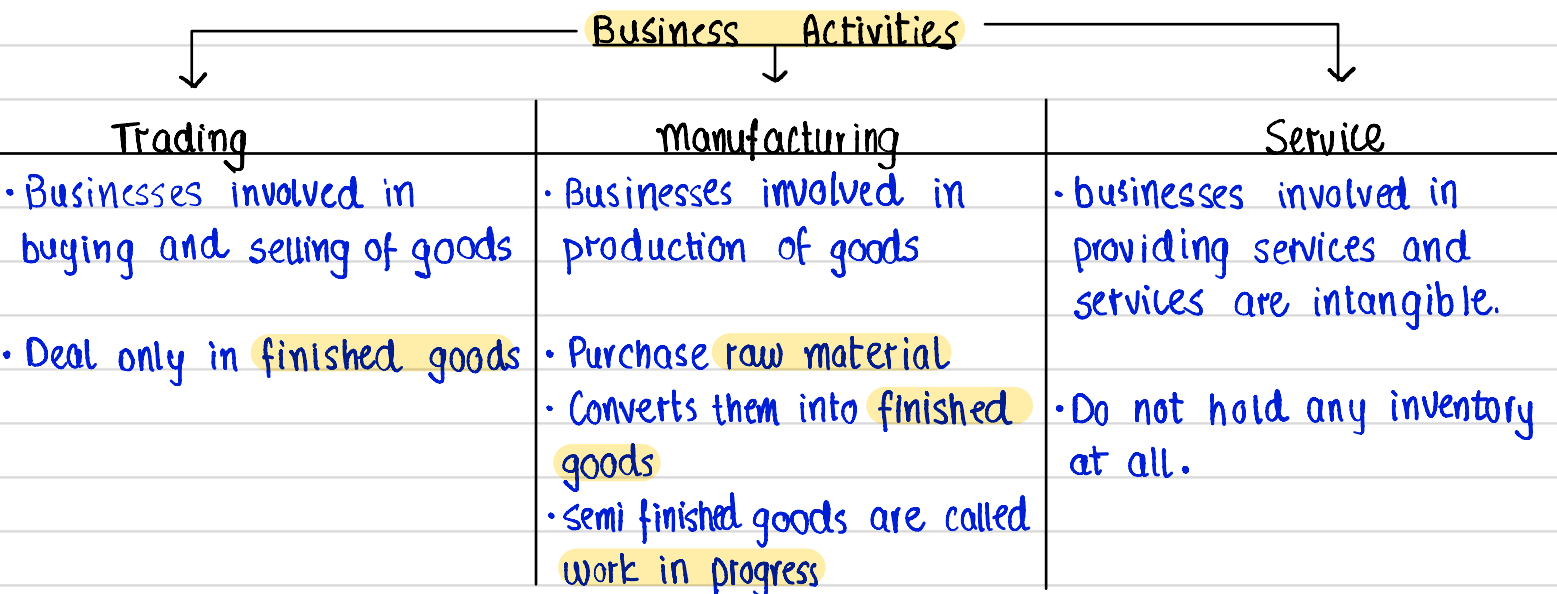
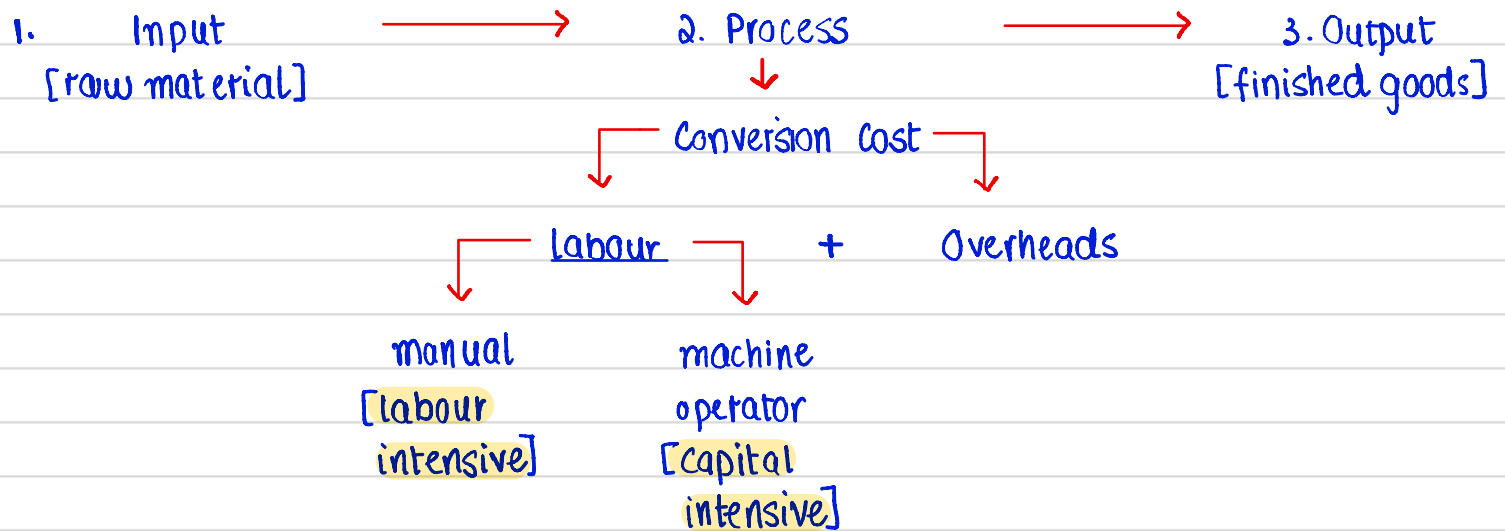


