HT 222 Financial and Accounting Management for Executives in Hospitality and Tourism Industry

Date: Saturday Time: 09:00 – 18:30 Room 8507

Cost Concepts

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Cost Concepts

Chapter 2

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SECOND EDITION

Managerial Accounting

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Learning Objective 1

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

Manufacturing Costs



Direct Materials

Raw materials that become an integral part of the product and that can be conveniently traced directly to it.



Direct Labor

Those labor costs that can be easily traced to individual units of product.



Example: Wages paid to automobile assembly workers

Manufacturing Overhead

Manufacturing costs that cannot be traced directly to specific units produced.



Nonmanufacturing Costs



Learning Objective 2

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

Product Costs Versus Period Costs



Quick Check 🗸

Which of the following costs would be considered a period rather than a product cost in a manufacturing company?

- A. Manufacturing equipment depreciation.
- B. Property taxes on corporate headquarters.
- C. Direct materials costs.
- D. Electrical costs to light the production facility.
- E. Sales commissions.

Quick Check 🗸

Which of the following costs would be considered a period rather than a product cost in a manufacturing company?

A Manufacturing equipment depreciation.

B. Property taxes on corporate headquarters.

C. Direct materials costs.

D. Electrical costs to light the production

facility.

Sales commissions.

Classifications of Costs

Manufacturing costs are often classified as follows:



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Comparing Merchandising and Manufacturing Companies



Manufacturers . . .

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





Balance Sheet

Merchandiser

Current assets

- ♦ Cash
- ♦ Receivables
- Merchandise Inventory

Manufacturer

Current Assets

- Cash
- Receivables
- Inventories
 - Raw Materials
 - Work in Process
 - Finished Goods

Balance Sheet

Merchandiser

Current assets

- Cash
- Receivables

Merchandise Inventorv Partially complete products—some material, labor, or overhead has been added.



Learning Objective 3

Prepare an income statement including calculation of the cost of goods sold.

The Income Statement

Cost of goods sold for manufacturers differs only slightly from cost of goods sold for merchandisers.



Manufacturing Company

Cost of goods sold:	
Beg. finished	
goods inv.	\$ 14,200
+ Cost of goods	
manufactured	234,150
Goods available	
for sale	\$248,350
- Ending	
finished goods	
inventory	(12,100)
= Cost of goods	
sold	\$236,250

Basic Equation for Inventory Accounts





Quick Check 🗸

If your inventory balance at the beginning of the month was \$1,000, you bought \$100 during the month, and sold \$300 during the month, what would be the balance at the end of the month?

- A. \$1,000.
- B.\$ 800.
- C. \$1,200.
- D.\$ 200.

Quick Check 🗸





Learning Objective 5

Understand cost classifications used to predict cost behavior: variable costs and fixed costs.

Cost Classifications for Predicting Cost Behavior



How a cost will react to changes in the level of activity within the relevant range.

- Total variable costs change when activity changes.
- Total fixed costs remain unchanged when activity changes.

Total Variable Cost

The total cost of batteries is based on the number of autos produced in a month



Variable Cost Per Unit

The cost of battery is constant per each auto produced





The **monthly rent** for an auto factory is fixed regardless of the number of autos produced



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Fixed Cost Per Unit

The average monthly rent per auto decreases as more autos are produced



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.	Average fixed cost per unit goes down as activity level goes up.

Quick Check 🗸

Which of the following costs would be variable with respect to the number of cones sold at a Baskins & Robbins shop? (There may be more than one correct answer.)

- A. The cost of lighting the store.
- B. The wages of the store manager.
- C. The cost of ice cream.
- D. The cost of napkins for customers.

Quick Check 🗸

Which of the following costs would be variable with respect to the number of cones sold at a Baskins & Robbins shop? (There may be more than one correct answer.) A. The cost of lighting the store. B. The wages of the store manager. The cost of ice cream. D. The cost of napkins for customers.

Learning Objective 6

Understand cost classifications used for assigning costs to cost objects: direct 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 material 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

Learning Objective 7

Understand cost classifications used in making decisions: differential costs, opportunity costs, and sunk costs.

Cost Classifications for Decision Making

- Every decision involves a choice between at least two alternatives.
- Only those costs and benefits that differ between alternatives are relevant in a decision. All other costs and benefits can and should be ignored.



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 Cost**

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 have already been incurred and cannot be changed now or in the future. These costs 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.



Suppose you are trying to decide whether to drive or take the train to Kuala Lumpur to attend a concert. You have ample cash to do either, but you don't want to waste money needlessly. Is the cost of the train ticket relevant in this decision? In other words, should the cost of the train ticket affect the decision of whether you drive or take the train to Kuala Lumpur? A. Yes, the cost of the train ticket is relevant. B. No, the cost of the train ticket is not relevant.

Suppose you are trying to decide whether to drive or take the train to Kuala Lumpur to attend a concert. You have ample cash to do either, but you don't want to waste money needlessly. Is the cost of the train ticket relevant in this decision? In other words, should the cost of the train ticket affect the decision of whether you drive or take the train to Kuala Lumpur? Yes, the cost of the train ticket is relevant. B. No, the cost of the train ticket is not relevant.

Suppose you are trying to decide whether to drive or take the train to Kuala Lumpur to attend a concert. You have ample cash to do either, but you don't want to waste money needlessly. Is the annual cost of licensing your car relevant in this decision?

A. Yes, the licensing cost is relevant.B. No, the licensing cost is not relevant.

Suppose you are trying to decide whether to drive or take the train to Kuala Lumpur to attend a concert. You have ample cash to do either, but you don't want to waste money needlessly. Is the annual cost of licensing your car relevant in this decision?

A. Yes, the licensing cost is relevant.B. No, the licensing cost is not relevant.

Quick Check 🗸

Suppose that your car could be sold now for \$5,000. Is this a sunk cost? A. Yes, it is a sunk cost. B. No, it is not a sunk cost.

Quick Check 🗸

Suppose that your car could be sold now for \$5,000. Is this a sunk cost? A. Yes, it is a sunk cost. No, it is not a sunk cost. **B**.

End of Chapter 2

