

Management Accounting

Week 2 Part 1

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Content

- Cost Allocation – Cost Pools
- Allocating Support Departmental Cost
- Joint Cost Situation
- Stock Costing Method (absorption costing)

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Cost Allocation Principles

- **Cause and effect Principle**
- **Benefit received Principle**
- *Fairness or equity*
- *Ability to bear*

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Cost Allocation - Purposes

- Better economic decision
- Motivation
- Justification
- Measure income

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Allocation Supporting Department

Operating department: produce product or service (e.g. Machining, assembly)

Supporting department: assist other support and operating department (Human Resource Management, information systems, Finance)

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Always allocate the cost of supporting department to operating department

Company A → Supporting Department → Operating Department

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An online book seller has two operating departments, **corporate sales and consumer sales**, and two support departments, **human resources and information systems**. Each sales department conducts merchandising and marketing operations independently. This book seller uses **number of employees** to allocate human resources costs and **processing time to allocate information systems costs**. The following data are available for year 2018

	Human Resources	Information Systems	Corporate Sales	Consumer Sales
Department Costs	15000	21000	50000	60000
Number of Employees	10	20	40	40
Number of Processing hours	10	50	70	80
Total Organization Cost				146000

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Three Methods

- Direct Method: to operating department only
- Step Down Method: allocate the support department with greatest percentage of support
- Reciprocal Method: Equation solving
- In all three methods, **never consider allocation base for your own department!**

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Direct Method

- Only care about allocation base in operating department

	Human Resources	Information Systems	Corporate Sales	Consumer Sales
Department Costs	15000	21000	50000	60000
Number of Employees	10	20	40	40
Number of Processing hours	50	10	70	80
Department cost after allocation				
Total Organization Cost				146000

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	Human Resources	Information Systems	Corporate Sales	Consumer Sales
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Department cost after allocation				
Total Organization Cost				146000

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Step Down Method

- Find the support department with the greatest percentage allocated to the other support department
- Step by Step

	Human Resources	Information Systems	Corporate Sales	Consumer Sales
Department Costs	15000	21000	50000	60000
Number of Employees	10	20	40	40
Number of Processing hours	50	10	70	80
Total Organization Cost				146000

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	Human Resources	Information Systems	Corporate Sales	Consumer Sales
Department Costs	15000	21000	50000	60000
Number of Employees	10	20	40	40
Number of Processing hours	50	10	70	80
Department cos after allocation				
Total Organization Cost				

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Reciprocal Method

- Find the correct equation
- Directly times the relative percentage

	Human Resources	Information Systems	Corporate Sales	Consumer Sales
Department Costs	15000	21000	50000	60000
Number of Employees	10	20	40	40
Number of Processing hours	50	10	70	80
Total Organization Cost				146000

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	Human Resources	Information Systems	Corporate Sales	Consumer Sales
Department Costs	15000	21000	50000	60000
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Number of Processing hours	50	10	70	80
Department cos after allocation				
Total Organization Cost				

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Exam Question

IT department costs are allocated based upon the number of processing hours.
the HRM department costs are allocated based on the number of employees.

	IT		HRM		Wholesale Banking	Retail Banking		
Budgeted costs (€, mln)	€	5.175	€	1.800	€	3.525	€	2.580
Number of processing hours (in thousands)		1.000		400		1.500		3.000
Number of employees (in full time equivalents)		2.000		500		6.000		8.000

- a) Using the step down method, what amount of IT department costs will be allocated to the Wholesale Banking Division, respectively the Retail Banking Division if the service department with the highest percentage of interdepartmental support service is allocated first?

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2a)

a)	Step down method	IT			5175		Wholesale banking	Retail banking
	HR to other dept		€ 1.800		225		675	900
			0,081632653				0,306122449	0,612244898
			422,4489796		5400,0		1.800,00	3.600,00

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