Management Accounting:

Level 4: Unit 5

Lecturer: Matthew Smith-Barrett

Unit Content: (Syllabus)

Level 4: Unit 5

On successful completion of this unit a student will be able to:

- Demonstrate an understanding of Management Accounting Systems.
- Apply a range of management accounting techniques
- Explain the use of planning tools used in management accounting
- Compare ways in which organizations could use management accounting to respond to financial problems.

Learning Outcome 2:

Level 4: Unit 5

Upon completion of this Learning Outcome, students should:

- Apply a range of management accounting techniques.

To realize the above objective the student should be able to:

P.3 Calculate costs using appropriate techniques of cost analysis to prepare an income statement using marginal and absorption costs.

M.2 Accurately apply a range of management accounting techniques and produce appropriate financial reporting documents.

D.2 Produce financial reports that accurately apply and interpret data fro complex business activities.

Week 5 -
Product Costings:

Level 4:
Unit 5

<u>Assessment Criteria M2 & D2:</u>

Upon completion of this lesson, students will be able to:

- Allocate
  - Fixed and Variable Costs.
- Execute
  - Normal and Standard Costing
  - Activity Based Costing
- Explain
  - The role of costing in price setting

Week 5 – Product Costings:

Level 4: Unit 5

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Fixed and Variable Cost allocations

L.O. 2: P.3

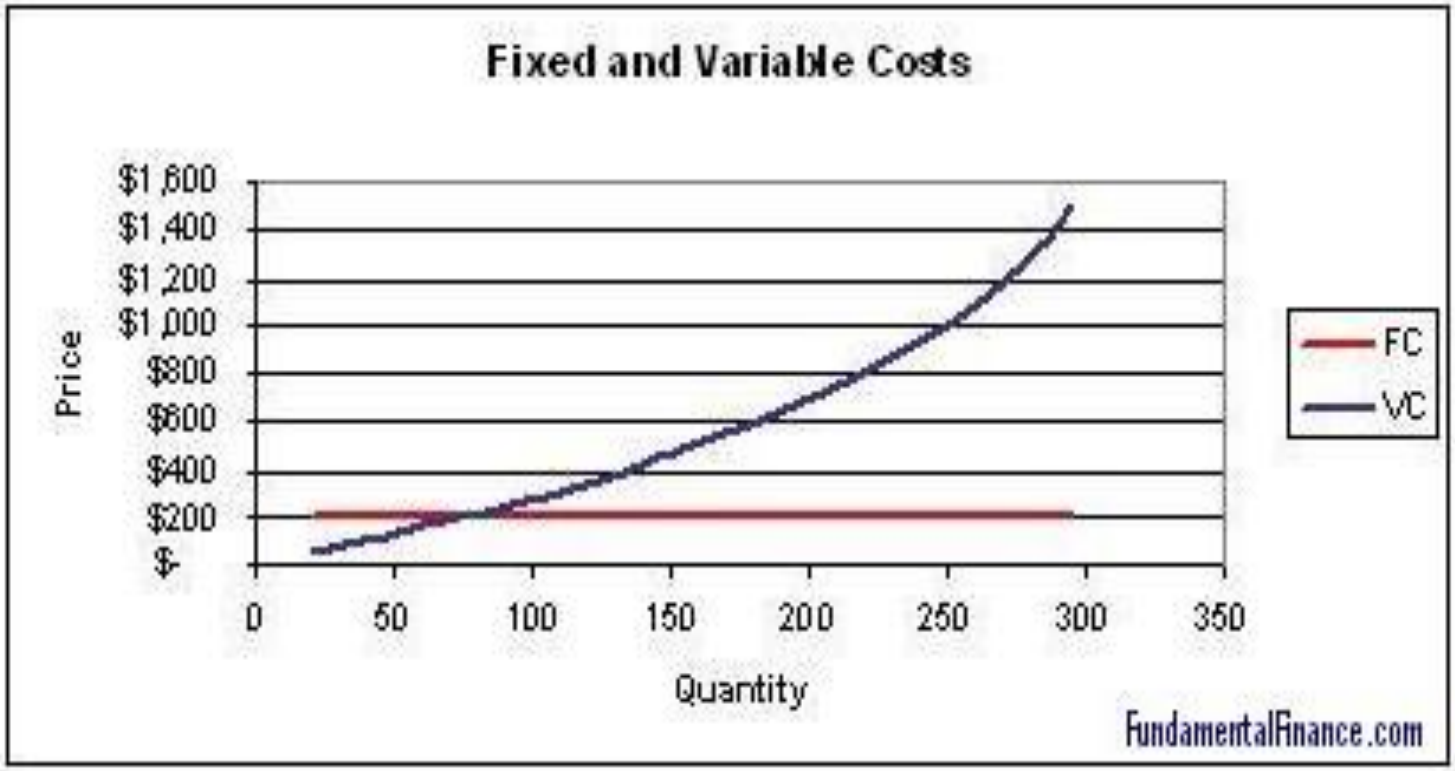
'Variable Cost'

