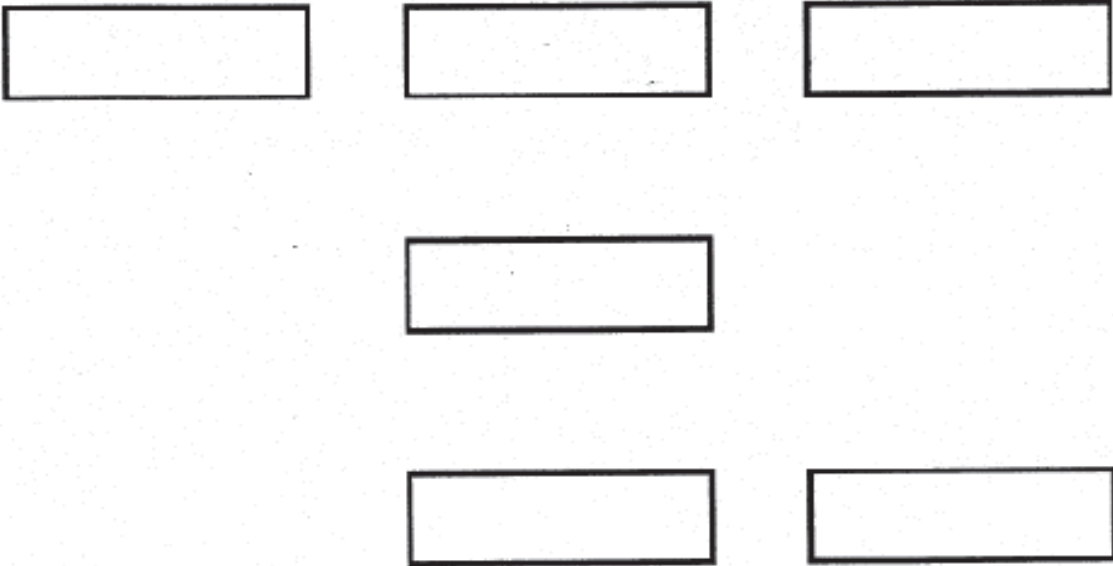


COST TERMS, CONCEPTS, AND CLASSIFICATIONS

Purpose of Cost Classification	Cost Classifications
Assigning costs to cost objects	<ul style="list-style-type: none">• Direct costs (can be easily traced)• Indirect costs (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 costs (proportional to activity)• Fixed costs (constant in total)• Mixed costs (has variable and fixed elements)
Making decisions	<ul style="list-style-type: none">• Relevant costs (differs between alternatives)• Irrelevant costs (should be ignored)

