

Principles of Accounting II

Lesson #6A

Managerial Accounting and Cost Classification

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Click the button below to navigate to the next slide.



Managerial Accounting

Managerial Accounting provides information to the internal decision makers of a business. Managerial accounting provides both financial and non-financial information.



Managerial Accounting Topics

Some of the topics of managerial accounting follow:

- Determining the costs of products and services
- Product Pricing
- Cost Analysis
- Budgeting
- Break-even analysis
- Profit Planning



Managerial Accounting vs. Financial Accounting

The major differences between managerial and financial accounting are in the following areas. See page 721 for more detail on these differences.

- Users and Decision Makers
- Purpose of Information
- Flexibility of Practice
- Timeliness of Information
- Time Dimension
- Focus of Information
- Nature of Information



Cost Classifications



Recall that one of the purposes of managerial accounting is to provide management with information about the costs of products or services.

Companies incur different types of costs that can be classified based on certain characteristics. Each cost classification provides management with a different type of information to be applied in analyzing different business situations.



Cost Classifications

Costs can be classified into five categories:

- Behavior
- Traceability
- Controllability
- Relevance
- Function



Cost Classifications

Any type of cost may be categorized using any one or a combination of the five different classifications.



Classification by *Behavior*

Costs can be

- **Fixed** – a cost which does not change as the volume of activity (production) changes
- **Variable** – a cost which changes with changes in the volume of activity
- **Mixed** – a cost which has both fixed and variable components



Classification by Traceability

Costs can be

- **Direct** – a cost which is incurred for the benefit of one specific product (**cost object**)
- **Indirect** – a cost which is incurred for the benefit of more than one cost object or which cannot be easily or efficiently traced to a specific cost object



Classification by Controllability

Costs can be

- **Controllable** – a cost which can be affected (controlled) at the hierarchical level which is being measured
- **Uncontrollable** – a cost which cannot be affected (controlled) at the hierarchical level which is being measured



Classification by Relevance

Costs can be

- **Sunk** – a cost which has already been incurred and cannot be avoided or changed regardless of future actions
- **Out-of-pocket** – a cost which requires future cash outlays
- **Opportunity** – a cost measured as the loss of potential benefits by choosing one course of action over another



Classification by Function

Costs can be

- **Product** – a cost which is necessary to produce a finished product
- **Period** – a cost which is necessary to run the business during a specified fiscal period



Primary Classifications

The three cost classifications we will focus on in our computations are

- Variable vs. Fixed
- Direct vs. Indirect
- Product vs. Period



Check Your Comprehension

Minchoy Company manufactures kitchen cabinets. Check your comprehension of the ways in which costs can be classified by identifying the appropriate classification for the cost items listed on the following slides for Minchoy Company.



Check Your Comprehension - Classification by Behavior

Variable vs. Fixed

- Variable costs change with volume; fixed costs stay constant within a relevant range of activity

Wood used in producing cabinets

Variable

Fixed

Click the button that matches your
classification for the item listed.

Correct!



The amount of wood used in producing cabinets would **vary** with the number of cabinets produced.



Think it Through

The amount of wood used in producing cabinets would **vary** with the number of cabinets produced; therefore, this would be classified as a **variable cost**.

Try Another



Check Your Comprehension - Classification by Behavior

Variable vs. Fixed

- Variable costs change with volume; fixed costs stay constant within a relevant range of activity

Cabinet pulls

Variable

Fixed

**Click the button that matches your
classification for the item listed.**

Correct!

The number of cabinet pulls used would **vary** with the number of cabinets produced.



Think it Through



The number of cabinet pulls used would **vary** with the number of cabinets produced, therefore, cabinet pulls used is a **variable cost**. Study this concept some more.

Try Another Classification



Check Your Comprehension - Classification by Behavior

Direct vs. Indirect

- Direct costs can be traced to a specific cost object; indirect costs benefit more than one cost object.

Paint used on cabinets

Direct

Indirect

Click the button that matches your
classification for the item listed.

Correct!

Since it would be difficult to trace the exact amount of paint used on any given cabinet, this cost would be classified as **indirect**.



Think it Through

This is a tough one. The amount of paint used on any given cabinet would be difficult to trace, therefore, paint would be considered an **indirect cost**.



Try Another



Check Your Comprehension - Classification by Behavior

Direct vs. Indirect

- Direct costs can be traced to a specific cost object; indirect costs benefit more than one cost object.

Cabinet pulls

Direct

Indirect

Click the button that matches your
classification for the item listed.

Correct!

Since a specific cabinet pull can be traced to a specific cabinet, this would be classified as a **direct** cost.



Think it Through

Since a specific cabinet pull can be traced to a specific cabinet, this would be classified as a **direct** cost.

Try Another Classification



Check Your Comprehension - Classification by Behavior

Product vs. Period

- Product costs are incurred in producing a product or providing a service; period costs are costs incurred in operating a business.

Rent expense on administrative offices

Product

Period

Click the button that matches your
classification for the item listed.

Correct!

Any administrative expense is considered a **period** cost. This cost cannot be traced to a product.



Think it Through

Any administrative expense is considered a **period** cost. This cost cannot be traced to a product.

Try Another



Check Your Comprehension - Classification by Behavior

Product vs. Period

- Product costs are incurred in producing a product or providing a service; period costs are costs incurred in operating a business.

Cabinet pulls

Product	Period
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Click the button that matches your
classification for the item listed.

Correct!

Because cabinet pulls are used in a finished product, they are considered a **product** cost.



Think it Through

Because cabinet pulls are used in a finished product, they are considered a **product** cost. Keep working on this concept.



Integrate Your Knowledge

Remember that costs can be categorized based on any of the classifications discussed above. Try identifying multiple cost classifications for the same cost item by taking the Cost Classification quiz.



End of
Lesson #6A

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