- A variable cost is a corporate expense that varies with production output. Variable costs are those costs that vary depending on a company's production volume; they rise as production increases and fall as production decreases.

Fixed costs are costs that are independent of output. These remain constant throughout the relevant range and are usually considered sunk for the relevant range (not relevant to output decisions). Fixed costs often include rent, buildings, machinery, etc.

Fixed and Variable Cost allocations

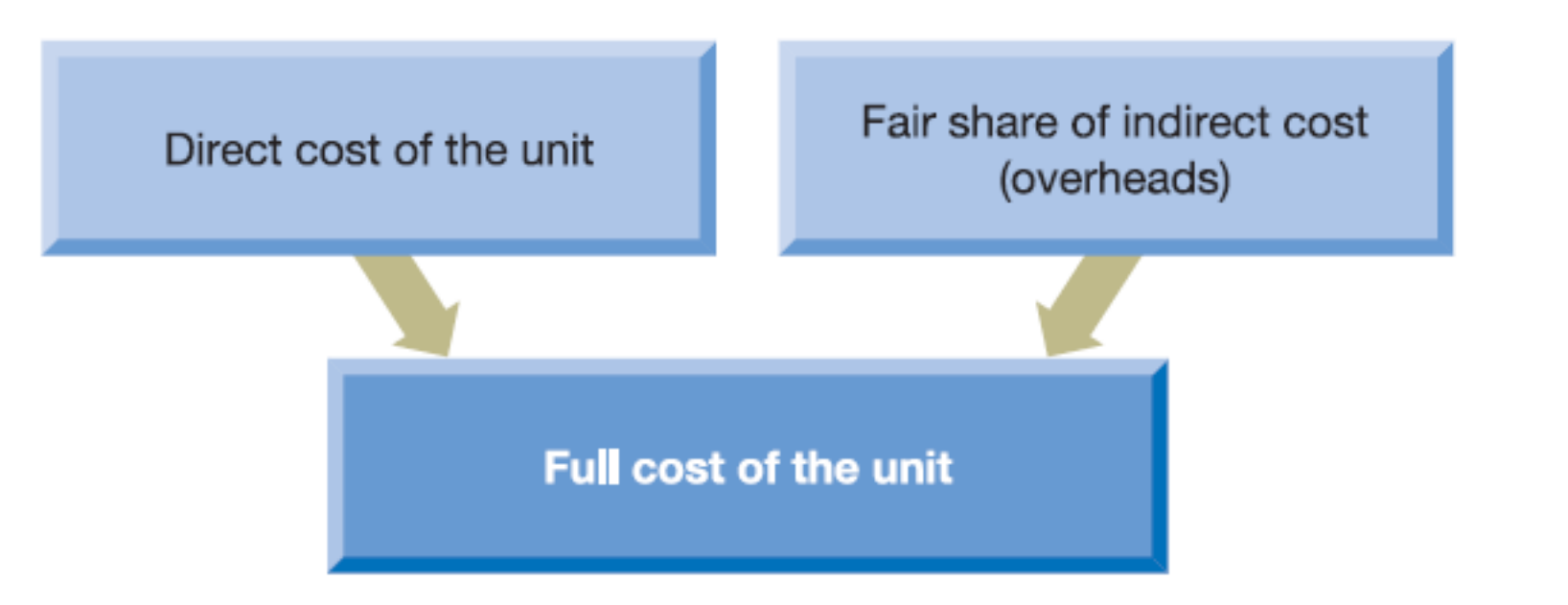
L.O. 2: P.3



Applying Absorption and Marginal Costing

L.O. 2: P.3

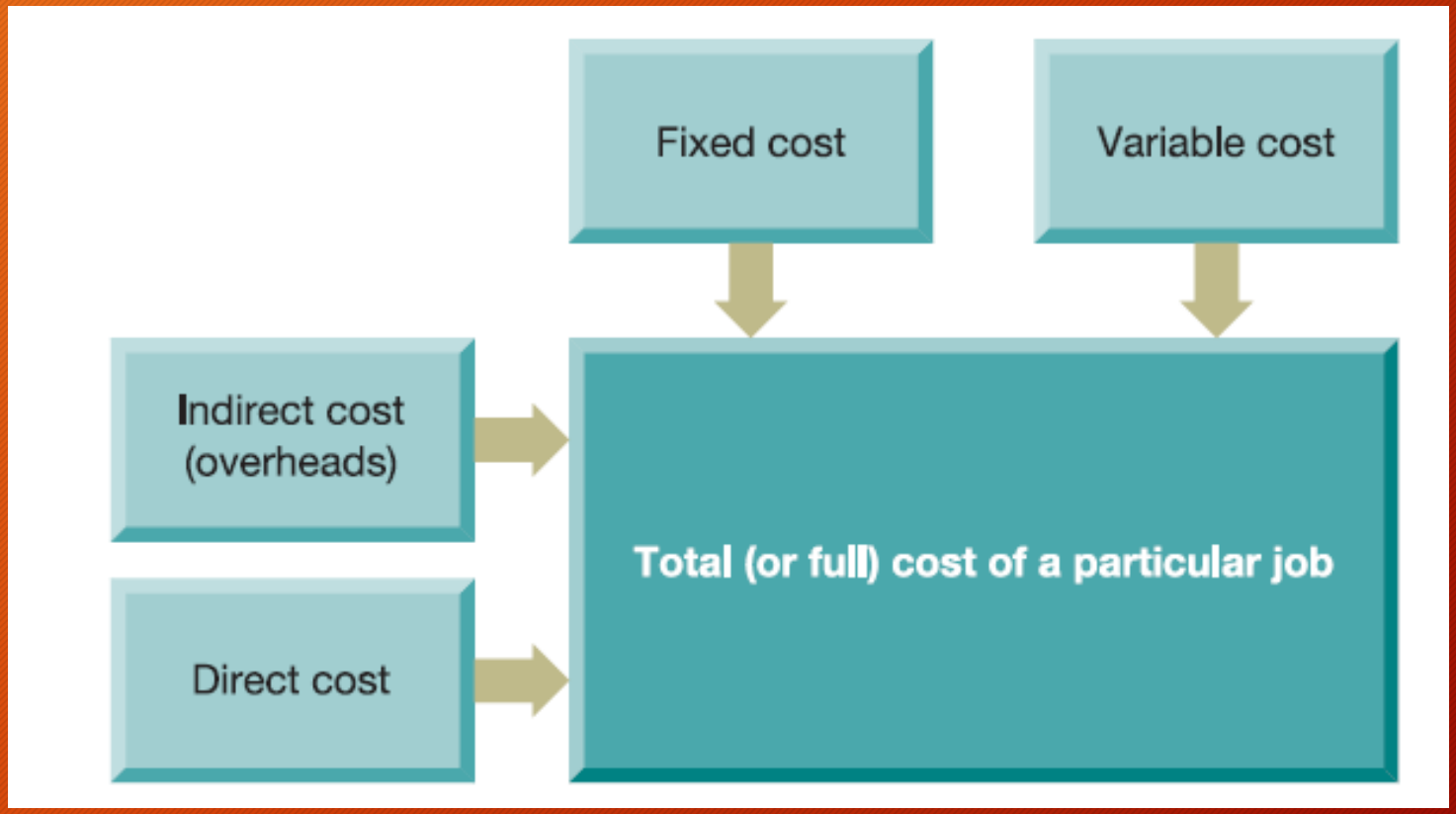
First we look at the Relationship between direct and indirect cost:



