

Different Types of Firms

- Manufacturing-sector companies purchase materials and components and convert them into finished products.
- Merchandising-sector companies purchase and then sell tangible products without changing their basic form.
- Service-sector companies provide services (intangible products).

Types of Manufacturing Inventories

- Direct materials—resources in-stock and available for use
- Work-in-process (or progress)—products started but not yet completed, often abbreviated as WIP
- Finished goods—products completed and ready for sale

Types of Product Costs

- Also known as inventoriable costs
 - Direct materials—acquisition costs of all materials that will become part of the cost object.
 - Direct labor—compensation of all manufacturing labor that can be traced to the cost object.
 - Indirect manufacturing—factory costs that are not traceable to the product in an economically feasible way. Examples include lubricants, indirect manufacturing labor, utilities, and supplies.

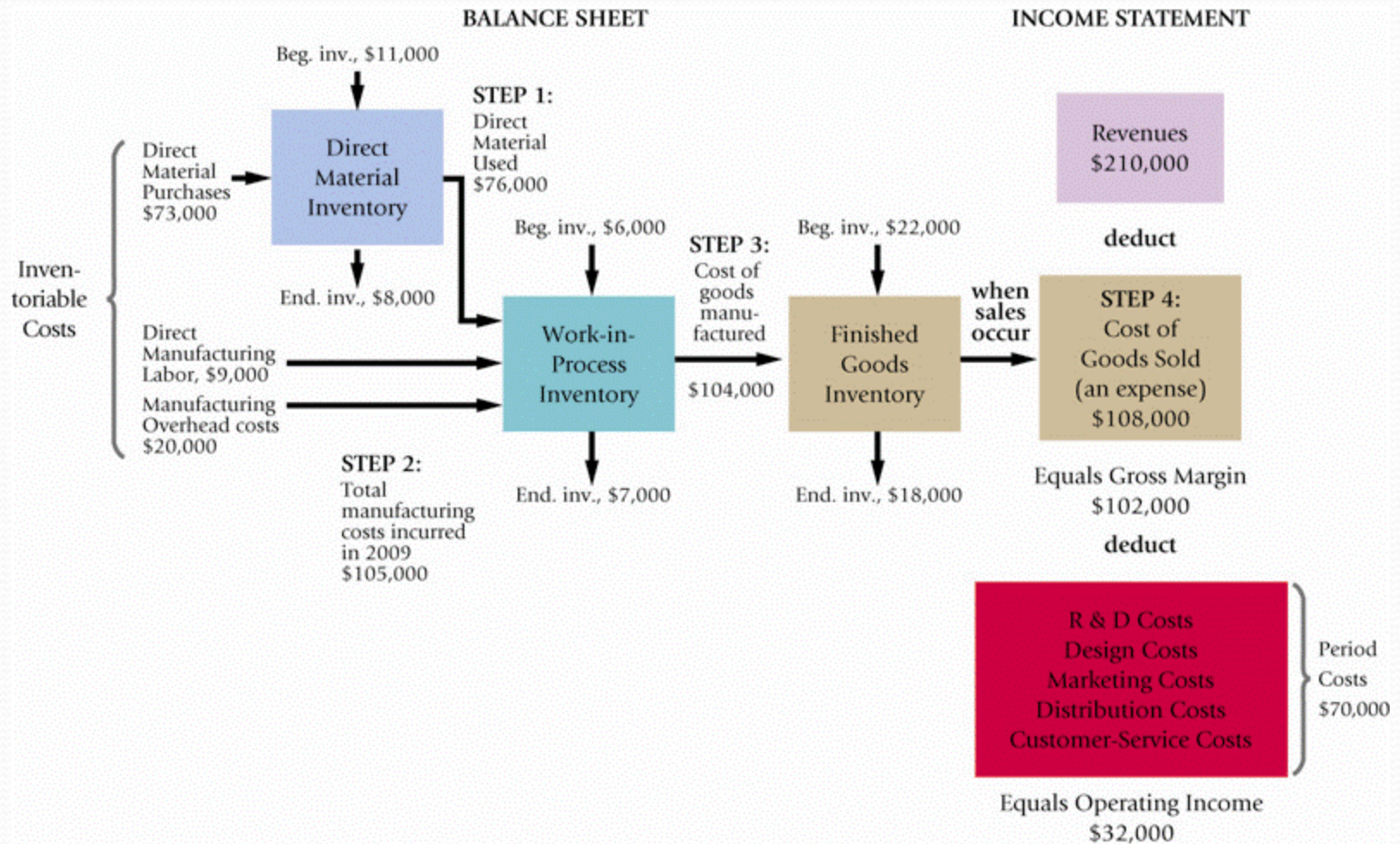
Accounting Distinction Between Costs

- Inventoriable costs—product manufacturing costs. These costs are capitalized as assets (inventory) until they are sold and transferred to Cost of Goods Sold.
- Period costs—have no future value and are expensed in the period incurred.

Cost Flows

- The Cost of Goods Manufactured and the Cost of Goods Sold section of the Income Statement are accounting representations of the actual flow of costs through a production system.
 - Note the importance of inventory accounts in the following accounting reports, and in the cost flow chart.

Cost Flows Visualized



Multiple-Step Income Statement

STEP 4

PANEL A: INCOME STATEMENT			
Cellular Products			
Income Statement			
For the Year Ended December 31, 2011 (in thousands)			
Revenues		\$210,000	
