

Management Accounting

Week 1 Part 1

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1

1

Contents

- Introduction to Management Accounting (1)
- Cost terms and Purpose (1)
- Job Costing (2)
- Process Costing (3)

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2

2

- Cost Accounting:
 - Measures / Report cost data
- Cost Management
 - Cost Reduction/ Strategic Implementation
- Management Accounting
 - Management accounting measures, analyses and reports financial and non-financial information that helps managers to achieve the organization's goals

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3

3

Cost Accounting vs Financial Accounting

	Management Accounting	Financial Accounting
<i>Purpose of information</i>	Decision making	Communicate financial position to outsiders
<i>Primary Users</i>	Internal managers	External users
<i>Focus and emphasis</i>	Future-oriented	Past-oriented
<i>Rules</i>	Do not have to follow GAAP; based on cost-benefit analysis	GAAP compliant; CPA audited
<i>Time span</i>	Time span Current to very long time horizons	Historical monthly, quarterly reports
<i>Behavioral implications</i>	Designed to influence employee behavior	Indirect effects on employee behavior because manager's compensation is often based on reported financial results

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4

4

Purposes of Cost/ Management Accounting

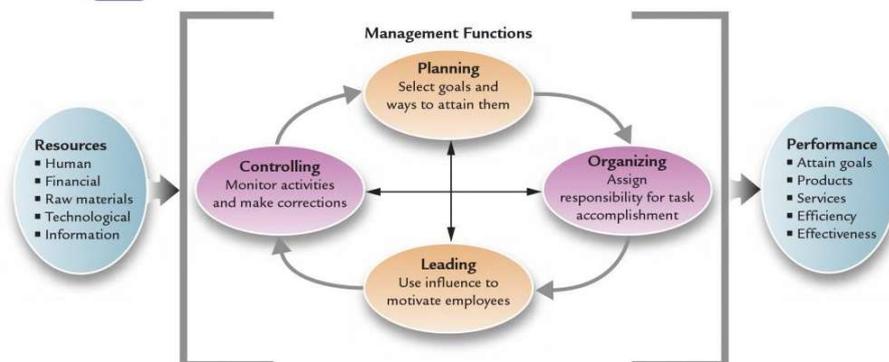
- Reporting
 - ❖ External/Internal, routine/non-routine
- Planning
 - ❖ Set goals/ Reach goals
- Controlling
 - ❖ Adjustment

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5

5

EXHIBIT 1.2 The Process of Management



Daft, R.L. (2014), *Management*, 12th ed. (Boston: Cengage Learning), p 7

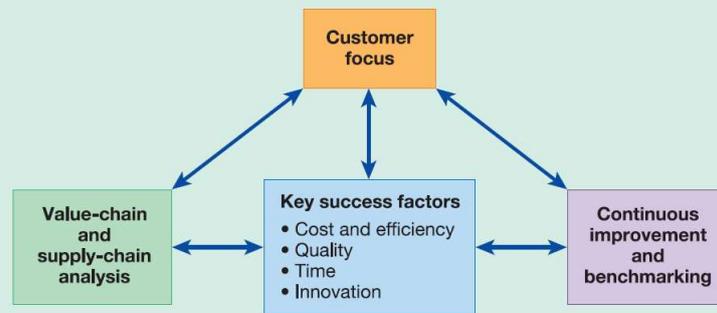
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6

6

Exhibit 1.4

Key themes in management decision making



Daft, R.L. (2014), *Management*, 12th ed.
(Boston: Cengage Learning), p 7

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7

7

Exam Practice

Which of the following is not an objective of managerial accounting

1. Providing information for decision making and planning
2. Assisting in directing and controlling operations
3. Maximizing profits and minimizing costs
4. Motivating managers towards the organization's goals