Applying Absorption and Marginal Costing

L.O. 2: P.3

Next we look at the Relationship between direct, indirect, variable and fixed cost of a particular job:



Charging overheads to jobs

L.O. 2: P.3

Using an example, we examine how overheads are charged to jobs.

Example 1:

Johnson Ltd, a business that provides a personal computer maintenance and repair service to its customers, has overheads of £10,000 each month. Each month 1,000 direct labour hours are worked and charged to cost units (jobs carried out by the business). A particular PC repair undertaken by the business used direct materials costing £15. Direct labour worked on the repair was 3 hours and the wage rate is £16 an hour. Overheads are charged to jobs on a direct labour hour basis. What is the full (absorption) cost of the repair?

Cost Allocation

L.O. 2: P.3

When allocating costs, it is prudent that the Management Accountant allocate cost elements that are specific to particular cost centres.

These are items that relate to, and are specifically measurable in respect of, individual cost centres, that is, they are part of the direct cost of running the cost centre.

Examples include:

- salaries of indirect workers whose activities are wholly within the cost centre, for example the salary of the cost centre manager;
- rent, where the cost centre is housed in its own premises for which rent can be separately identified;
- electricity, where it is separately metered for each cost centre.

Cost Apportionment

L.O. 2: P.3

Apportion the more general overheads to the cost centres. These are overheads that relate to more than one cost centre, perhaps to them all.

They would include:

- rent, where more than one cost centre is housed in the same premises;
- electricity, where it is not separately metered;
- salaries of cleaning staff who work in a variety of cost centres.

Example of Cost allocation

L.O. 2: P.3

Go to Exercise:

Activity Based Costing (ABC)

L.O. 2: P.3

Activity-based costing (ABC) aims to overcome the kind of problem just described by tracing the cost of all support activities directly to particular products or services. For a manufacturing business, these support activities may include materials ordering, materials handling, storage, inspection and so on. The cost of the support activities makes up the total overheads cost. The outcome of this tracing exercise is to provide a more realistic, and more finely measured, account of the overhead cost element for a particular product or service.

Activity Based Costing (ABC)

L.O. 2: P.3

To implement a system of ABC, managers must begin by carefully examining the business's operations. They will need to identify:

1. Each of the various support activities involved in the process of making products or providing services;
2. The costs to be attributed to each support activity; and
3. The factors that cause a change in the costs of each support activity, that is, the **cost drivers**.

Normal and Standard Costing

L.O. 2: D.2

Normal costing is used to value manufactured products with the actual materials costs, the actual direct labour costs, and manufacturing overhead based on a predetermined manufacturing overhead rate.

Standard costing values its manufactured products with a predetermined materials cost, a predetermined direct labor cost, and a predetermined manufacturing overhead cost.

Costing in Price Setting

L.O. 2: D.2

The Role of Cost in Price Setting Decisions.

There are four costs that impact a Firm's pricing Decisions:

1. Total cost
2. Fixed cost
3. Variable cost
4. Unit variable cost

Pricing - factors to consider when setting price

L.O. 2: D.2

There are several factors a business needs to consider in setting a price:

- **Competitors**
- **Costs**
- **The state of the market for the product**
- **The state of the economy**
- **The bargaining power of customers in the target market**
- **Other elements of the marketing mix**

Reference List

L.O. 1: P.2

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