COST FLOWS IN A MANUFACTURING FIRM

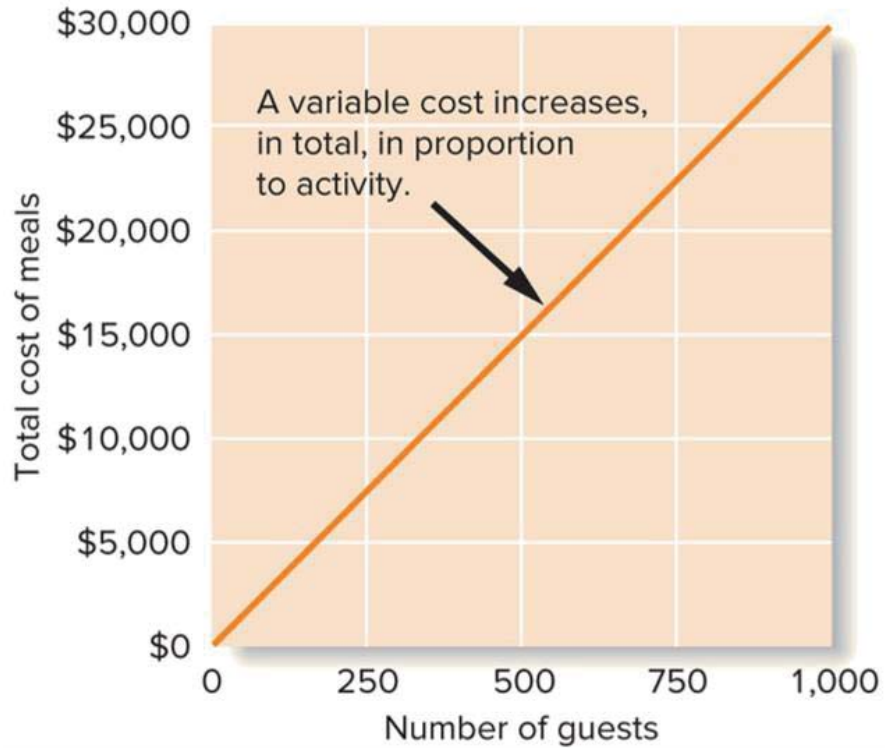


PRODUCT vs. PERIOD COSTS

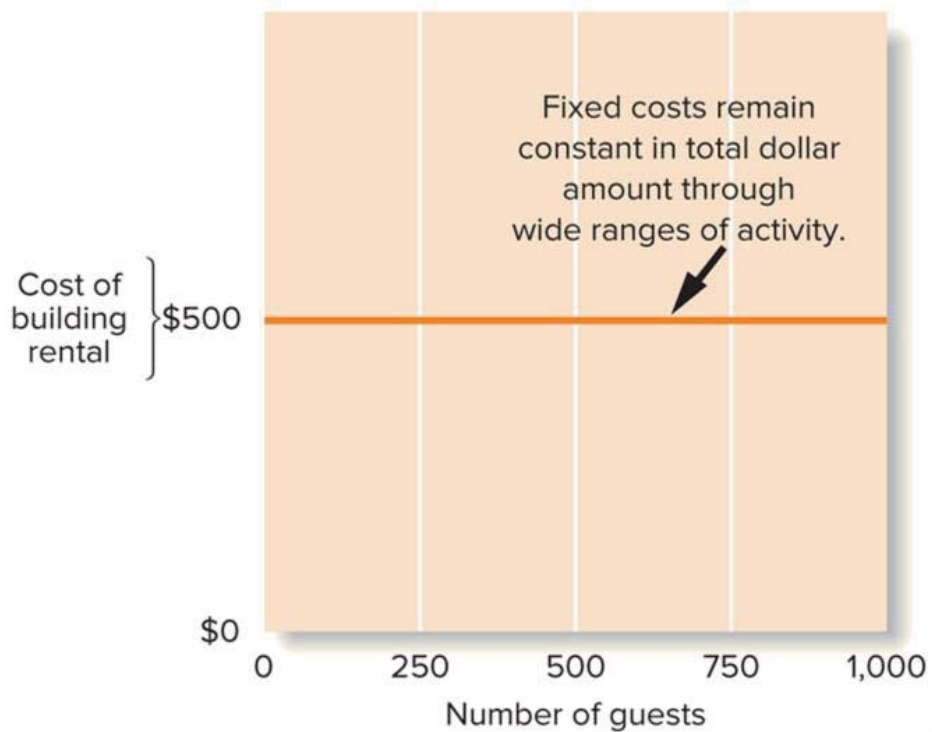
Factory

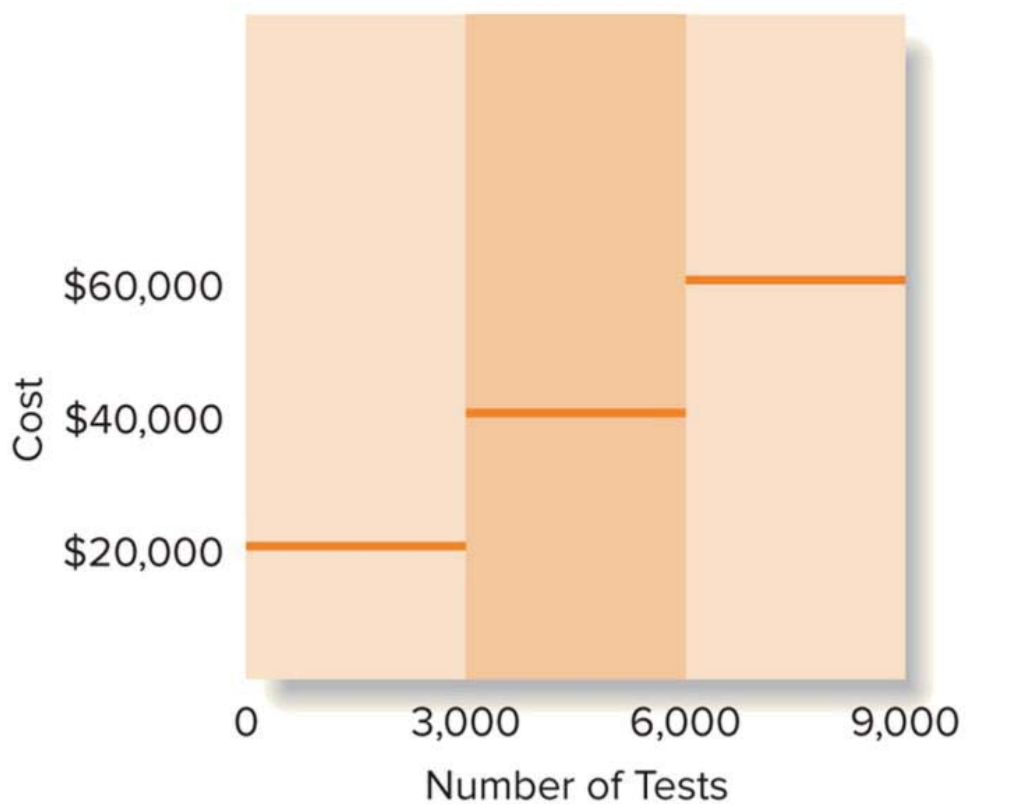
Sales & Administration

Total Cost of Meals



Total Cost of Renting the Building





Comparison of Cost Classifications for Predicting Cost Behavior

Behavior of Cost (within the relevant range)		
Cost	In Total	Per Unit
Variable	Total variable cost increase and decrease in proportion to changes in the activity level.	Variable cost per unit remains constant.
