\$80,000
Cost of goods sold	?



Rider Company	
Statement of Cost of Goods Manufactured	
for the Year Ended December 31, 20X1	
Direct Material	
DM Inventory, 1/1/20X1	_____
Add: DM Purchases	_____
Total DM available for use	_____
Less: DM Inventory, 12/31/20X1	_____
DM used in production	_____
Direct Labor - Wages	

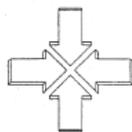
Manufacturing Overhead	
Indirect Material	_____
Indirect Labor	_____
Utilities, factory	_____
Property taxes, factory	_____
Insurance, factory	_____
Equipment rental	_____
Depreciation, factory	_____
Total Factory Overhead	_____
Total Manufacturing Costs	

Add: Work-in-Process Inventory, Jan. 1, 20X1	_____
Total Manufacturing Costs to account for	_____
Less: Work-in-Process Inventory, Dec. 31, 20X1	_____
Cost of Goods Manufactured	_____
Cost of goods sold:	
Beginning finished goods inventory	_____
Add: Cost of goods manufactured	_____
Goods available for sale	_____
Less: Ending finished goods inventory	_____
Cost of goods sold	_____

Direct Costs and Indirect Costs

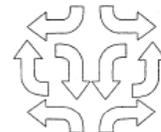
Direct costs

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



Indirect costs

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



Differential Costs and Revenues

Costs and revenues that differ among alternatives.

Example: You have a job paying \$1,500 per month in your hometown. You have a job offer in a neighboring city that pays \$2,000 per month. The commuting cost to the city is \$300 per month.

Differential revenue is:
 $\$2,000 - \$1,500 = \$500$
Differential cost is:
 $\$300$

Opportunity Costs

The potential benefit that is given up when one alternative is selected over another.

Example: If you were not attending college, you could be earning \$15,000 per year. Your opportunity cost of attending college for one year is \$15,000.



Sunk Costs

Sunk costs cannot be changed by any decision. They are not differential costs and should be ignored when making decisions.

Example: You bought an automobile that cost \$10,000 two years ago. The \$10,000 cost is sunk because whether you drive it, park it, trade it, or sell it, you cannot change the \$10,000 cost.

