



Cost Accounting 2

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Chapter 3

1 The concept of standard cost

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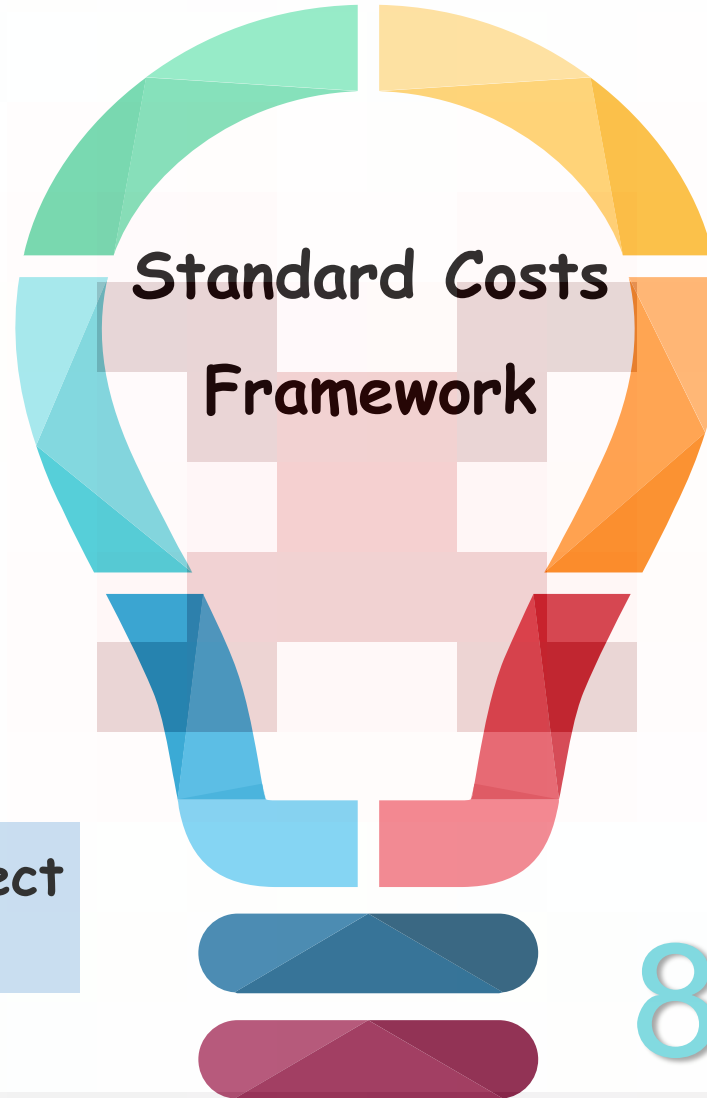
2 Target costing definition

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3 Activity-based costing Accounting

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Standard Costs Framework



4 Standard cost objectives

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5 Standardization of Direct materials costs

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6 Standardization of Direct labor

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7 Standardization of Indirect manufacturing costs

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8 Procedures for implementing the standard costing system

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Introduction

- ❑ The term standard costs are the most used to express specific costs in advance in most of costs literature and research.
 - what are the standard costs?
 - what is the difference between standard costs and both the target costs and the activity costs?
 - how the standardization of the cost elements is prepared, what are their objectives.
 - what are the procedures of designing a good system for standard costs?

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Concept of Standard Cost

1/1- Evolution of Standard Cost Accounting:

It can be said that the **standard costs** have first emerged because of:

- The **scientific management movement** through which the scientific seeds of the standard costs system were developed.
- The need for a way to **measure production costs** in some industries, along with the start of the production process to determine the selling price of the product before its production.
- The need **to control costs** from the historical (actual) cost of previous years.

1/2- The concept of standard costs:

The standard or typical cost is the standard or pattern that the actual cost of the product must have upon implementation, which must be determined in advance according to scientific and practical foundations and the conditions of the firm so that the company's management can identify the factors of waste to avoid them, and the factors of efficiency to develop them.

1/2- The concept of standard costs:

The standard or typical cost Standard costs are calculated, like any costs, in terms of two parts: quantity and price. Cost is calculated as a result of the interaction between quantity and price.

1/2- The concept of standard costs:

For example:

- ❑ The cost of a shirt from the raw material (cloth) is equal to the meters used in making the shirt multiplied by the price of one meter **(2 meters x 20 pounds = 40 pounds),**

1/2- The concept of standard costs:

- ❑ The cost of a finished shirt from labor wages is equal to the number of work hours spent in making the shirt multiplied by the price of (The rate) one hour's wages (**half hour x 15 pounds = 7.5 pounds**).
- ❑ Thus, the cost can be determined for the input elements used in production (actual cost) or that must be used in production (standard cost).