Fixed	Total fixed cost is not affected by changes in the activity level within the relevant range.	Fixed cost per unit decreases as the activity level rises and increases as the activity level falls.

Mixed Costs – An Example

If your fixed monthly utility charge is \$40, your variable cost is \$0.03 per kilowatt hour, and your monthly activity level is 2,000 kilowatt hours, what is the amount of your utility bill?

$$Y = a + bX$$

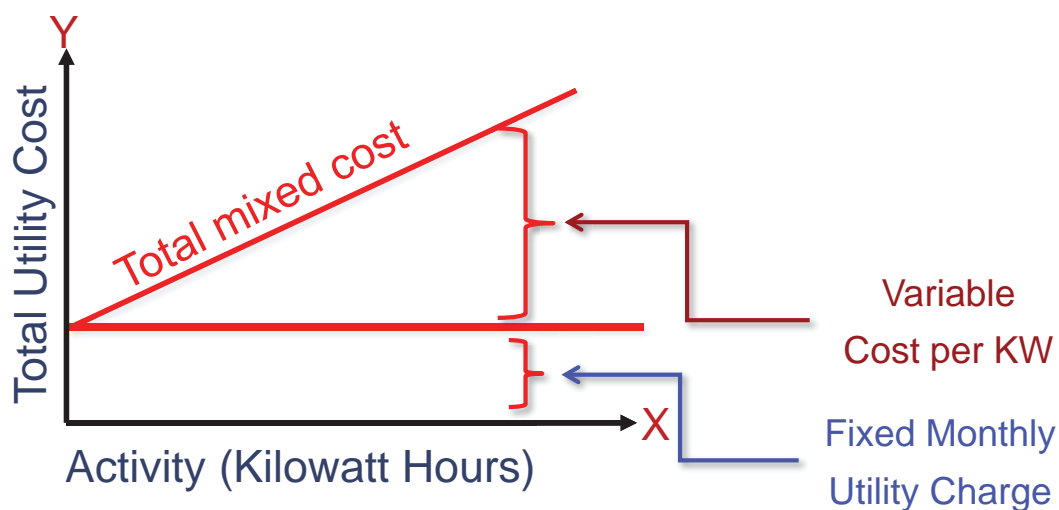
$$Y = \$40 + (\$0.03 \times 2,000)$$

$$Y = \mathbf{\$100}$$

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Mixed Costs – Part 1

A mixed cost contains both variable and fixed elements. Consider the example of utility cost.



