

# Summary of the Types of Cost Classifications

**Financial Reporting**

**Predicting Cost Behavior**

**Assigning Costs to Cost Objects**

**Making Business Decisions**

# Learning Objective 1

**Understand cost classifications used for assigning costs to cost objects: direct costs and indirect costs.**

# Assigning Costs to Cost Objects

## Direct costs

- Costs that can be easily and conveniently traced to a unit of product or other cost object.
- Examples: direct material and direct labor

## Indirect costs

- Costs that cannot be easily and conveniently traced to a unit of product or other cost object.
- Example: manufacturing overhead

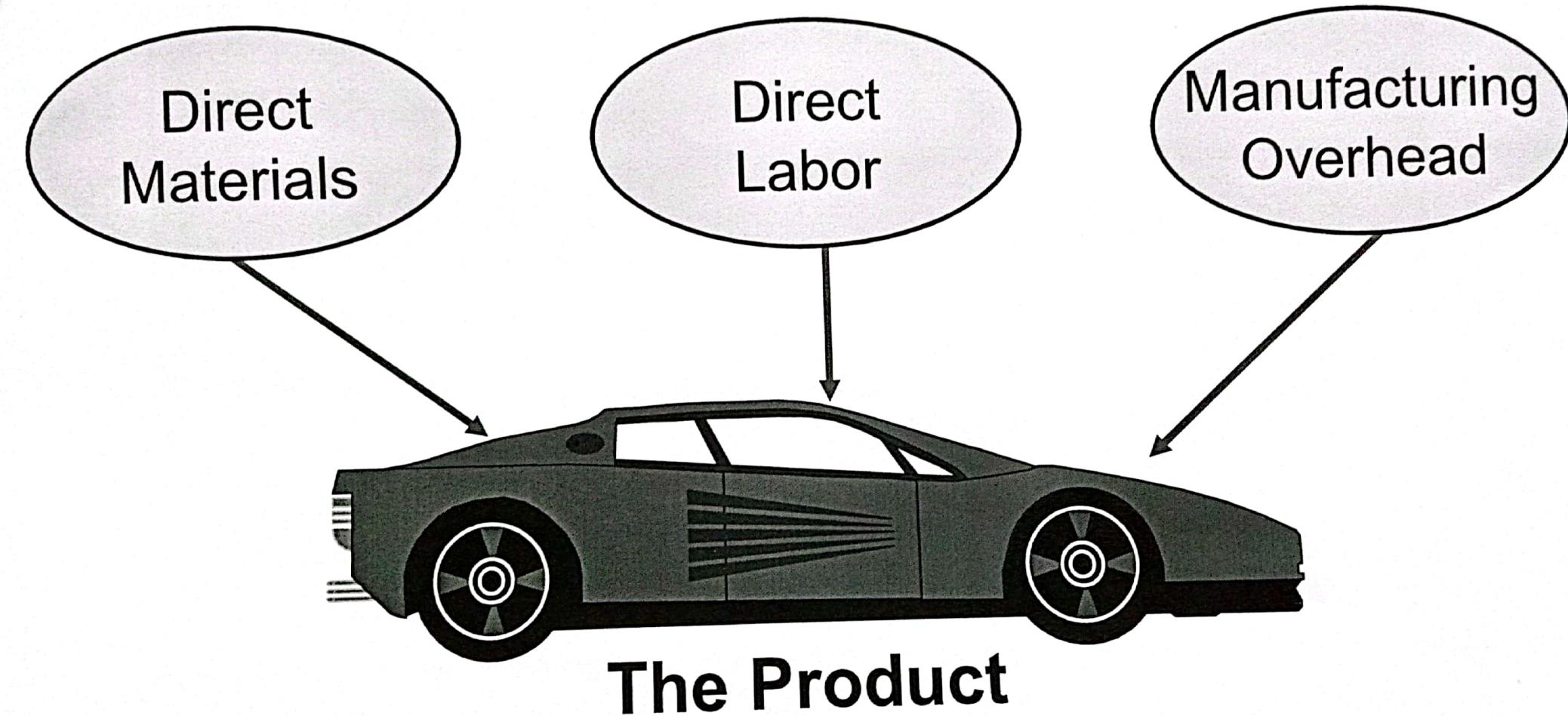
## Common costs

Indirect costs incurred to support a number of cost objects. These costs cannot be traced to any individual cost object.

