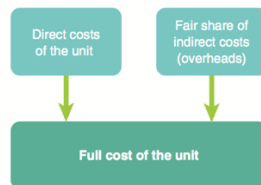


Costing

- **Why calculate costs?**
 - To value inventory (BS)
 - To determine COGS (P&L)
 - For contractual purposes
 - For management decision making (e.g. pricing)
 - To motivate employees
- **Cost accounting** involves measuring, recording and reporting costs of any cost object (e.g. product, service, department, customers, employees)
- **Direct Costs**
 - Can be economically physically traced to specific cost objects
 - E.g. flour for bread, baker's wages, steel for cars, cloth for shirts, plastic for toys
- **Indirect Costs (Overhead)**
 - Not directly traceable to specific goods
 - E.g. oil for lubricating machines, maintenance staff wages



- **Product Costs**
 - Directly related to finished products
 - Expenses as COGS, manufacturing goods
- **Period Costs**
 - According to financial period, not specific goods
 - E.g. Selling and Administration costs, advertising
 - Anything not involved in manufacturing
 - No future benefits

Traditional Costing Systems (2)

→ use a single, volume-based cost driver.

In most cases, it assigns the OH to products of their relative usage of direct labour, thus distorts the cost of products because the proportion of the activity actually consumed by a specific product does not universally correspond with a single cost driver. It is based on the assumption that products cause costs, which is valid for certain direct costs but not activities indirectly related on the product units.

- A. **Job order costing** – costs assigned to each individual job, usually for customized product
- Each job can be distinguished from all other jobs
 - Costs are measured according to job, not set time periods
 - e.g. legal services, travel, patient healthcare
- B. **Process Costing** – allocates exactly the same cost to each homogeneous product

- Production involves continuous process of similar items (departments assembly → painting → painting)
- Costs assigned according to set periods of time

→ **Printing can be in both categories**

Predetermined Overhead Rate

- Based on relationship between estimated annual costs and estimated annual operating activity
- established at the beginning of year
- single figure used to apply overhead costs to jobs
- enables estimated costs of overheads to be determined at any given time
- Cost driver → machine hours, labour hours, etc.

$$\text{Predetermined OH Rate} = \frac{\text{budgeted total OH}}{\text{budgeted cost driver}}$$

$$\text{Overhead Applied} = \text{Predetermined OH rate} \times \text{Actual Cost Driver}$$

Overhead Applied – Actual Total OH

If it is positive, over applied; negative, under applied.

Overheads are allocated using a predetermined rate, cost allocated may not equal actual costs

Under-applied means the assigned costs are less than the actual costs incurred.

Activity-based Costing

1. Determine cost pools
2. Allocate costs to cost pools
3. Find cost drivers that best represent costs allocated with specific cost pools
4. Update costs associated with cost pools and cost drivers on a regular basis

Limitations:

1. It is difficult to find cost drivers which represent specific overhead costs
2. Certain costs may fall in to multiple cost pools
3. It is difficult and time-consuming to update cost drivers, costs associated with different cost pools on a regular basis
4. Certain costs are impossible to divide and allocate on a per production unit cost e.g. CEO's salary
5. Not all costs add value to production