

# Chapter 1

## Cost accounting: Basic concepts

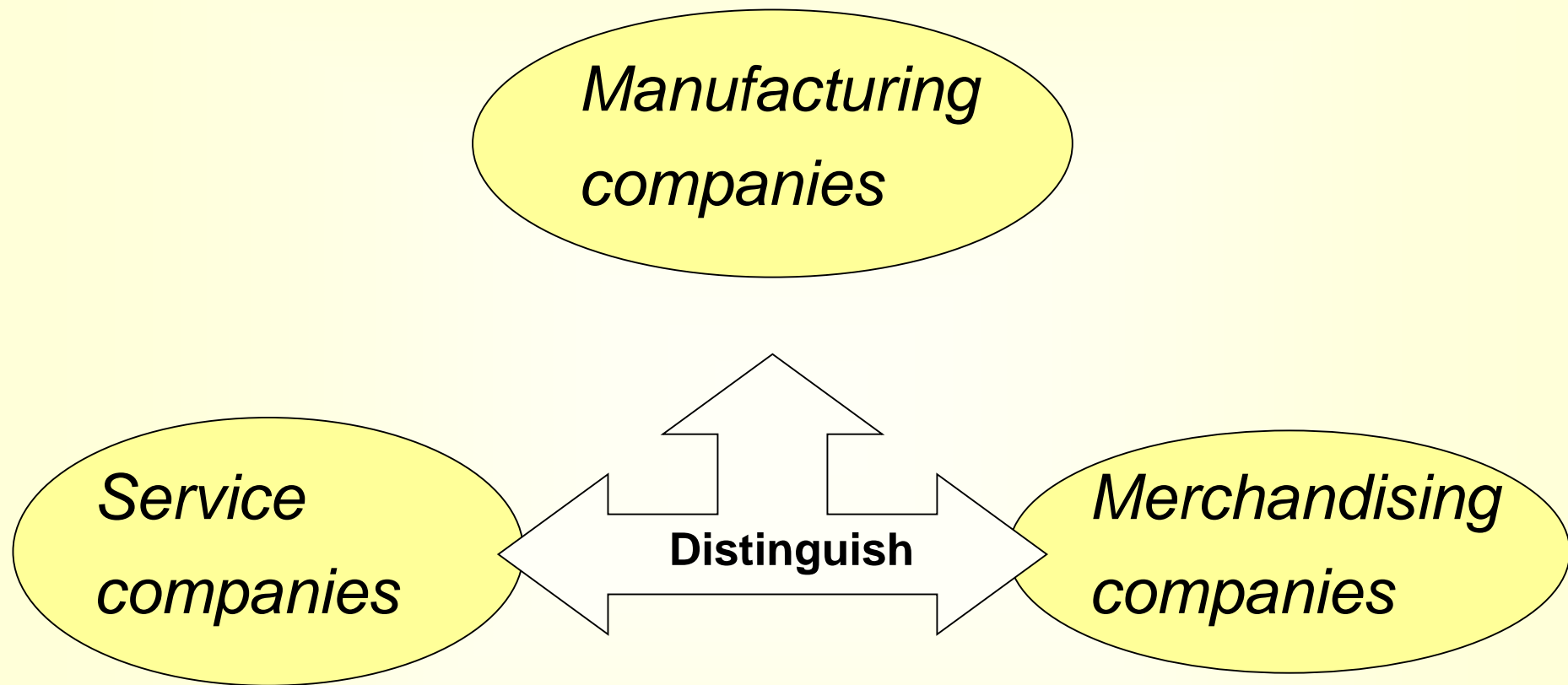
# ***CONTENTS***

## ***Chapter 1. Cost accounting: Basic concepts***

1. Accounting information for internal and external reporting
2. Cost accounting: Definition and objectives
3. Cost terminology: Basic terms
4. External income statement and Internal income statement

# Learning Objectives

- *Distinguish between manufacturing, merchandising and service companies*
- *Distinguish between internal and external fields*
- *Present a framework for cost accounting*
- *Define and illustrate a cost terminology*
- *Distinguish between internal and external income statements*



*Manufacturing companies*

purchase materials and components and convert them into finished goods.

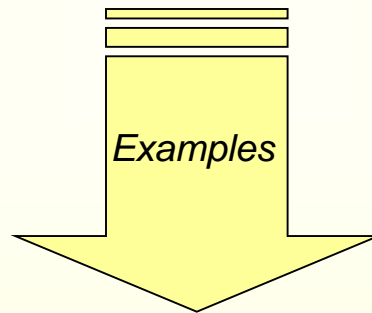
Manufacturing companies must also develop, design, market and distribute their products.

*Examples*

***Furniture companies, automotive companies, food-processing companies, textile companies, etc.***

*Merchandising companies*

purchase and then sell tangible products  
without changing their basic form.