1/2- The concept of standard costs:

- ❑ Then, when determining the standard cost of the input elements, **a standard is determined for each of the quantities used** from the element, and the **price of obtaining one unit of this quantity**.
- ❑ Then by "multiplying them" results in the standard cost.



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The concept of target cost

The standard cost and target cost are similar in that each is determined in advance before starting production, but their objectives differ as the target cost aims to:



2/1- The target cost concept:

- ❑ **The target cost** is an activity aims at **reducing the costs** of new products and **ensures the quality** and **reliability of the product** in order to meet the requirements of the consumer in the required time.

2/1- The target cost concept:

- ❑ This can be done by examining the potential ideas of a reduction in the product planning stages, the research and development stage, and the experimental model production stage of this product.**

2/2 Characteristics of target costs:

- 1- Target costs are calculated in the development and design phase and differ from standard cost control systems that are applied in the production phase
- 2- Target costing is not a management method for controlling costs in the traditional sense. Rather, it is a method that aims at reducing costs.
- 3- The implementation of the target costs requires the cooperation of all departments within the firm.

2/2 Characteristics of target costs:

4- Target costs are suitable for multi-product projects with small capacity, and small productive projects with large production capacity in one cycle such as food industries.

2/3- Steps to determine and calculate the target cost:

1-Planning and designing products according to the customers' needs and desires:

- ❑ It is the first step in determining and calculating the target cost which begins when the firm receives a specific production order from a customer or when the firm wants to develop an existing product or launch a new product.
- ❑ After preparing the project, **an initial estimate of the design cost is made.** It is possible to use, at this stage, the cost of similar products that the company had produced before, and after developing the product development plan.

2/3- Steps to determine and calculate the target cost:

2- Determining the target price:

- ❑ It is the starting point for determining the target cost of the new product.
- ❑ After that, the selling price is determined based on the results of the market study and the estimation of competitors' policies.
- ❑ The target selling price can be determined according to the product specifications or on the basis of functions
 - ✓ (for example, in the case of cars there is a shape - attractiveness - a comfort - operating cost and others).

2/3- Steps to determine and calculate the target cost:

3- Determining the target profit:

- ❑ After estimating the target selling price, the target profit from the production and sale of the product is determined. It refers to the amount of profits that the enterprise wants to achieve from the product.**

2/3- Steps to determine and calculate the target cost:

4- Determining the target cost:

- ❑ There are two methods of calculating and determining the target cost, namely:

(A) Discount method:

- ❑ According to this method, the target cost is calculated using the following equation:

$$\text{Target Cost} = \text{Target Selling Price} - \text{Target Profit}$$

2/3- Steps to determine and calculate the target cost:

(B) Method of addition:

- ❑ The target cost can be calculated according to the addition method based on determining **the target cost for each part or activity**, starting with the current cost level and taking into account any potential cost reductions.
- ❑ This cost is added to each product according to the functions achieved by the product in order to reach the target cost for the new product.

2/3- Steps to determine and calculate the target cost:

However, this method has several shortcomings, the most important of which are:

- 1. It is difficult to link this method with the organization's plans in a systematic way.**
- 2. It is difficult under this method to include the new ideas to reduce the cost.**

2/3- Steps to determine and calculate the target cost:

Therefore, the discount method is better for determining the target cost for the following reasons:

- 1. Applying a reduced rate to the current cost reflects the rate of technological development in performing the tasks.**
- 2. This method can be applied to existing products that are to be developed, or if the firm is producing other products largely similar to the new product.**

2/4 Advantages of the target cost system:

The target costing system is characterized by the following:

- 1. Contribute to reducing costs.**
- 2. Working to develop the team work among the organization's members through the contribution of all parties in creating cost.**
- 3. Working on the basis of achieving the customer's desires and meeting his/her needs, and thus providing a high-quality product in conformity with the specifications allocated based on market studies.**

2/4 Advantages of the target cost system:

The target costing system is characterized by the following:

- 4- Continuing the policy of continuous improvement of products as a result of using support systems for the target cost such as value analysis, engineering, and management.**
- 5- The ability to remain in the market as a result of taking into account its demands, what it offers and how competitors present it in this market.**



The End
Thank You