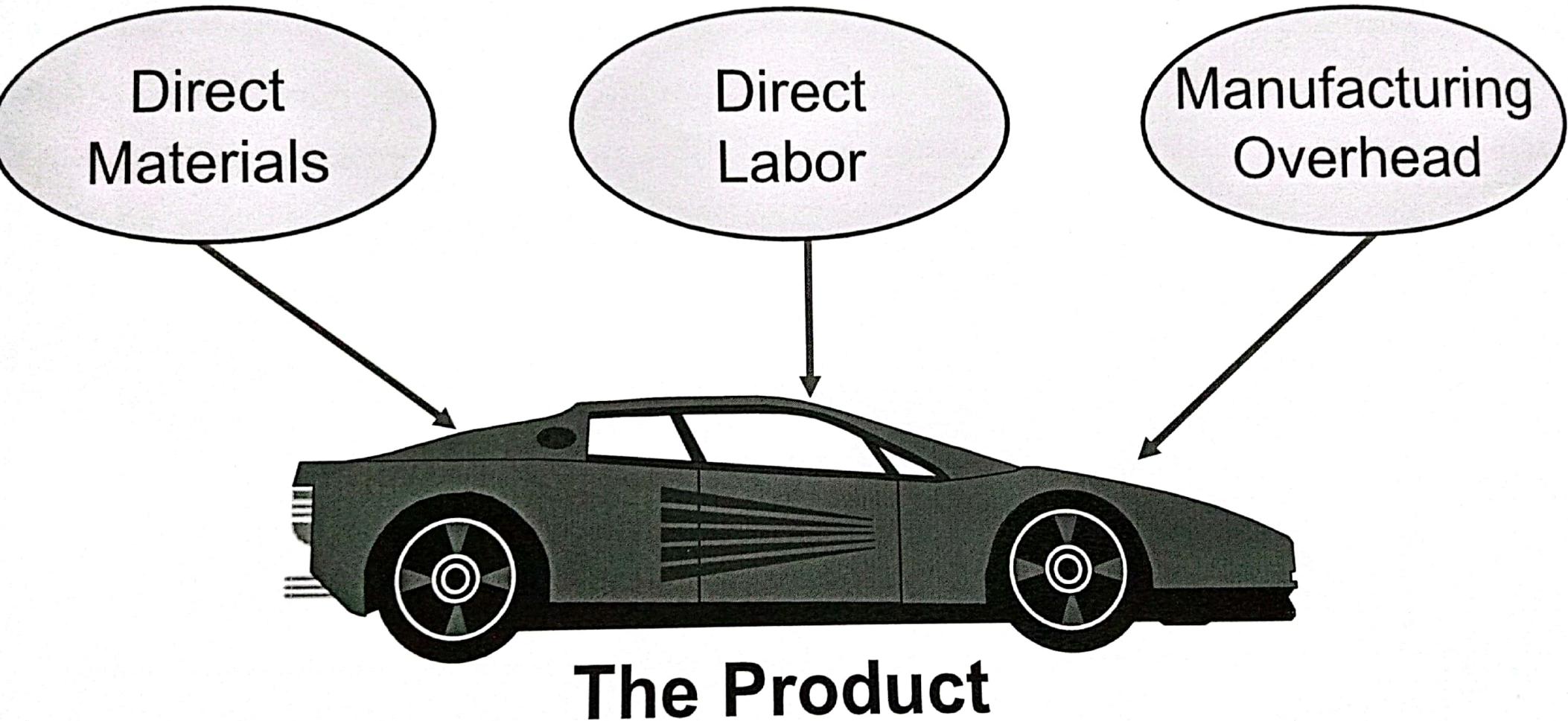
## Learning Objective 2

Identify and give examples of each of the three basic manufacturing cost categories.