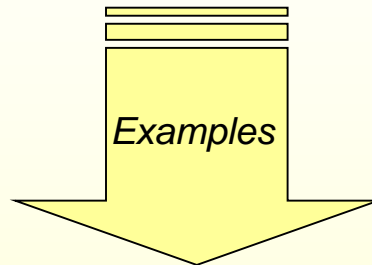


*Examples*

***Bookstores, department stores, distribution companies, wholesalers, etc.***

*Service companies*  
provide services or intangible  
products for their customers.

Labor is the biggest cost category.

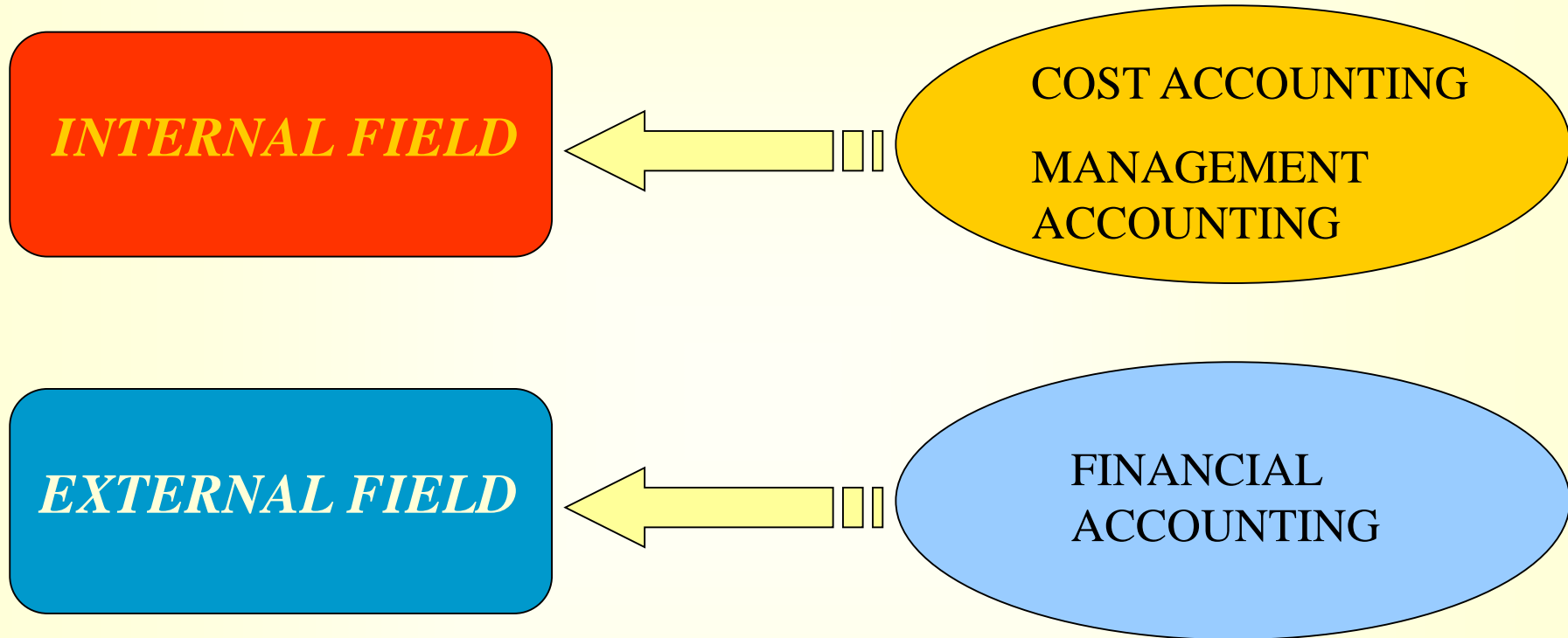


***Law firms, accounting firms, banks, insurance companies, advertising agencies, radio and television stations, internet-based companies, etc.***





