Cost Accumulation/Special Decisions

Now that you are officially engaged in managerial/cost accounting, we see that most of our focus is on COSTS. You will learn, read and interpret more about costs than you may have ever wanted to know. However, there are good reasons! Just think of your own personal lives. If you do not track your costs and expenses isn't it easy to run short of money? Will you prosper this way? Probably the answer is no. And so your business ventures must also consider costs very thoroughly!

Let's start with some new terminology. First we have the cost object. The cost object is the item we are examining costs for. So, if we want to analyze costs for iPhones then the iPhone is the cost object. What is the cost driver? A cost driver is anything that "drives" or has a relationship to an item. For example, the number of labor hours worked is a driver to total labor hours incurred. Costs can be direct or indirect. A direct cost is just like it sounds- it is one that is easy to trace back to the object. An indirect cost is one that is difficult, or nearly impossible to trace back to a specific object. Can you think of examples for each of these? I'm sure you can!

Here is a formula you will need this session: **Allocation Rate = Total costs to be allocated / cost driver**

**** Video Alert****

Here is a great video that I found for you on YOUTUBE that discusses direct and indirect costs:

http://www.youtube.com/watch?v=oAJirAV5nso

Southwest Airlines is a great example. I mention this because I have studied Southwest in graduate school. Their business model is really fascinating to me. They do things "slightly" different than others!

As we delve deeper into costing, we may feel overwhelmed by all the costs associated with a product or service. Yet, we have many decisions to make! We will see some real scenarios of how to analytically determine some important decisions using these new tools and a few new ones!

Relevant and Special Decisions

As I mentioned earlier, we are faced with many costing decisions on a frequent basis. Do we make something ourselves in the factory or do we buy it? Do we lease it from someone else? Let's say we are asked by a customer for a special order. What do we say? Do we have the manpower, time and materials to fulfill this order? Even if we do, should we? Is it worth it? You can probably see all the decisions we are faced with!

Special orders can be analyzed using quantitative analysis in a three step process. Remember that opportunity cost is the situation that you forego by making one decision over another. If you decide to plant tomatoes in the garden instead of lettuce with limited space, you have foregone the opportunity for lettuce. **Sunk costs** are those costs that are unavoidable and become irrelevant to any decision making. If you have already purchased a machine and cannot return or sell it, then it is a sunk cost in your decision-making. You are "stuck" with that cost.

Web Site Alert

This site shows the difference between sunk costs and opportunity costs:

http://wiki.answers.com/Q/What_is_the_difference_between_opportunity_cost_and_sunk_cost

We wrap up with **Segment Accounting**. As we become more versed in cost accounting, we may be asked to analyze various activities and products for the managers. We may be producing Fruit Loops and Rice Krispies. Segment accounting is analyzing the numbers to see if we should produce MORE Fruit Loops, discontinue Fruit Loops or just keep the status quo!

Enjoy your week!

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Reference

Edmonds, T. Olds, P., McNair, F., & Tsay, B. (2012). *Survey of Accounting* (3rd ed.). New York, NY: McGraw-Hill Irwin.