# Classifications of Manufacturing Costs

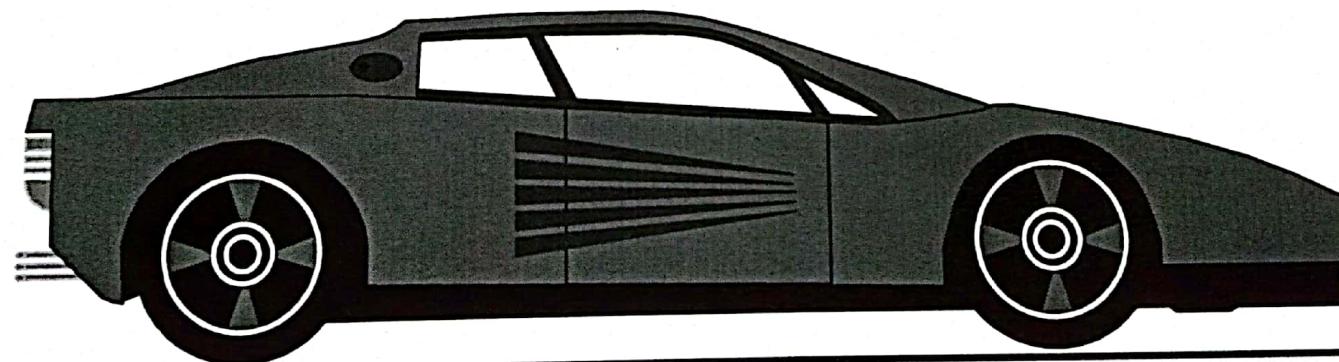


# Classifications of Manufacturing Costs



# Direct Materials

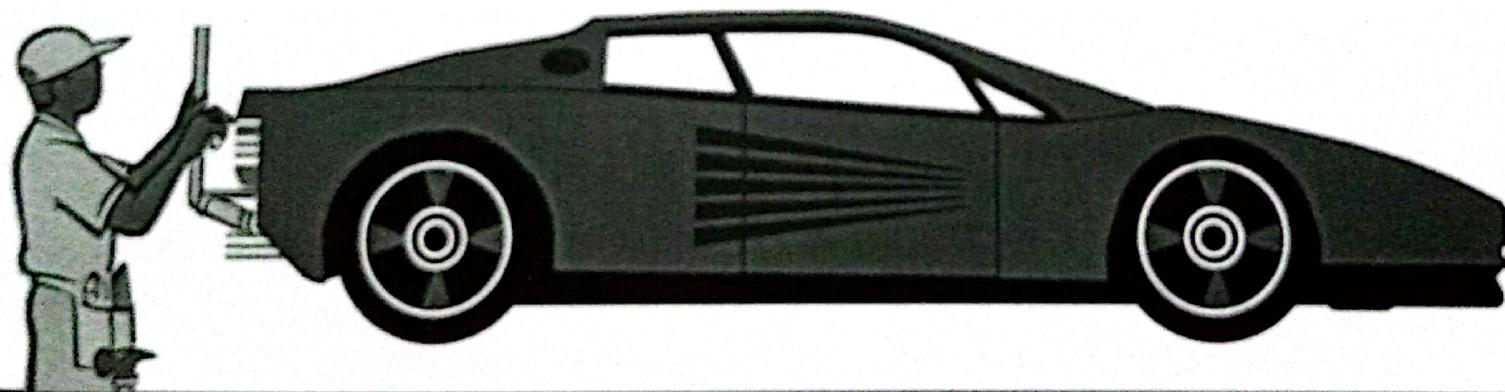
Raw materials that become an integral part of the product and that can be conveniently traced directly to it.



**Example:** A radio installed in an automobile

# Direct Labor

Those labor costs that can be easily traced to individual units of product.



**Example: Wages paid to automobile assembly workers**

# Manufacturing Overhead

Manufacturing costs that cannot be easily traced directly to specific units produced.

## Examples: Indirect materials and indirect labor

Materials used to support the production process.

Examples: lubricants and cleaning supplies used in the automobile assembly plant.

Wages paid to employees who are not directly involved in production work.

Examples: maintenance workers, janitors, and security guards.

# Nonmanufacturing Costs

## Selling Costs

Costs necessary to secure the order and deliver the product.

Selling costs can be either direct or indirect costs.

## Administrative Costs

All executive, organizational, and clerical costs.

Administrative costs can be either direct or indirect costs.