# 1. Accounting information for internal and external reporting



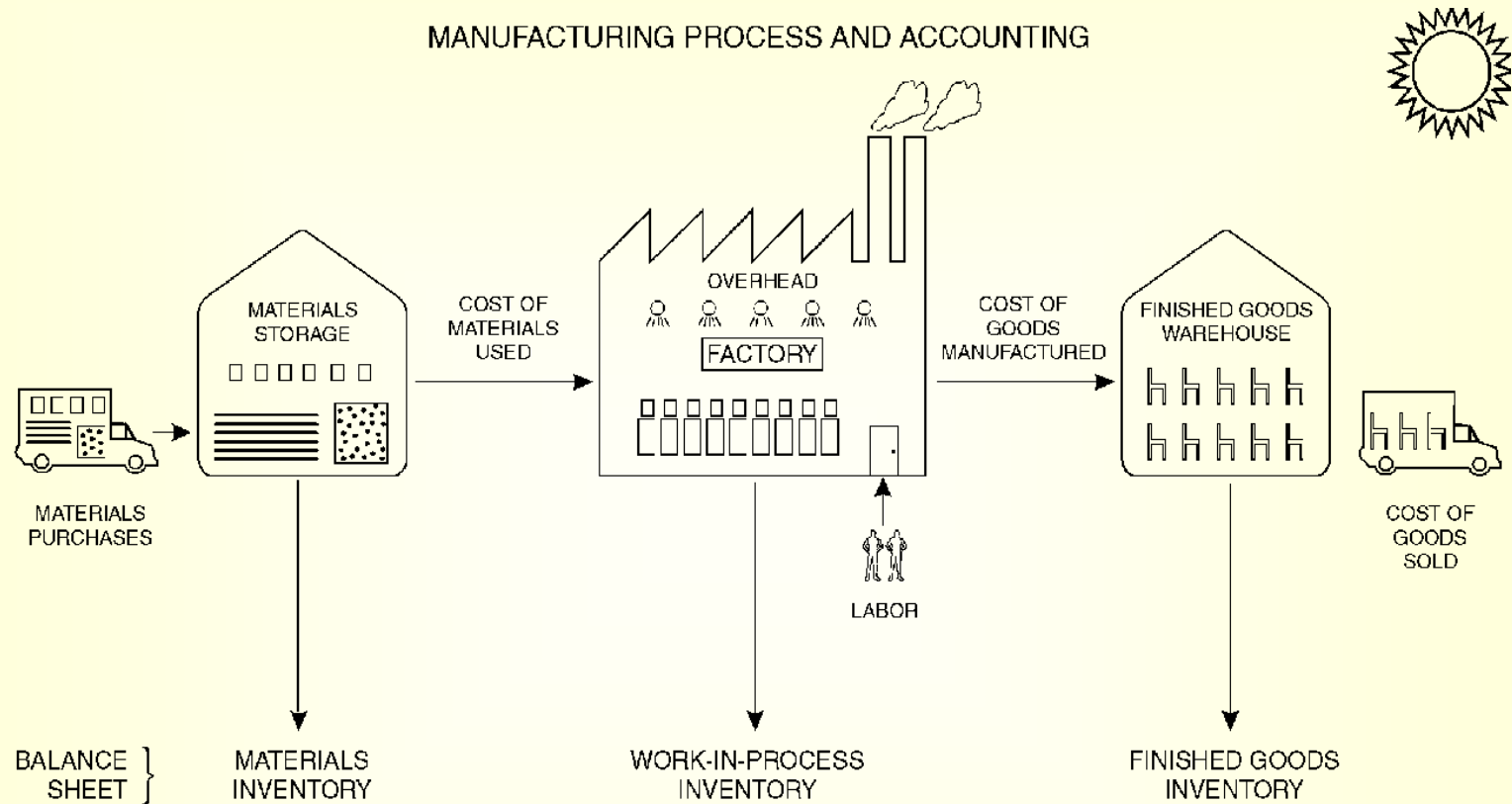
## 1. Accounting information for internal and external reporting

<i>Internal users</i>	<i>External users</i>
Managers	Suppliers / Customers
Sales representatives	Government regulators
Production supervisors	Shareholders
Sales managers	Insurance companies
Distribution managers	Financial companies
Manufacturing managers	Banks
Etc.	Etc.

