

Measuring Costs

Measuring profits or net income is the most important thing accountants do. The second most important task is measuring costs. Costs are extremely important to running a business and managing them effectively can make a substantial difference in a company's bottom line.

Any business that sells products needs to know its product costs and depending on what is being manufactured and/or sold, it can get complicated. Every step in the production process has to be tracked carefully from start to finish. Many manufacturing costs cannot be directly matched with particular products; these are called indirect costs. To calculate the full cost of each product manufactured, accountants devise methods for allocating indirect production costs to specific products. Generally accepted accounting principles (GAAP) provide few guidelines for measuring product cost.

Accountants need to determine many other costs, in addition to product costs, such as the costs of the departments and other organizational units of the business; the cost of the retirement plan for the company's employees; the cost of marketing and advertising; the cost of restructuring the business or the cost of a major recall of products sold by the company, should that ever become necessary.

Cost accounting serves two broad purposes: measuring profit and furnishing relevant information to managers. What makes it confusing is that there's no one set method for measuring and reporting costs, although accuracy is paramount. Cost accounting can fall anywhere on a continuum between conservative or expansive. The phrase actual cost depends entirely on the particular methods used to measure cost. These can often be as subjective and nebulous as some systems for judging sports. Again accuracy is extremely important. The total cost of goods or products sold is the first and usually largest expense deducted from sales revenue in measuring profit.