INTRODUCTION TO COST AND MANAGEMENT ACCOUNTING

Cost/Expense: Outflow of resources.



Stages of Manufacturing



Labour intensive business: Business organisations dependant on manual labour rather than technology and machinery


Capital intensive business: Business organisations which are more dependant on machines rather than manual labour.

What are the overheads cost?

1. Indirect material [for e.g.: lubricants for machinery]
2. Indirect labour [for e.g.: store staff, watchman etc]
3. Supervisor wages
4. Factory manager's salary
5. Rent and rates
6. Insurance
7. Heat, light, power and electricity
8. Repair and maintenance
9. Depreciation - Decrease in the value of resources [such as machinery]

Classification of Cost

1. **Elements / Components**: 1. material 2. labour 3. Overheads

2. **Nature**  Direct
Indirect

3. **Behaviour**  Fixed
Variable

4. **Function**  production - includes material, labour and factory overheads
non production - include administration cost, selling and distribution cost, advertising and marketing

INTRODUCTION TO COSTING

Functions of Cost and management accounting:

- Planning
- Decision Making
- Evaluation and Appraisal

Classification of Cost

• Element → material, labour and overheads

• **Nature**
 ↙ ↘
Direct Indirect

• **Behaviour**
 ↙ ↘
Variable Fixed

• **Function**
 ↙ ↘
Production Non Production

Direct Cost

The cost which is directly related to or associated with production, or the cost, which can directly be identifiable to a particular unit cost is defined as 'Direct Cost'.

For example:

- Direct Material
- Direct Labour
- Direct Expenses (Royalties or license cost)

The sum of all the direct costs is known as '**Prime Cost**'

Prime Cost = Direct Material + Direct labour + Direct Expenses

Note: Direct costs are normally variable cost but if there is a special contract with suppliers of raw material, labour force or royalty owners to pay a certain fixed amount, then in that case direct cost can be a 'fixed cost'.

Indirect Cost

The cost which is not directly related to production or the cost which cannot be directly traced to a particular unit cost but which is part of production is defined as 'Indirect Cost'. For example:

- Indirect material
- Indirect Labour (factory supervisor's salary)
- Rent, rate and electricity (of factory)
- Repair and maintenance and depreciation (of plant and machinery)

The sum of all the indirect costs is known as 'Factory Overheads'

Indirect Costs can be fixed (e.g.: depreciation) and variable (e.g.: fuel for machinery)

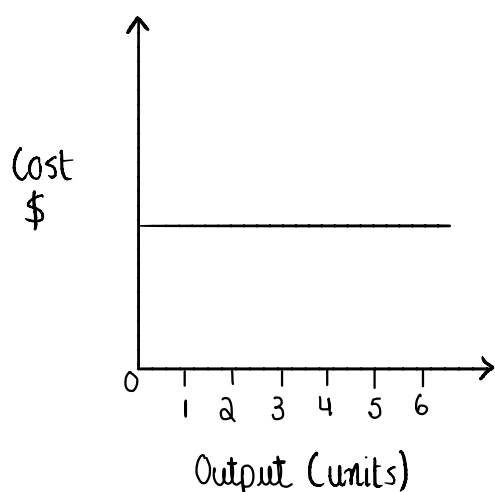
Fixed Cost

The cost which remains fixed or constant at all levels of output in the short run is defined as fixed cost. For example:

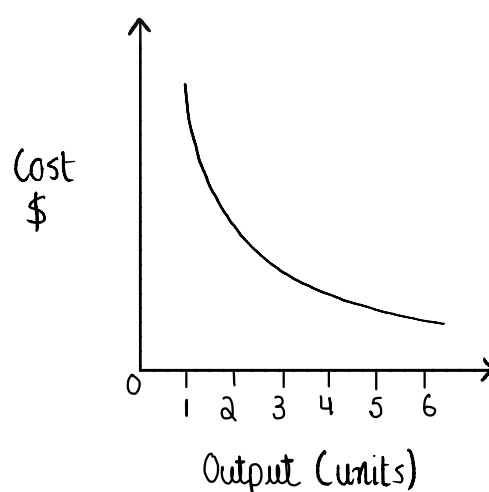
- Rent and rates of factory
- Insurance of factory
- Factory supervisor's salary

Fixed costs have to be paid no matter the firm is not doing any production or working at full capacity. In total it remains constant, but per unit fixed cost decreases with an increase in level of output.

