

Management Accounting

Week 2 Part 2

1

Allocation of Indirect cost by Single Rate vs Dual Rate

- Single Rate: one rate only
- Dual Rate: variable cost pool and fixed cost pool

Single Rate : Total cost in the pool by Total amount of allocation base

Dual Rate: Fixed total by fixed base + Variable Total by variable base

Dual-rate allocation is similar to the direct allocation method

2

Exam Practice

Describe how the dual-rate method is useful to division managers in decision-making.

1)The dual-rate method is helpful to managers because it does not distinguish between fixed and variable costs, therefore, the allocation of costs are simplified and reporting is made easier.

2)The dual-rate method provides information to division managers about cost behavior. Knowing how fixed costs and variable costs behave differently is useful in decision making.

3)The dual-rate method is useful because it has a low cost to implement it and makes the decision making much easier for the managers

4)The dual-rate method is not useful to managers

3

Allocating Common Cost

- Costs are shared among multiple cost objects but very difficult to find a cause-and-effect relationship
- Stand-alone Cost Method
- Incremental Cost Allocation Method

4

Standalone method

Allocate by the normal price ratio

A beef burger alone is 5 euro

A cola alone is 2 euro

A combi of a beef burger and a cola together is 6 euro

How to record the cost of the beef burger and cola when you purchase the combi?

Incremental Cost Method

Allocate by the primary party with standalone price and then the other party by the incremental amount

A beef burger alone is 5 euro

A cola alone is 2 euro

A combi of a beef burger and a cola together is 6 euro

How to record the cost of the beef burger and cola when you purchase the combi?

Joint Costs

- Single Production Process yield multiple products
- Joint Product: high sales value
- By-Product: low sales value
- Split-off point: products become separately identifiable
- Separable costs: all costs incurred beyond the split-off point

Allocating Joint Costs Approaches

- Physical Measure
- Sales Value Measure
- The estimated net realizable value (NRV) method
- The constant gross margin percentage (NRV) method (Mentioned in the lecture, a bit complicated and never really tested before)

Physical Measure

- Allocation base is physical measure (based on volume, weight, etc)
- May not really be reasonable

9

Example:

640 liters raw milk can produce cream and liquid skim. It is shown under the table. It costs € 500 to the split-off point to yield 200 liters cream and 400 liters of liquid skim. The sales price for cream is 3 euro per liter and for liquid skim is 1 euro per liter. The company has already sold 150 liters of cream and 350 liters of liquid skim,

	Production	Sales
Cream	200L	150L at 3 euro/L
Liquid Skim	400L	400L at 1 euro/L

How much joint cost should be allocated to cream and liquid skim respectively **under physical approach (the volume)**

10

Sales value at Split-off point

- Allocation base is sales value of the joint products
- Note that sales value refers to how much the products **can be sold, not how much they already sold.**

11

Example:

640 liters raw milk can produce cream and liquid skim. It is shown under the table. It costs € 500 to the split-off point to yield 200 liters cream and 400 liters of liquid skim. The sales price for cream is 3 euro per liter and for liquid skim is 1 euro per liter. The company has already sold 150 liters of cream and 350 liters of liquid skim,

	Production	Sales
Cream	200L	150L at 3 euro/L
Liquid Skim	400L	400L at 1 euro/L

How much joint cost should be allocated to cream and liquid skim respectively **under sales value approach**

12

Estimated NRV Approach

- Products are further processed beyond the split-off point
- Based on the ratio of NRV (Net Realizable Value)
- NRV equals the final sales value – additional production cost

Example:

640 liters raw milk can produce cream and liquid skim. It is shown under the table. It costs € 500 to the split-off point to yield 200 liters cream and 400 liters of liquid skim. The sales price for cream is 3 euro per liter and for liquid skim is 1 euro per liter. The company has already sold 150 liters of cream and 350 liters of liquid skim,

200L of cream can further processed to yield 150 liters of butter cream at additional processing(separable) costs of €200. Butter cream is sold for 6 euro per liter.
400L of liquid skim can be further processed to yield to produce 300L of condensed milk at a cost of €300. Condensed milk can be sold at 2 euro per liter.

How much joint cost should be allocated to cream and liquid skim respectively **under NRV approach**

Constant gross margin NRV

- Overall gross margin profit is constant for every product
- Also means the percentage of cost of goods sold taking up the sales price is the same

Steps:

1. Make the cost allocated to one product "X" and the remaining will be allocated to the other product
2. Set up the equation and solve the equation

640 liters raw milk can produce cream and liquid skim. It is shown under the table. It costs € 500 to the split-off point to yield 200 liters cream and 400 liters of liquid skim. The sales price for cream is 3 euro per liter and for liquid skim is 1 euro per liter. The company has already sold 150 liters of cream and 350 liters of liquid skim,

200L of cream can further processed to yield 150 liters of butter cream at additional processing(separable) costs of €200. Butter cream is sold for 6 euro per liter.

400L of liquid skim can be further processed to yield to produce 300L of condensed milk at a cost of €300. Condensed milk can be sold at 2 euro per liter.

How much joint cost should be allocated to cream and liquid skim respectively **under constant Margin approach**

Further process or not

- Only consider the additional sales gain to further processing cost
- Never consider the separable cost (sunk cost)

Example:

640 liters raw milk can produce cream and liquid skim. It is shown under the table. It costs € 500 to the split-off point to yield 200 liters cream and 400 liters of liquid skim. The sales price for cream is 3 euro per liter and for liquid skim is 1 euro per liter. The company has already sold 150 liters of cream and 350 liters of liquid skim,

200L of cream can further processed to yield 150 liters of butter cream at additional processing(separable) costs of €200. Butter cream is sold for 6 euro per liter.
400L of liquid skim can be further processed to yield to produce 300L of condensed milk at a cost of €300. Condensed milk can be sold at 2 euro per liter.

Should we further process to produce butter cream and condensed milk.

Exam Practice

Example Midterm Exam 6012B0421Y Q28-29