cost classification as f to students you are required to know the different ways of classifying and describing costs some terminology you should know here are cost objects cost units and cost centers cost objects are any item or activity for which costs are being separately measured the most common cost objects are a company's output its product or service but it could also be a department a product line or a process etc a cost unit this is a unit of product or service in relation to which costs are ascertained it is the cost incurred by a company to produce store and sell one unit of a particular product computed usually as the average cost a cost unit includes all fixed and all variable costs incurred in a unit of product or service for example it costs company a 10000 to produce 5000 widgets companies A's cost per unit is 10000 divided by 5,000 so 2 per unit cost centres are a part of an organization it is a location person or item of equipment for which cost can be ascertained and used for the purpose of cost control examples of call centers include research and development departments marketing departments help desks customer service centers and so forth cost can be classified by element function nature controllability responsibilities product or period and behavior by element which is material labor or expense costs material costs are all costs of materials purchased labor costs are all staff costs relating to employees on the payroll of an organization expense costs are all other costs incurred by the organization which are not material or labor costs function costing involves grouping costs based on the different functions or activities of the organization for example a business may classify costs into production costs or non production costs production costs are those costs incurred when converting raw materials into finished or part finished goods non production costs are all costs not related with the production process production costs are direct materials direct materials are the materials which go into the making of a product direct labor direct labor are the costs of labor directly involved in the making of the product direct expenses are the cost of expenses directly involved in the making of the product variable production costs these are the indirect costs that relate to production they vary in direct proportion to the quantities of production and fixed production overheads these are the indirect costs that relate to production they are fixed and do not vary in relation to the quantities of production non production costs are administration costs these are the general costs of running the business selling costs these are the costs associated with marketing and taking sales orders distribution costs these are the costs of distributing the finished products and finance costs these are the costs incurred in order to finance the organization by nature direct and indirect costs direct costs can be defined as costs which can be completely attributed to a cost object cost objects may be a product cost unit a department or a project cost Center examples of direct costs direct materials for example cloths for making curtains direct labor for example the wages of the workers stitching the cloth to make the curtains direct expenses for example the freight charges for importing specialized materials for the curtains the total of direct costs which is direct materials plus direct labor plus direct expenses is known as prime costs indirect costs cannot be directly identified to a specific cost object they are costs that typically benefit multiple cost objects and it will be impractical to accurately attribute them to individual products services or departments examples of indirect costs include the following indirect materials these include materials that cannot be traced to an individual curtain for example machine oil used to lubricate the machines indirect labor for example the cost of a supervisor who supervises the curtain makers indirect expenses

for example the cost of renting the factory the total of indirect costs which is indirect materials plus indirect labor plus indirect expenses is known as overheads by controllability all costs for a company are controllable costs at some level of management however some costs are uncontrollable costs we regards to a particular manager or department if a manager or department has Authority and responsibility for certain costs those costs are called controllable costs the non controllable costs are those costs that a department or manager doesn't have authority over and cannot change the difference between controllable and uncontrollable costs is of particular significance to management because managers want to be held responsible only for those costs which are within their control and not for the costs which are beyond their control responsibilities costing involves grouping costs together according to which individual manager or management team are responsible for the control of the cost a responsibility cost accounting system divides an organization into several part or responsibility centers each responsibility center has a manager responsible for the operation and performance of that center by product or period cost this classification becomes important when you study marginal and absorption costing product costs are all the costs involved in making or buying an item of inventory these costs are included in the inventory value and therefore the cost of sales value at the time of sale period costs are all costs not included in product costs since these costs are not involved in the production process these costs are included in the income statement for the period in which they relate the distinction between product and period costs is necessary for calculating inventory values and profit figures behavior costing involves grouping costs according to the way they behave cost behavior is concerned with the impact a change in output has on costs cost analysis Bible behavior is concerned with the way different types of production costs change with changes in activity levels understanding cost behavior is central to budgeting costing and decision-making cost behavior tends to classify cost as fixed costs variable costs semi variable costs and stepped costs fixed costs are those costs that are not affected by changes in quantities of output as activity levels increase fixed cost stay the same probably the best example of a fixed cost would be a factory's rent no matter how much units a factory produces the rent costs are the same a good visual representation of behavioral costs is via a graph here is what fixed costs would look like as you see no matter how much the activity level increases the costs remain constant variable costs are costs that are directly related to changes in quantities of output as activity levels increase variable costs increase in proportion to them so for example if the number of units produced doubles so will the variable costs or if the number of units produced goes up by 10 percent variable costs go up by 10 percent also semi variable costs are costs that have both a fixed cost element and a variable cost element the best example to explain semi variable costs are telephone bills with a landline you have the fixed line rental charge and a variable call cost charge stepped costs are costs that are fixed up to a certain level of activity once that activity level is reached there is an additional cost again fixed up to a certain level of activity and so forth a good example of stepped costs will be supervisor costs if for example one supervisor is required for every ten workers as the number of workers increase so will the supervisory costs behavioral costs are all relevant within a range of activity this means the activity level over which the observed cost behavior is valid understanding cost behavior is very important for management's planning and control processes for example the fixed cost of rent is only fixed up to the

capacity of the unit rented once this is exceeded new or additional premises will need to be rented and this fixed cost becomes a stepped cost therefore managers must use cost behavior to predict costs within a cost behavior range

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