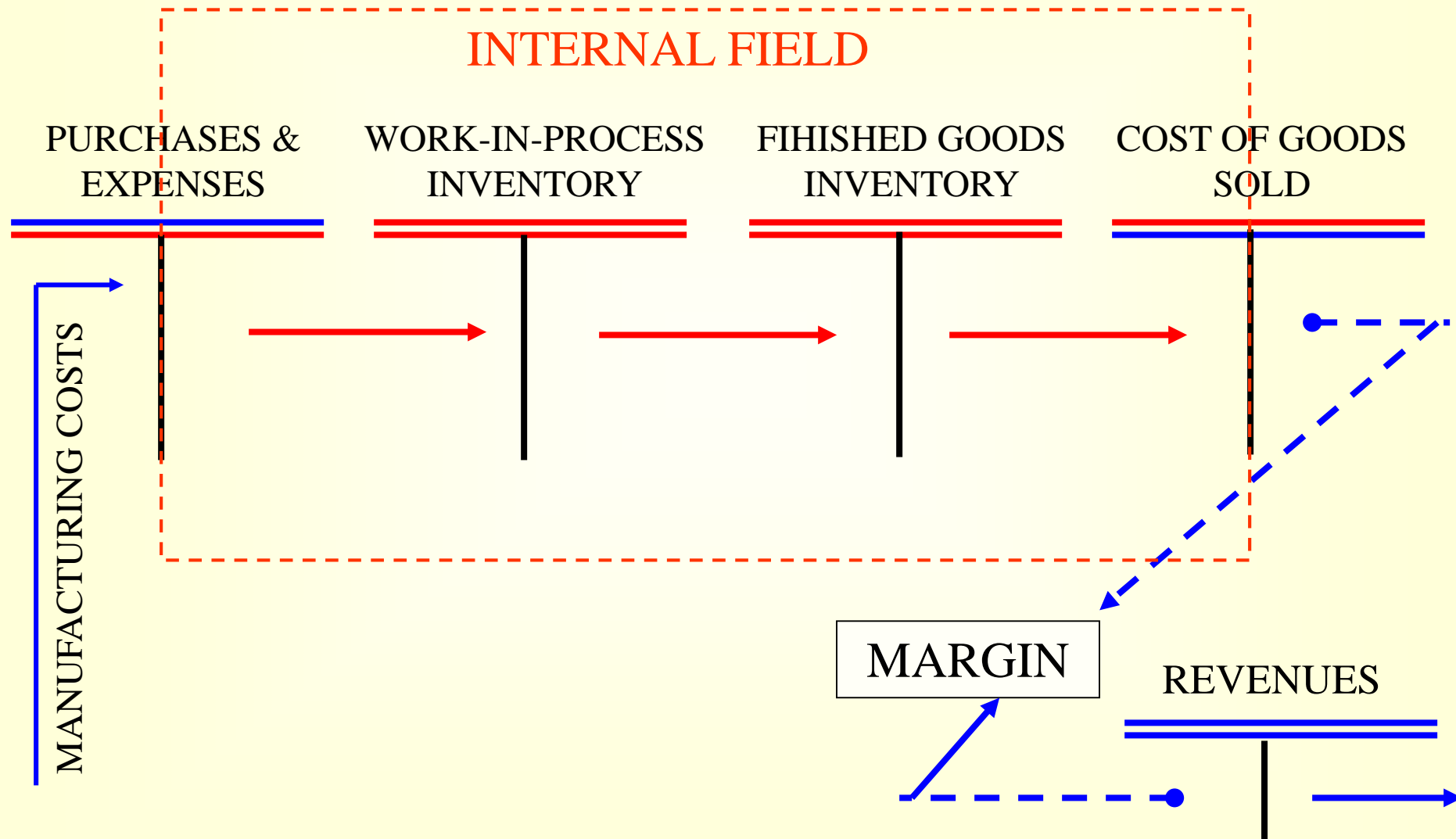
## ***Differences between internal and external fields***

<b><i>EXTERNAL</i></b>	<b><i>INTERNAL</i></b>
<b>Emphasize the past</b>	<b>Emphasize the past, present and future</b>
<b>Use financial information</b>	<b>Use financial and non-financial information</b>
<b>Adhere strictly to GAAP (Generally Accepted Accounting Principles)</b>	<b>Is not nearly so restricted by GAAP</b>

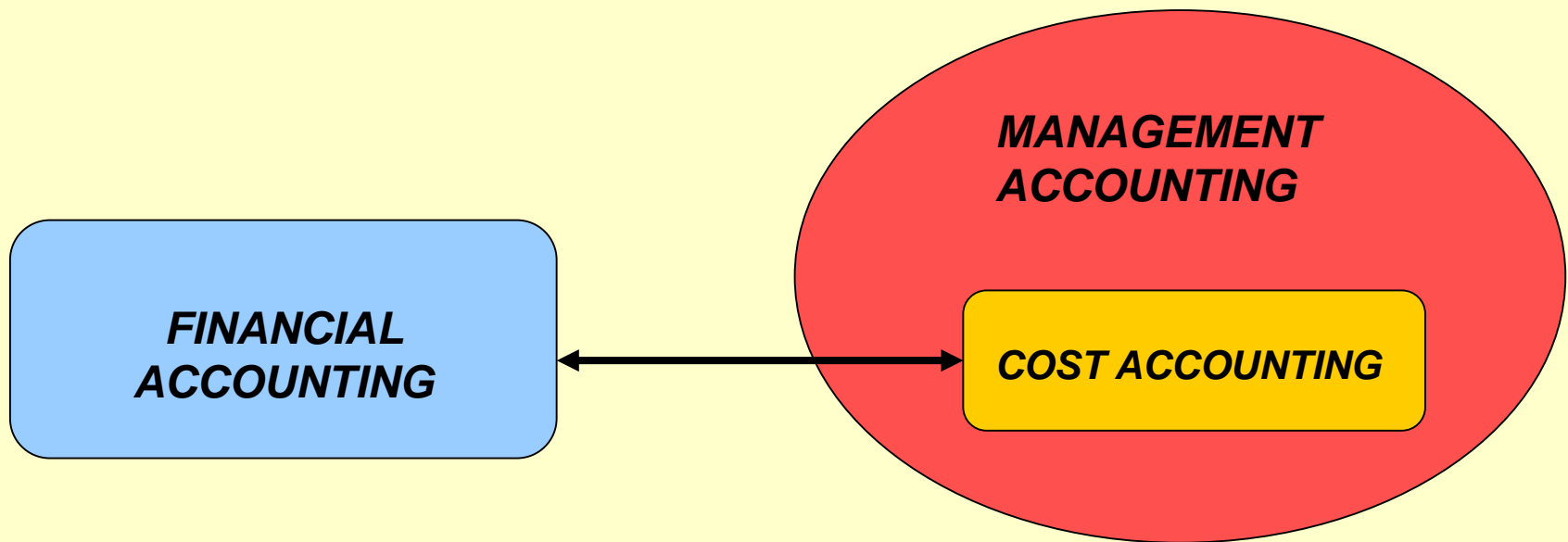
# 1. Accounting information for internal and external reporting