Costs of goods sold:			
Beginning finished goods inventory, January 1, 2011	\$22,000		
Costs of goods available for sale	<u>\$104,000</u>		
Costs of goods manufactured (see Panel B)	\$126,000		
Ending finished goods inventory, December 31, 2011	<u>\$18,000</u>		
Cost of goods sold		<u>\$108,000</u>	
Gross margin (or gross profit)		\$102,000	
Operating costs			
R&D, design, mktg., dist., & cust.-service cost	\$70,000		
Total operating costs		<u>\$70,000</u>	
Operating income		\$32,000	

Cost of Goods Manufactured

PANEL B: COST OF GOODS MANUFACTURED			
Cellular Products			
Schedule of Cost of Goods Manufactured*			
For the Year Ended December 31, 2011 (in Thousands)			
STEP 1	Direct materials:		
	Beginning inventory, January 1, 2011	\$11,000	
	Purchases of direct materials	<u>\$73,000</u>	
	Cost of direct materials available for use	\$84,000	
	Ending inventory, December 31, 2011	<u>\$8,000</u>	
	Direct materials used		\$76,000
STEP 2	Direct manufacturing labor		\$9,000
	Manufacturing overhead costs:		
	Indirect manufacturing labor	\$7,000	
	Supplies	\$2,000	
	Heat, light, and power	\$5,000	
	Depreciation-plant building	\$2,000	
	Depreciation-plant equipment	\$3,000	
	Miscellaneous	<u>\$1,000</u>	
	Total manufacturing overhead costs		<u>\$20,000</u>
STEP 3	Manufacturing cost incurred during 2011		\$105,000
	Beginning work-in-progress inventory, January 1, 2011		<u>\$6,000</u>
	Total manufacturing costs to account for		\$111,000
	Ending work-in-progress inventory, December 31, 2011		<u>\$7,000</u>
	Cost of goods manufactured (to income Statement)		<u>\$104,000</u>

* Note that this schedule can become a Schedule of Cost of Goods Manufactured and Sold simply by including the beginning and ending finished goods inventory figures in the supporting schedule rather than in the body of the income statement.

