The University of Melbourne

ACCT20001

Cost Management

Summary

Lecture 1-5 Summary

Distinctions between managerial accounting, financial accounting and cost accounting

Firstly, financial accounting is historical in nature, management accounting can be based on historical or future information. **Secondly,** financial accounting is mainly for external users, management accounting is mainly for internal users.

Cost accounting measure and reports information related to the organisation's acquisition and consumption of resources. The costs of these resources are then typically allocated to cost objects.

Cost accounting information is firstly used in the valuation of inventory which forms part of an entity's balance sheet, secondly can determine the cost of goods of sold which forms part of the income statement. Both the balance sheet and the income statement are the main components of financial accounting reports.

Cost accounting information can be used to determine which products or services should be chosen to produce, what price should be charged for products or services, how many products should be produced to achieve the target profit. These information can be related to management accounting.

Allocation of indirect costs

Indirect costs can be defined as the cost which cannot be economically traceable to the cost object. Therefore, an appropriate allocation base is needed to ensure the accurate allocation of indirect costs.

An appropriate allocation base should be a good representation of the cost driver. Changes in the measured quantity of the allocation base should correspond to changes in the amount of overhead costs that are incurred by the organisation to produce cost object.

This ensures the amount of indirect cost allocated to the cost driver reflects as much as possible the amount of cost that is caused by the cost object, therefore resulting in accurate cost allocation.

Cross subsidization

Cross subsidization is the practice of charging higher prices to one group of customers to subsidize lower prices for another group.

Before cross subsidizing products, company needs to consider how each product should be priced. The price charged should cover all product cost, including operating expenses, rent expenses, material expenses, labour expenses, etc.

Cross subsidization can benefit new products entering into the market, and the product which has fallen into a highly competitive market circumstances. However, cross subsidization is also possible to lose some market share for the products with higher price because other competitors can charge lower price for that product to attract more customers.

Lecture 6-7 Summary

Cost Volume Profit analysis (CVP)

CVP can be used firstly to calculate the units or revenues required in order to achieve breakeven, **secondly** calculate the units or revenue required to achieve a target profit, **thirdly** calculate margin of safety which is excess of budgeted revenues over breakeven revenues, **fourthly** aimed to sensitivity analysis which analysis the impact of changes to key variables (selling price, variable costs, fixed costs) on profits or breakeven.

Revenue

Revenue is the inflows of assets received in exchange for products or services provided.

Revenue driver is factors that affects revenues, such as units of output sold, selling price and levels of marketing costs.

Contribution Margin (CM)

Total CM = Total Revenue – Total Variable Cost

CM per unit = Selling price – Unit Variable Cost

CM Ratio = $\frac{Selling\ price - Unit\ Variable\ Cost}{Selling\ price}$

Profit Volume

V = $\frac{Total\ Fixed\ Costs + Target\ Profit}{Selling\ price - Unit\ Variable\ Cost} = \frac{Total\ Revenue - Total\ Variable\ Cost\ (Total\ CM)}{Selling\ price - Unit\ Variable\ Cost}$

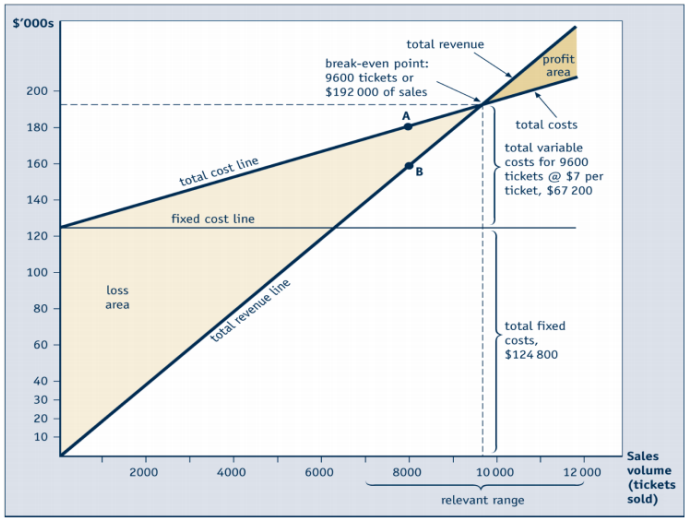
Target Profit = Total Revenue – Total Variable Cost – Total Fixed Cost

Total CM = Total Fixed Cost + Target Profit = Total Revenue – Total Variable Cost

Breakeven Volume

In Breakeven, target profit is zero.

V = $\frac{Total\ Fixed\ Costs + 0}{Selling\ price - Unit\ Variable\ Cost}$



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