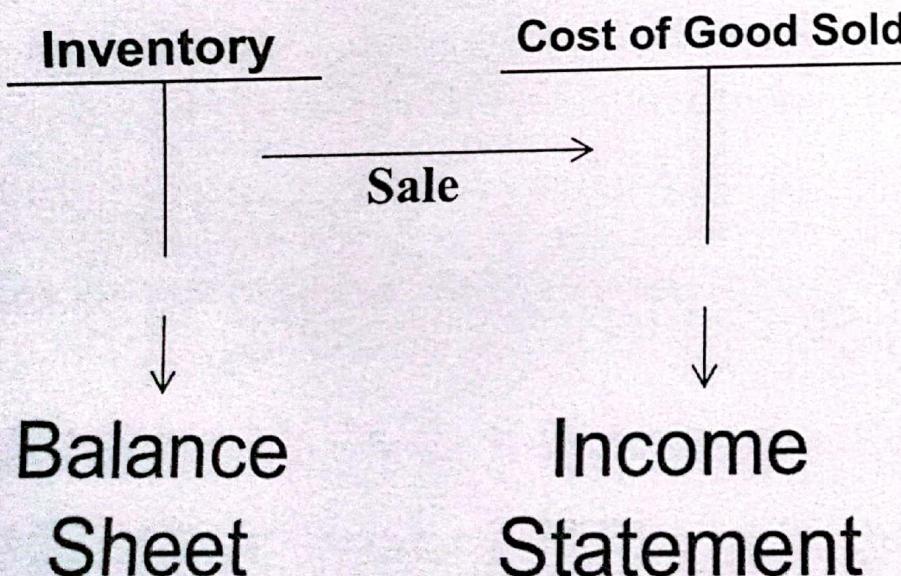


# Learning Objective 3

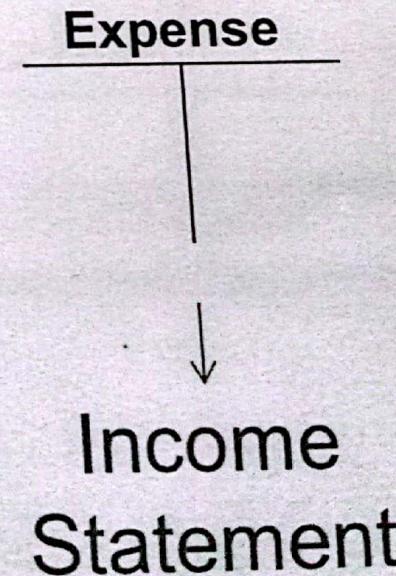
**Understand cost classifications used to prepare financial statements: product costs and period costs.**

# Cost Classifications for Preparing Financial Statements

**Product costs include direct materials, direct labor, and manufacturing overhead.**



**Period costs include all selling costs and administrative costs.**



# Quick Check ✓

Which of the following costs would be considered a period rather than a product cost in a manufacturing company?

- A. Manufacturing equipment depreciation.
- B. Property taxes on corporate headquarters.
- C. Direct materials costs.
- D. Electrical costs to light the production facility.
- E. Sales commissions.