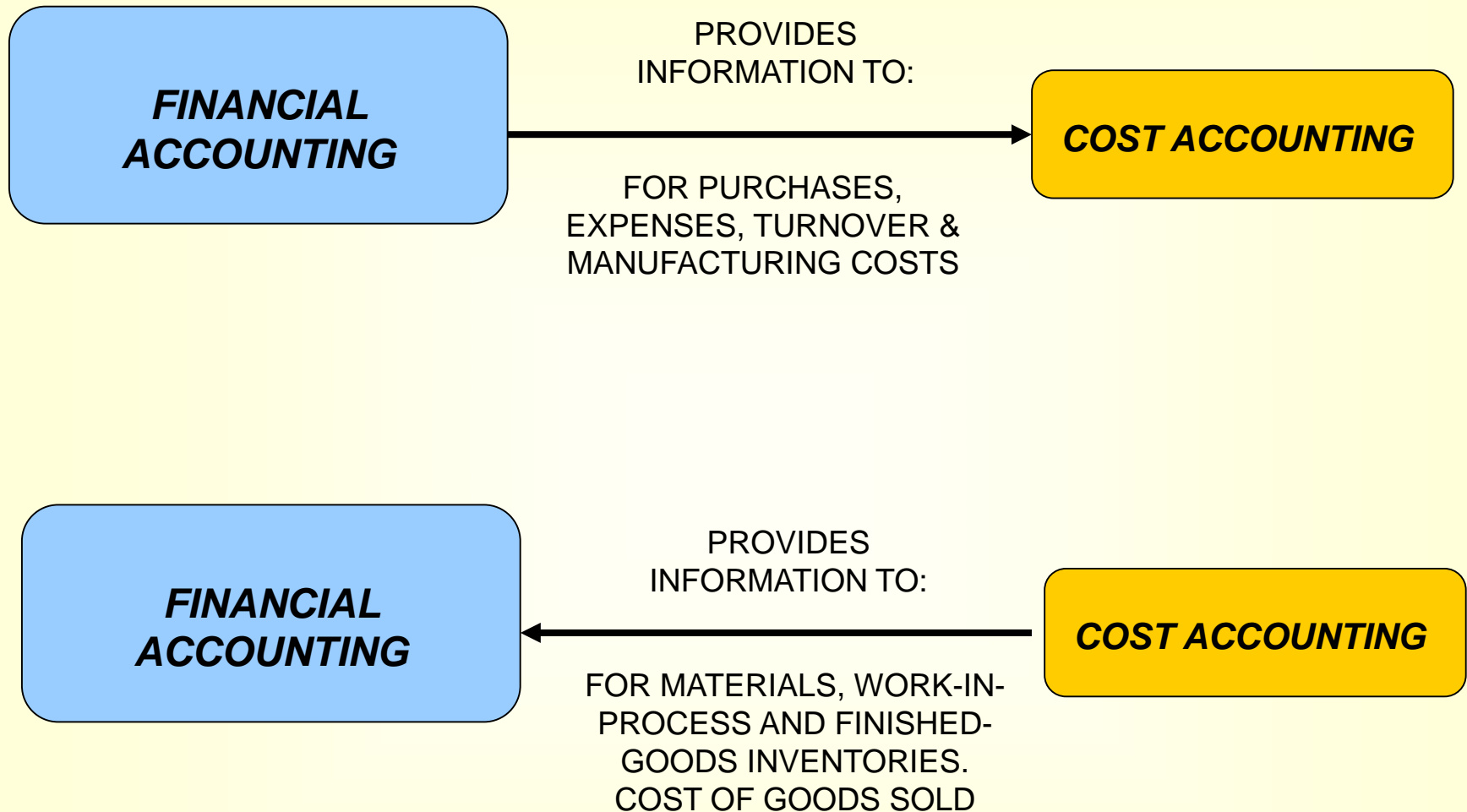
## GENERAL-LEDGER T-ACCOUNTS FOR INTERNAL FIELD



## ACCOUNTING SYSTEMS



## 2. Cost Accounting: Definition and objectives



# A Framework for Cost Accounting

Three features of cost accounting  
and cost management:

1. Calculating the costs of products
2. Obtaining information
3. Analyzing information

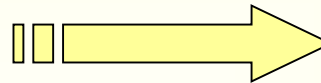


# A Framework for Cost Accounting

## OBJECTIVES

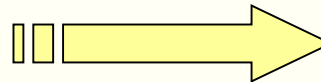
## TEMPORAL PERSPECTIVE

*1. Calculating the costs of products*



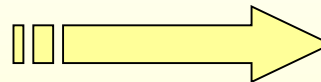
*Past*

*2. Planning and Controlling*



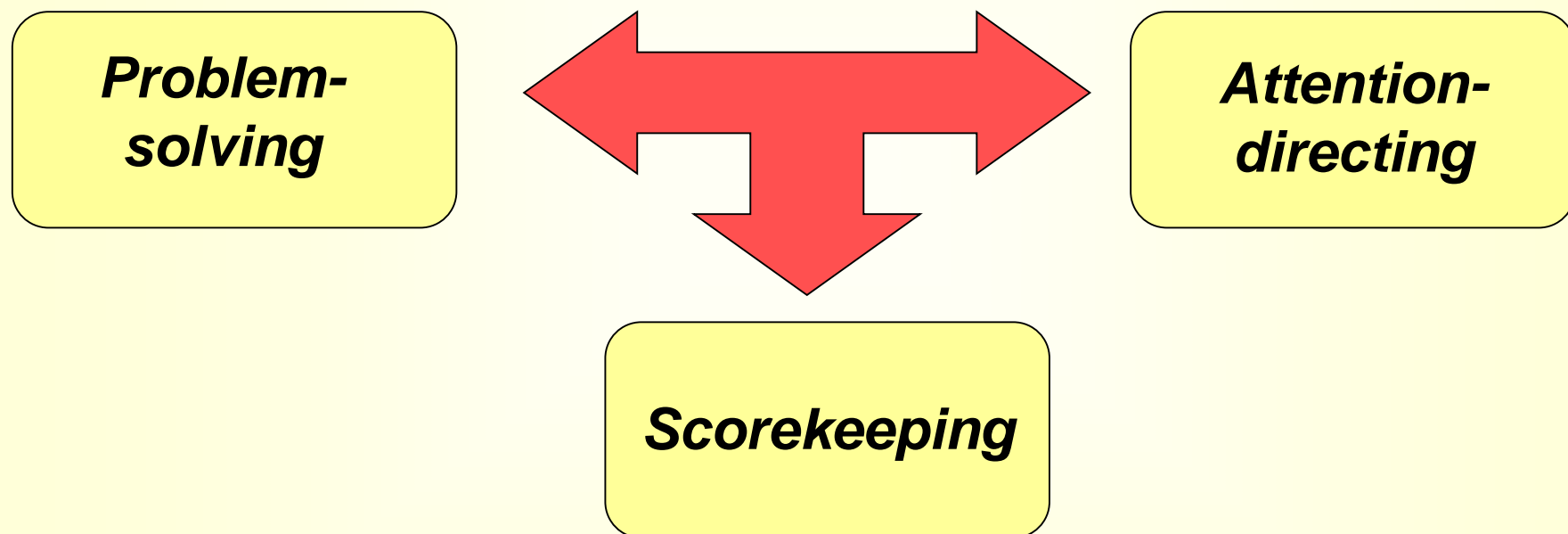
*Present + Future*

*3. Providing information that helps make decisions*



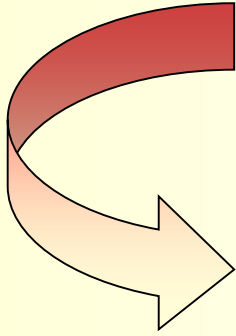
*Future*

# Roles of management accountants

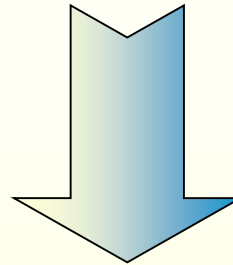


# Problem-Solving

This role asks:



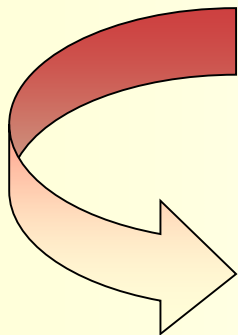
Which of the several available alternatives is the best?



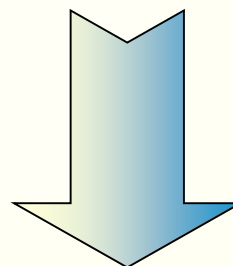
This involves comparative analysis for decision-making.