Total Fixed Cost



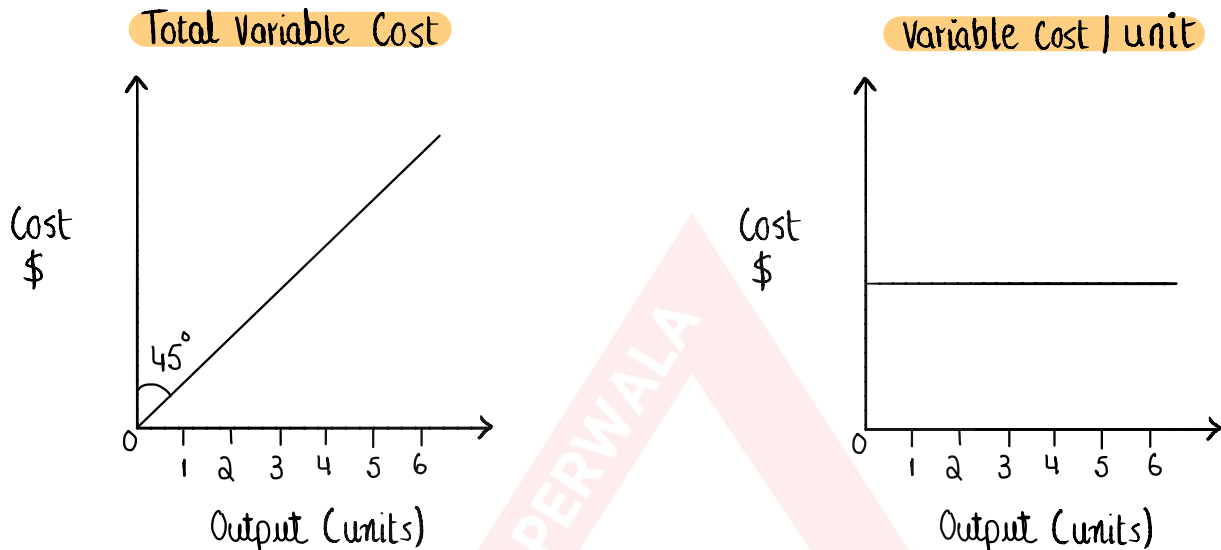
Average Fixed Cost /
Fixed Cost per Unit



Variable Cost

The cost which varies due to change in the output level is defined as variable cost. Variable cost in total increases with increase in level of output but unit variable cost remains constant [assumption of break even analysis / marginal costing]. For example:

- Direct material
- Direct labour
- Variable production overheads
- Variable sales overheads etc.



Total Cost

The sum of total fixed and total variable cost is known as total cost.

$$y = mx + c$$

Annotations for the equation $y = mx + c$:

- y is labeled as "Dependant variable".
- m is labeled as "gradient".
- x is labeled as "Independent variable".
- c is labeled as "constant".

$$\text{Total Cost} = \text{Variable cost per unit (output level)} + \text{Total Fixed Cost}$$

OR

$$\text{Total Cost} = \text{Total Variable Cost} + \text{Total Fixed Cost}$$

INTRODUCTION TO COST AND MANAGEMENT ACCOUNTING

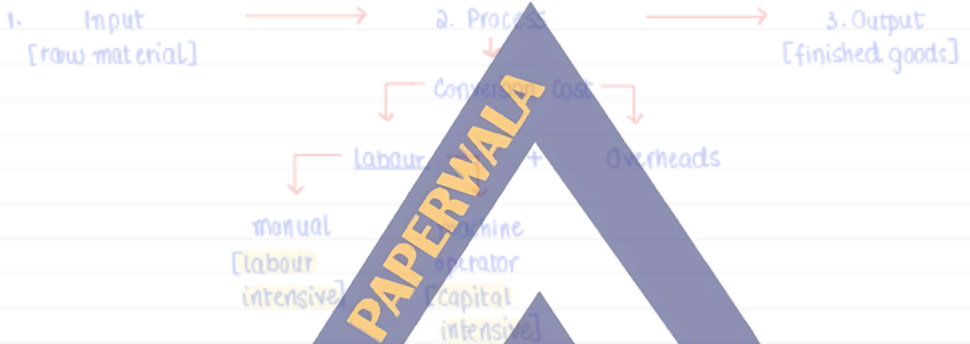
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ADEEL PAPERWALA