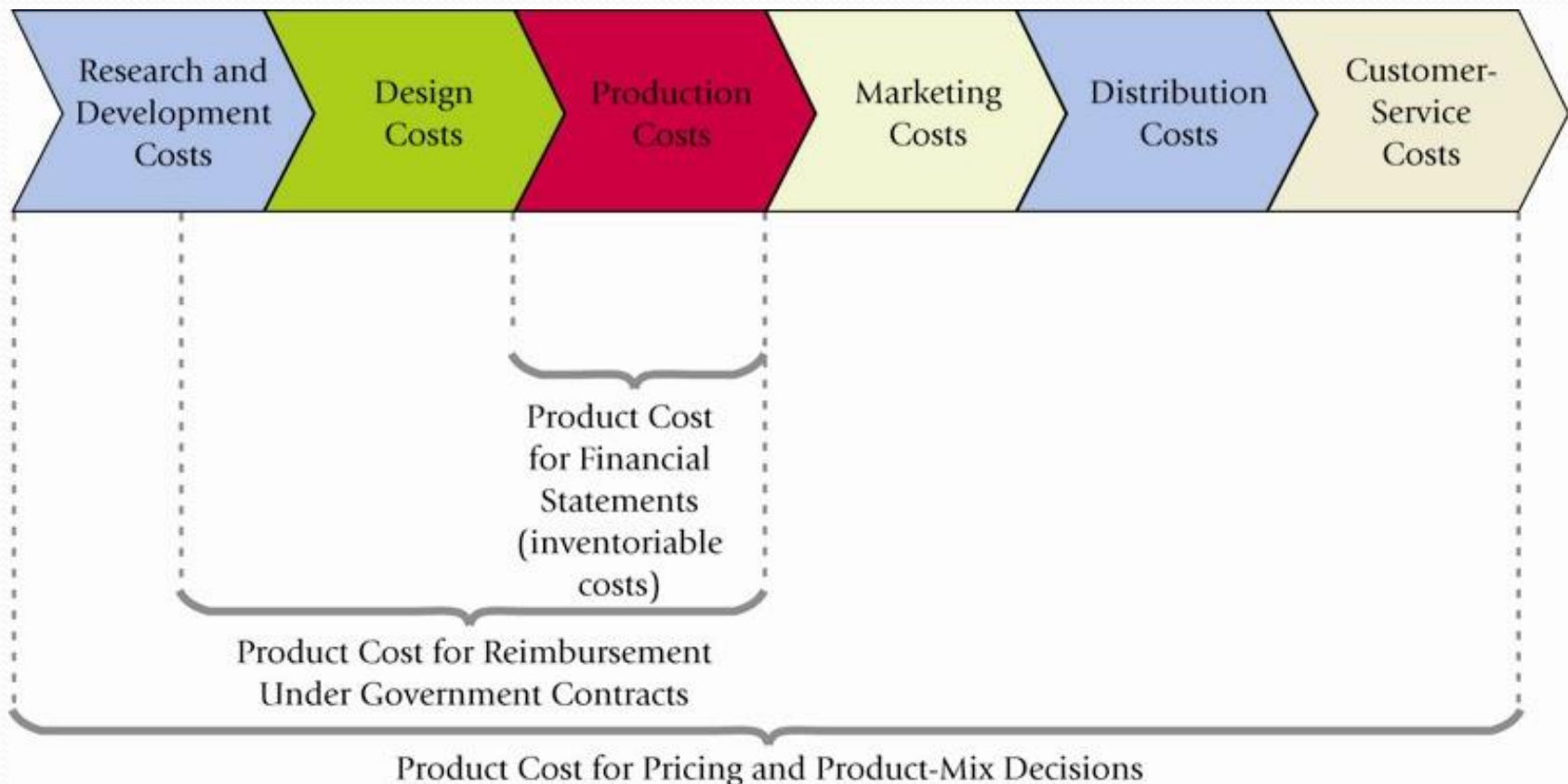
Other Cost Considerations

- Prime cost is a term referring to all direct manufacturing costs (materials and labor).
- Conversion cost is a term referring to direct labor and indirect manufacturing costs.
- Overtime labor costs are considered part of indirect overhead costs.

Different Definitions of Costs for Different Applications

- Pricing and product-mix decisions—decisions about pricing and maximizing profits
- Contracting with government agencies—very specific definitions of allowable costs for “cost plus profit” contracts
- Preparing external-use financial statements—GAAP-driven product costs only

Different Definitions of Costs for Different Applications



Three Common Features of Cost Accounting and Cost Management

1. Calculating the cost of products, services, and other cost objects
2. Obtaining information for planning and control, and performance evaluation
3. Analyzing the relevant information for making decisions