

BU247 Notes

Jacky Zhao

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1 Chapter 2

How management accounting supports internal decision making:

- Pricing
 - Facing a market-determined price, an organization will use product cost information to decide whether its cost structure will allow it to compete profitably
 - When the organization can set the price, they often set it so that it is an increment of its product cost - aka **cost plus pricing**
- Product Planning
 - Organizations use **target costing** to focus efforts during product and process design on developing a product that has a good profit potential in view of market requirements
- Budgeting
 - Most widespread use of cost info is in budgeting, a management accounting tool that projects income and costs for various levels of production and sales activity
 - Budgets provide the basis for earnings forecasts, which is to be issued to the stock market
- Performance Evaluation
 - Managers compare the actual results from the budget period with expectations that were reflected in the budget prepared to assess performance
- Contracting
 - In cost reimbursement contracts, organizations are reimbursed their cost plus a profit increment for the goods or services they provide under the contract
 - Governments are frequent and large-scale users of this type of contracts

Cost Objects

- any item for which a cost is to be determined
- Examples:
 - products, product lines, production lines, services, organization departments, and even the entire organizations

Direct Cost

- the cost has a direct cause-and-effect relationship with the cost objects
- Defining Characteristic:
 - the cost would not exist absent the cost object

Indirect Cost

- no direct cause-and-effect relationship with the cost objects
- Example:
 - weekly wage of car assembly workers (unrelated to # of car produced)
 - However, if we have unit wage of \$20/unit for workers, then this wage becomes direct cost

Variable Costs

- costs that vary directly with some underlying level of activity , such as number of units produced
- **Direct material cost** is a form of variable cost
- Defining Characteristic:
 - total variable cost depends on how much of the resource is used
 - resources that are attributable is variable, such as wood used to make a chair cannot be used to make another
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