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8

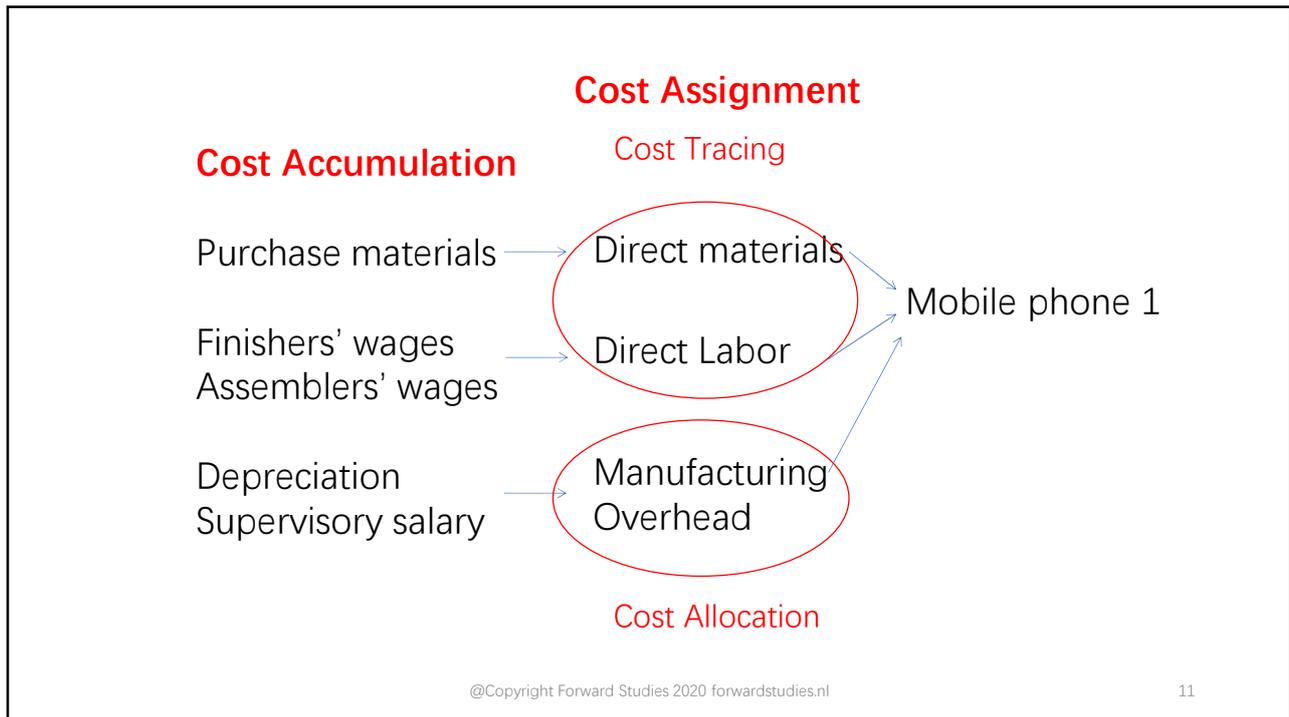
8

Cost and Cost Object

- *Cost*: usually monetary amount
 - ❖ Direct Cost: identified economically feasible
 - ❖ Indirect Cost: cannot/ economic infeasibility
- *Cost Object*: Separate measurement of costs is required. E.g. Output, operational
- First way (Classification) to calculate total cost:
Total Cost = Direct Cost + Indirect Cost

Two stages of cost accounting

- Cost accumulation: classification of costs (materials, labor, etc.)
- Cost assignment: assigning cost to various cost objects
 - ❖ *Direct Cost: Cost-tracing*
 - ❖ *Indirect Cost: Cost allocation*



11

Cost Allocation Example

Step 1: Find the **cost allocation base rate**

$$= \frac{\textit{Total Cost to be allocated}}{\textit{Total Number of Allocation Base}}$$

Step 2: Cost for this task/project

$$\textit{Allocation Base Rate} * \textit{Number of allocation base USED IN THIS PROJECT}$$

12

Alternative calculation for cost allocation

- Essentially, the same equation with slight difference in the steps of interpretation

Cost allocated in a specific project

$$= \frac{\text{No. of allocation base used in the project}}{\text{Total No. of allocation base}} * \text{total cost to be allocated}$$

Example

The total HRM system cost for this company is 20000 euro, the allocation base is the number of employees. Given the total number of employees of this company is 100 and finance department has 4 employees. How much HRM system cost should be allocated to finance department?

Allocation base / Cost Driver

Allocation base can be determined at the company's direction

Cost Driver: any factor that affects total Costs

When the allocation base is determined by the causation effect, approximately synonymous with Cost Driver

Exam Practice

What is a cost object ?

- 1) A cost object is a resource sacrificed or foregone to achieve a specific objective
- 2) A cost object is anything for which a separate measurement of costs is desired
- 3) A cost object is a cost incurred or historical cost, as distinguished from a budgeted or forecasted cost
- 4) None of the above

Exam Practice

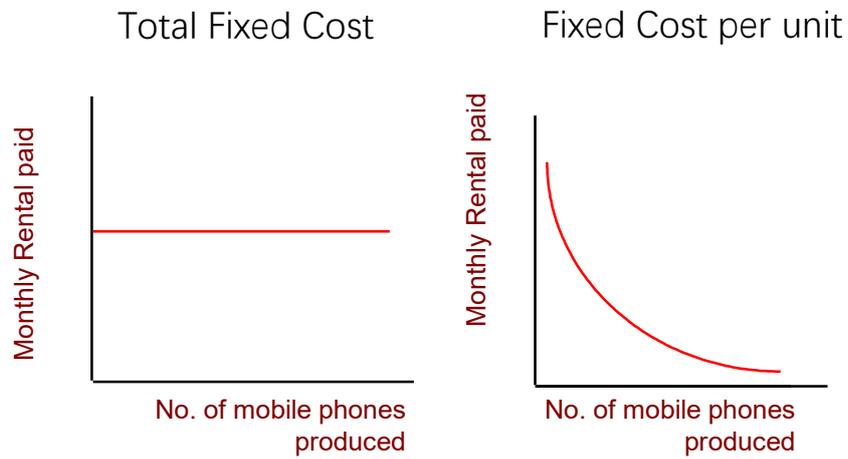
Which of the following best describes cost allocation ?