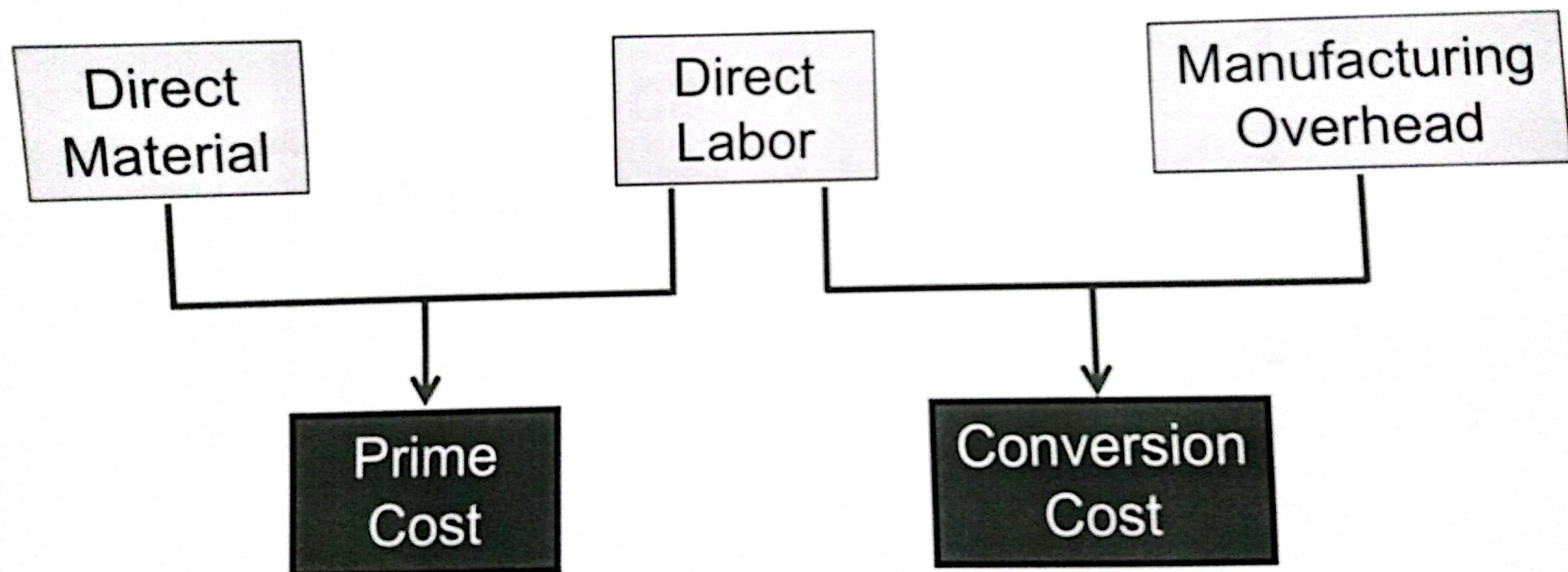
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# Prime Costs and Conversion Costs

Manufacturing costs are often classified as follows:



# Learning Objective 4

**Understand cost classifications used to predict cost behavior: variable costs, fixed costs, and mixed costs.**

# Cost Classifications for Predicting Cost Behavior

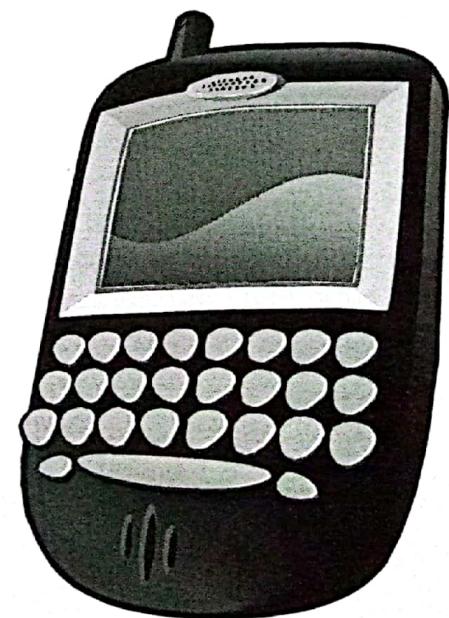
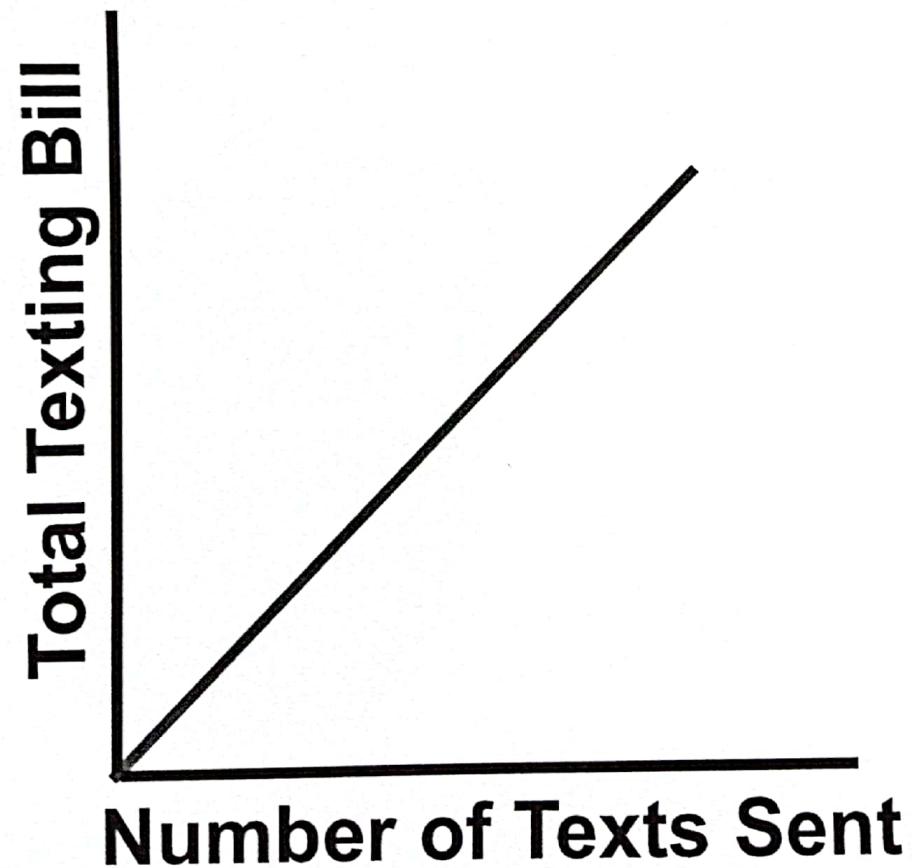


