



Prifysgol Cymru
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University of Wales
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BA Business Management

Management Economics LCBB5002

Week 1 Lesson 2

Costs

Trawsnewid Addysg; Trawsnewid Bywydau
Transforming Education; Transforming Lives



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By the end of this session you should be able to understand:

- What a cost is
- Cost classification

Definitions...

Cost – the amount of expenditure (**actual/notional**) incurred or **attributable** to a specified activity or thing/ item

Cost Unit – a unit of an thing or activity to which costs can be calculated e.g kg/ tonne

Cost Object – anything that stakeholders/ users of accounting information want to know the cost of e.g product, sales area, SBU

Cost Centre – department, machine, project

Let's model cost units in groups

Write down the appropriate cost units you would use for the following:

- Road transport truck/ Cargo haulage
- Maize/ Wheat grain production
- Minerals extraction
- Beer Brewing business
- Electricity
- Water
- Healthcare/ Care Home

Let's model cost units in groups

Write down the appropriate cost units you would use for the following:

- Road transport truck/ Cargo haulage - **tonne mile/ tonne per mile**
- Maize/ Wheat grain production – **kg, tonne, metric tonne**
- Minerals extraction - **kg, tonne, metric tonne, load**
- Beer Brewing business – **Barrel, Gallon, Litres**
- Electricity - **KWH**
- Water – **Litres, Cubic litres**
- Healthcare/ Care Home - **Bed night, procedure, bed night**

Ways of measuring costs:

- **Historical cost** (most popular) i.e how much did you buy an item for
- **Economic value** – value that can be obtaining from the asset e.g rental income and property value appreciation/ capital gained
- **Net realisable value** – value that can be obtained from selling the item
- **Replacement value** – cost to replace the item

Definitions...

Cost Centre

a production or service location, activity or item where costs are accumulated.

- Mine
- Factory
- Organisation function e.g finance, IT, HR

Revenue Centre

a department or operations area with a revenue maximisation responsibility

- Sales department
- Sales centre

Profit Centre

a section of a business that contributes to overall company profits

- (Strategic Business Unit – SBU)

**Why is there need to ascertain costs/ revenues/
profits**

**Refer definition of management accounting
(objectives)**

Control
Decision making
Planning

**Why is there need to ascertain costs/ revenues/
profits**

**Refer definition of management accounting
(objectives)**

Control – control costs so they do not spiral out of
control

Decision making – pricing and contract negotiation,
product production stoppage,

Planning – strategy and competitive planning

Cost classification

Typically we can classify our costs by:

Nature – materials, labour, expenses

Function – departments etc HR, Finance...

Direct or indirect – Direct Costs (identifiable and increases as volume increases) – direct material, labour etc and the sum of all direct costs is **Prime Costs**.

Indirect costs – not identifiable but increases with volume (**overheads**) e.g electricity. **Production or non-production overheads**

Calculating costs

	£	£
Direct Costs:		
Direct Material	x	
Direct Labour	x	
Direct Expenses	x	
Prime Cost		x
Production Overheads		x
Production Cost		x
Non-Production Overheads		x
Total Cost		x

Calculating costs

York Deli is a restaurant in central Birmingham that serves Indian and Chinese Cuisine. Prepare a cost summary using data below:

Note that 70% of service department costs relate to production and the remaining 30% relate to non-production activities.

Electronic components	£14,600
Assembler wages	£4,830
Assembly foreman's salary	£650
Welding rods used by the assemblers	£500
Workshop cleaner's wages	£790
Salespeople's salaries	£1,500
Packaging for delivery to customers	£1,260
Warehousing costs	£1,100
Advertising costs	£1,750
Factory power and heating costs	£930
Service department costs (see above)	£2,400
Royalty payments	£1,200
Personnel department salaries	£1,400
Outside delivery company costs	£1,640

Split service department:

- Production overheads = $70\% \times £2,400 = £1,680$
- Non-production overheads = $30\% \times £2,400 = £720$

	£	£
Direct costs:		
Direct material	14,600	
Electronic components		
Direct labour	4,830	
Assembler wages		
Direct expenses	1,200	
Royalty payments		
Prime cost		20,630
Production overheads		4,550
Service dept £1,680 + Assembly foreman's salary £850 + Welding rods used by assemblers £500 + Workshop cleaner's wages £790 + Factory power and heating costs £930		
Production costs		25,180
Administration, selling and distribution costs		
Salespeople's salaries	1,500	
Packaging for delivery to customers	1,260	
Warehousing costs	1,100	
Advertising costs	1,750	
Service department costs	720	
Personnel department costs	1,400	
Outside delivery company costs	1,640	
		9,370
Total costs		34,550

Pricing

After calculating total costs, companies can then set appropriate prices considering various factors including:

- **Cost, Volume, Government controls, Perceived value, Trade requirements, Competition**

Pricing strategies

- **Penetration** – low first then increase
- **Discount** - tactically reducing prices to stimulate demand
- **Premium** – high quality products e.g sport cars, etc
- **Price Skimming** – high first then low
- **Odd number pricing** – £0.99, £4.99
- **Price discrimination** – different prices, different markets

Reading list

Essential reading

- Drury, C., (2012) Management and Cost Accounting (8th edition) London: Thomson Business Press
- Atrill, P., McLaney E., (2012) Management Accounting for Decision Makers, FT Prentice Hall
- Seal W, Garrison R, Noreen, E., Rohde, C., (2014) Management Accounting. McGraw Hill Education

Further reading

- Horngren, T., Forster, G., (2003) (11th edition) Cost Accounting, A Managerial Emphasis, London: Prentice Hall International
- Noreen, E., (2011) Management Accounting, McGraw Hill

Next session:

Cost behaviour: fixed, variable, mixed, splitting mixed costs (graphical,
High-Low Method)