# Scorekeeping

This role asks:



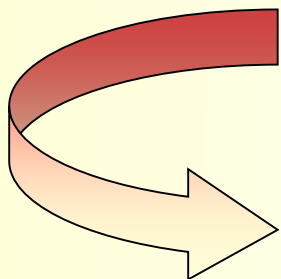
How is the business doing?



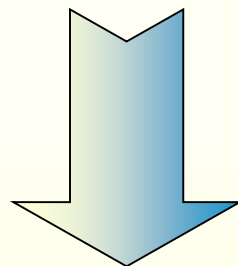
This involves accumulating data and reporting reliable results to all levels of management.

# Attention-Directing

This role asks:



Which opportunities and problems should be emphasized first?



This involves helping managers focus their attention properly.

## Purchase

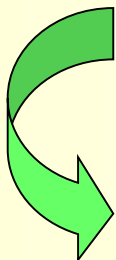
A product or service which has been bought.

## Cost

is a resource used to achieve a specific cost object.

$$\boxed{[C] \text{ Cost}} = \boxed{[Q] \text{ Quantity (Physical Units, p.u.)}} \times \boxed{[P] \text{ Price (Unit Price, u.p.)}}$$

## Cost object



This is anything for which a separate measurement of costs is desired.

**Examples: Product, Service, Activity, Department, Brand category, Project, etc.**

# Cost Object Examples at BMW

Cost Object	Illustration
Product →	BMW X5 sports activity vehicle
Service →	Dealer-support telephone hotline
Project →	R&D project on DVD system enhancement
Customer →	Herb Chambers Motors, a dealer that purchases a broad range of BMW vehicles
Activity →	Setting up production machines
Department →	Environmental Health & Safety

**Payment**

An amount of money that you pay.

**Receive  
payment**

An amount of money that you receive.

**Investment**

An amount of money that you invest,  
or the thing that you invest it in.

**Revenue**

Income from business activities.



## **Product**

Any output that has a positive sales value or an output that enables an organization to avoid incurring costs.

## **Product cost**

Sum of the costs assigned to a product for a specific purpose.

## **Production process**

Acquiring, coordinating, and assembling resources to produce a product or deliver a service.