Cost behavior refers to how a cost will react to changes in the level of activity. The most common classifications are:

- **Variable costs.**
- **Fixed costs.**
- **Mixed costs.**

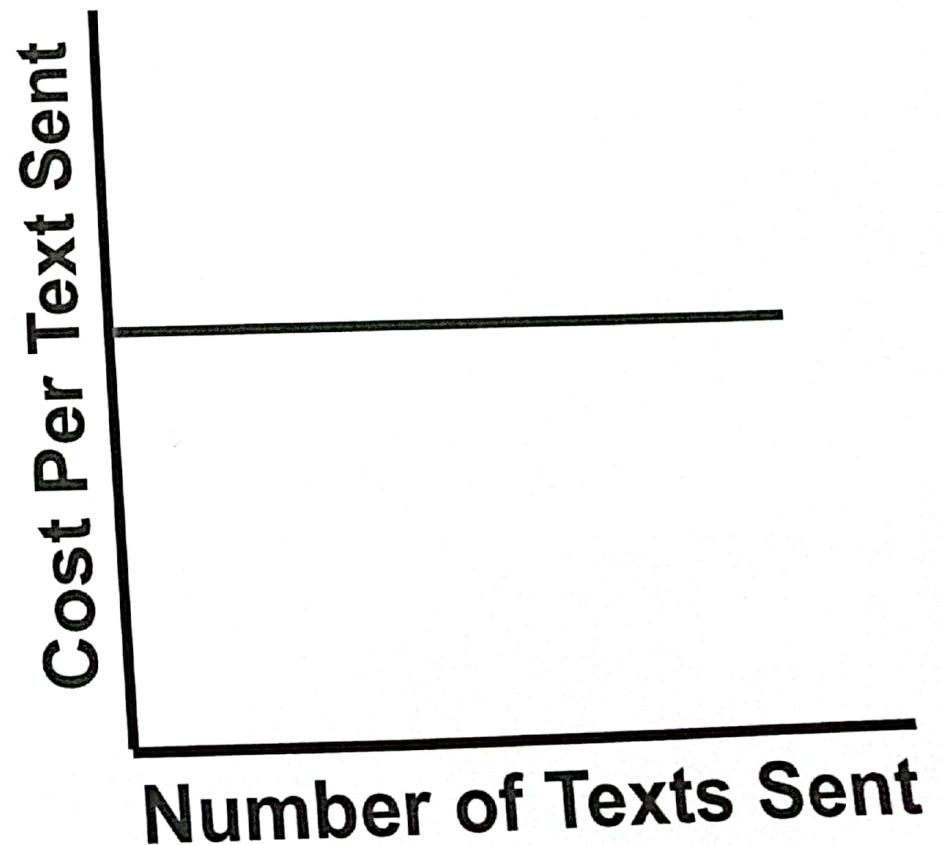
# Variable Cost

A cost that varies, in total, in direct proportion to changes in the level of activity. Your **total texting bill** may be based on how many texts you send.



# Variable Cost Per Unit

However, variable cost per unit is constant. The **cost per text sent** may be constant at 5 cents per text message.



# The Activity Base (Cost Driver)