- 1) The assigning of direct costs to the chosen cost object
- 2) The assigning of indirect costs to the chosen cost object
- 3) A factor that links in a systematic way an indirect cost or group of indirect costs to a cost object
- 4) A grouping of individual cost items

Alternative way of classification of cost

- *Variable Costs*: Change with level of output
- *Fixed Costs*: do not change with a level of output

Cost Behavior for Fixed cost

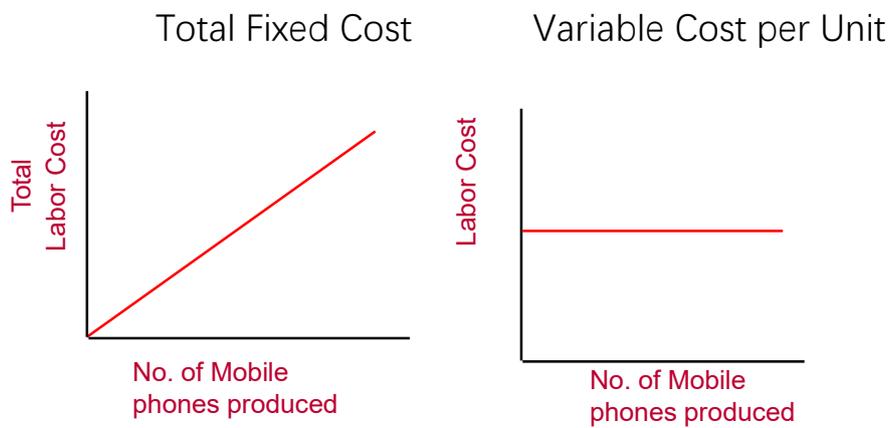


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19

19

Cost Behavior for Variable Cost



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20

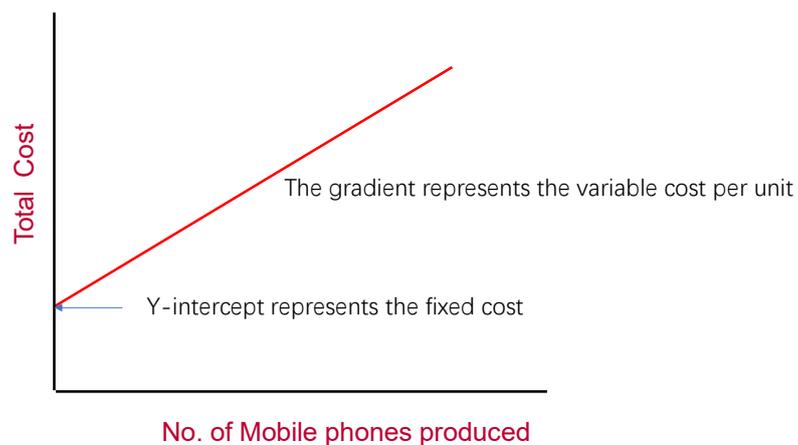
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Major assumptions for classification

- Costs are variable or fixed with respect to a specific cost object
- Time span must be defined
- Total costs are linear
- There is only one cost driver
- Variations in the cost driver are within a 'relevant range'

21

Total Cost Graph



22

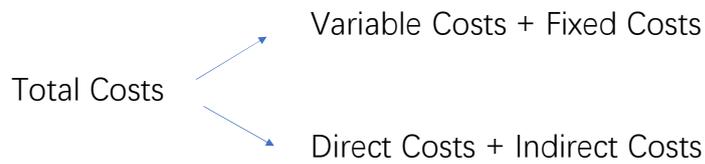
Relevant Range

- Relationship between volume and cost is valid
- E.g. the rent of machine and the No. of mobile phone produced

Unit Cost

- total cost divided by total number of units

Fixed Cost	10000
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Variable Cost per unit	20
Expected Production	100
Total expected variable cost	2000
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Total Cost	
Unit Cost	
<hr/>	



Points to Note:

- There are two ways of classification of Costs
- Direct Costs are normally variable costs but not absolutely
- Fixed Costs are normally indirect costs but not absolutely
- Don't mixed with these two. Stick to one classification when calculating the total cost

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25

25

Exam Practice

Distinguish direct costs from indirect costs.

1. Direct costs are historical or past costs incurred while indirect costs are predicted or forecasted costs.
2. Direct costs are those that change in total in proportion to changes in the related level of total activity or volume while indirect costs are those that remain unchanged in total for a given time period, despite wide changes in the related level of total activity or volume.
3. Direct costs include the acquisition costs of all materials that eventually become part of the cost object and can be traced to the cost object in an economically feasible way while indirect costs include compensation of all manufacturing labour that can be traced to the cost object in an economically feasible way.
4. Direct costs are related to the particular cost object and can be traced to that cost object in a cost-effective way while indirect costs are related to the particular cost object but cannot be traced to that cost object in a cost-effective way

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26

26