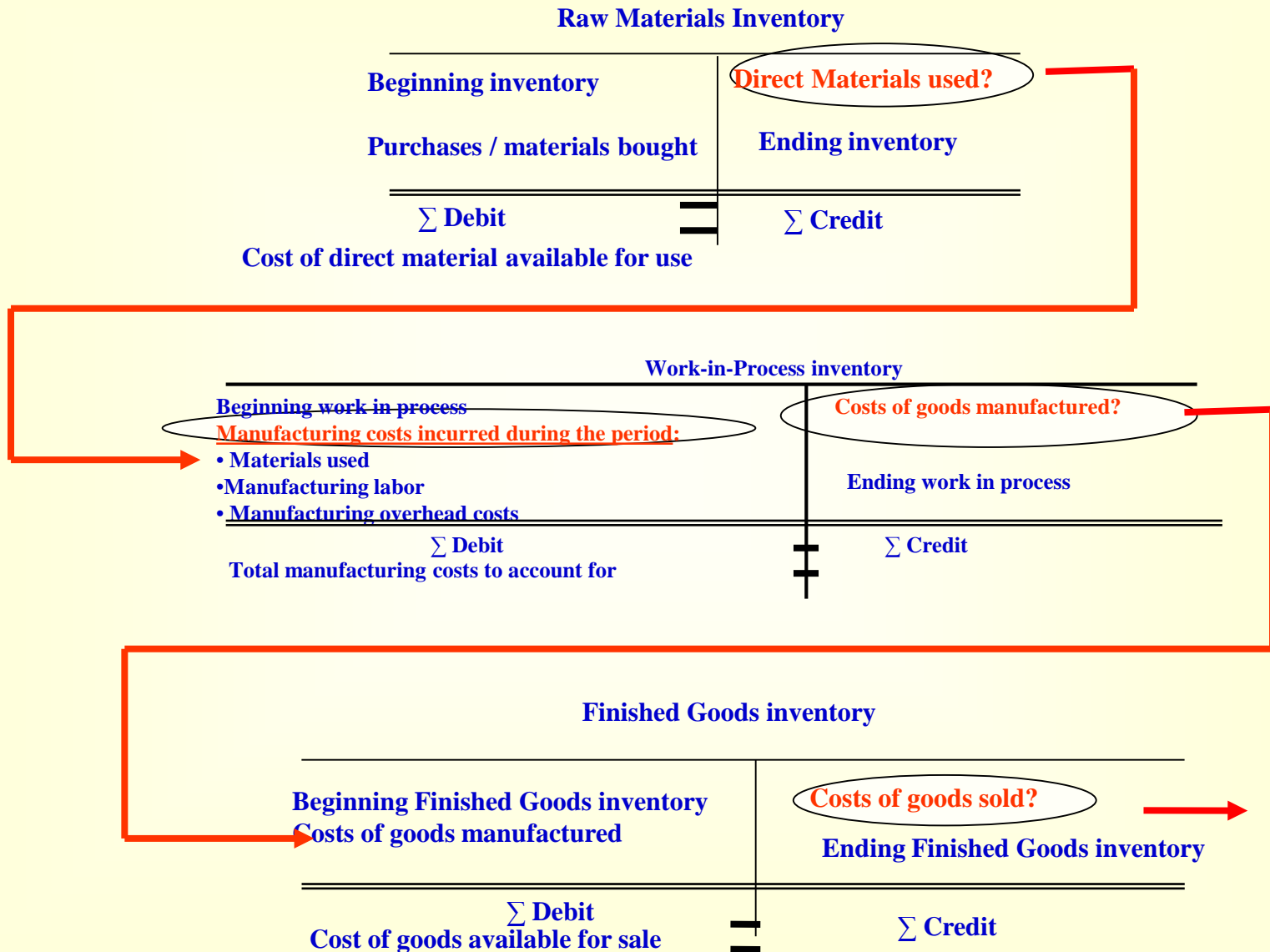
## **Acquisition costs**

Include the price of materials **plus** freight-in (inward delivery) charges, sales taxes, insurance, handling costs and custom duties.

## **Inventoriable costs**

Are all costs of a product that are regarded as assets when incurred and become costs of goods sold.

# REMEMBER.....



**REMEMBER.....**

## **Examples of Manufacturing Costs**

Materials: wood,  
iron, paper, etc.

Salaries, wages,  
manufacturing labor

Electric power  
Heat power  
Light power  
Water power  
Telephone line

Indirect materials  
Lubricants  
Plant maintenance  
Cleaning labour  
Plant rent  
Plant insurance

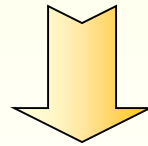
Property taxes on plants  
Depreciation of plant  
Depreciation of plant equipment  
Depreciation of plant building

Property taxes

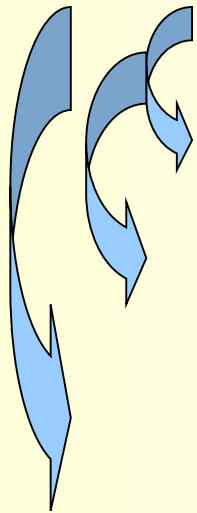
Maintenance labor

## *External income statement or Profit & loss account*

*This shows the results of financial accounting*



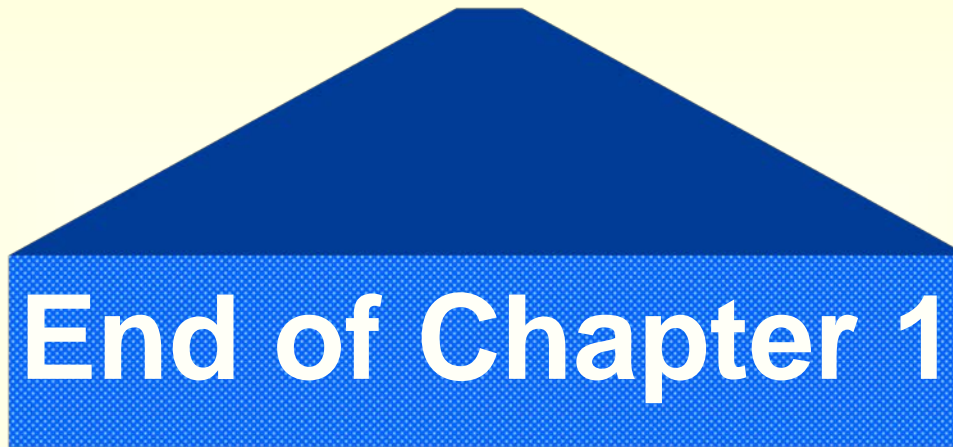
*It can be divided into three categories :*



- *Profit or loss on ordinary activities*
- *Profit or loss for the financial year*
- *Profit or loss on extraordinary activities*

# Internal Income Statement or Example of Performance Report

		<i>PRODUCT "A"</i>			
<i>concepts</i>		<i>units</i>	<i>unit cost</i>	<i>\$ Value</i>	<i>%</i>
+	Revenues	10	2,000	<b>20,000</b>	100%
-	Cost of Good Sold	10	1,500	<b>15,000</b>	75%
=	Gross Margin	10	500	<b>5,000</b>	25%
	Operating Cost (Cost period):				
-	Marketing Department			800	4%
-	Administration Department			300	1.5%
=	Operating income	10	390	3,900	19.5%



# End of Chapter 1

*Any questions?*

*Thank you for your attention.*