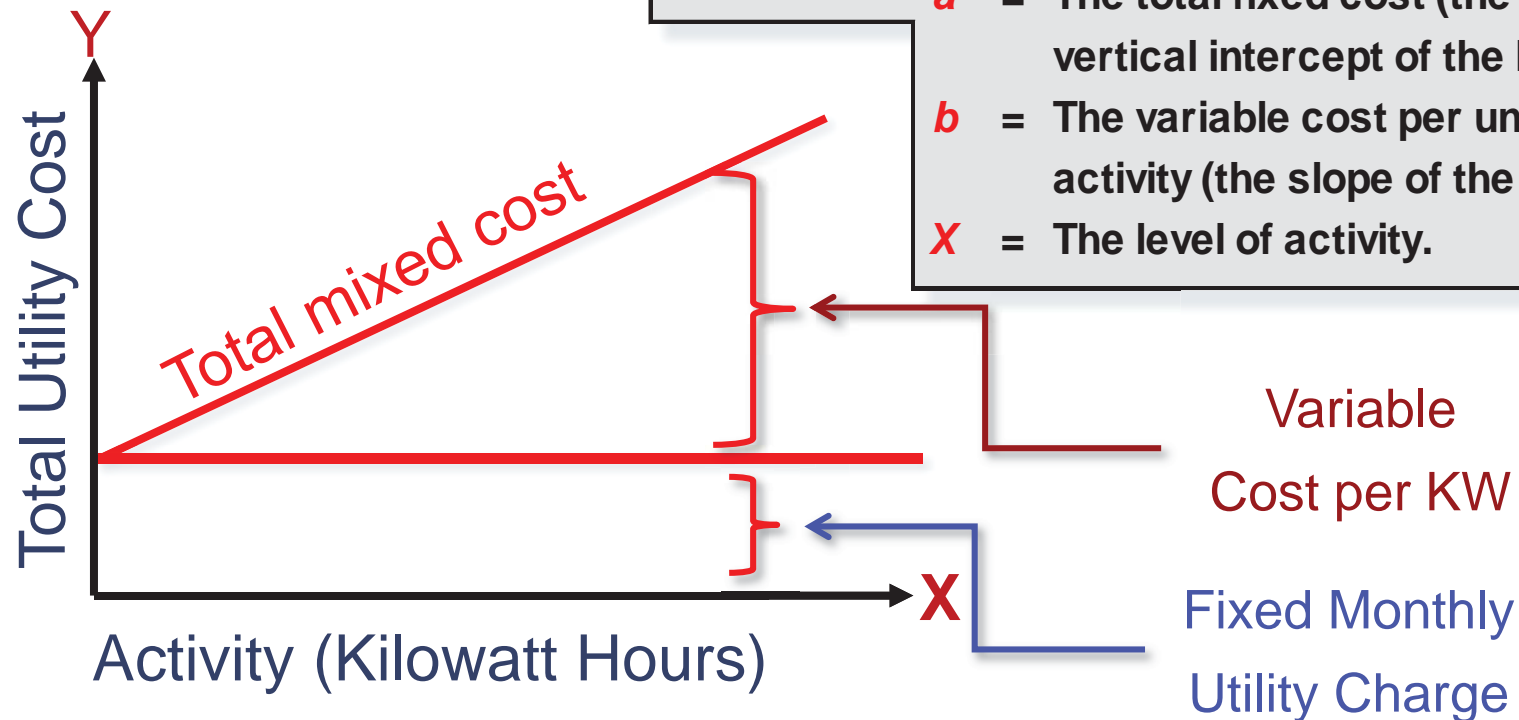
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Mixed Costs – Part 2

The total mixed cost line can be expressed as an equation: $Y = a + bX$

Where:

- Y = The total mixed cost.
- a = The total fixed cost (the vertical intercept of the line).
- b = The variable cost per unit of activity (the slope of the line).
- X = The level of activity.



The Traditional and Contribution Formats

Comparison of the Contribution Income Statement with the Traditional Income Statement

Traditional Format		Contribution Format	
Sales	\$ 100,000	Sales	\$ 100,000
Cost of goods sold	70,000	Variable expenses	60,000
Gross margin	\$ 30,000	Contribution margin	\$ 40,000
Selling & admin. expense:	20,000	Fixed expenses	30,000
Net operating income	\$ 10,000	Net operating income	\$ 10,000

Used primarily for
external reporting.

Used primarily by
management.

