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# **Introduction**

To complete the cost accounting course, I need to write an essay of chapters 1 and 2 from the book Cost Accounting: A Managerial Emphasis written by Rajan, Madhav V., Srikant M. Datar, and Charles T. Horngren. Cost accounting measures and reports financial and non-financial information related to the organization related to the purchase or consumption of resources. It is an important component of both management accounting and financial accounting.

Cost accounting developed to help the internal management in decision making. The information provided by cost accounting acts as a managerial tool so that business can utilize the available resources at optimum level. Management accounting is an extension of management aspects of cost accounting. It provides the information to management so that planning, organizing, directing, and controlling of business operations can be done in an orderly manner. And that's exactly where accounting management differs from financial management. Financial accounting focuses on reporting financial information to external parties such as investors, government agencies, banks, and suppliers based on Generally Accepted Accounting Principles (GAAP

The difference between management accounting and financial accounting is explained in chapter 1, the manager and management accounting. The role of a management accountant in an organization is also discussed in part 1.

Cost management is a very important part of management accounting. Cost management is the process of planning and controlling the budget of a project or company. It includes activities such as planning, budgeting, financing, and project control so that the project can be completed within the approved budget. To allocate the costs to the products, it is very important that the costs are classified. Certain costs can be directly attributed to the final product, but certain of the costs cannot.

The different forms of costs are discussed in Chapter 2, an Introduction to cost terms and purposes.

## **Learning Objectives**

1. Distinguish financial accounting from management accounting
2. Understand how management accountants help firms make strategic decisions
3. Describe the set of business functions in the value chain and identify the dimensions of performance that customers are expecting of companies
4. Explain the five-step decision making process and its role in management accounting
5. Describe three guidelines management accountants follow in supporting managers
6. Understand how management accounting fits into an organization’s structure
7. Understand what professional ethics mean to management accountants
8. Define and illustrate a cost object
9. Distinguish between direct costs and indirect costs
10. Explain variable costs and fixed costs
11. Interpret unit costs cautiously
12. Distinguish inventoriable costs from period costs
13. Illustrate the flow of inventoriable and period costs
14. Explain why product costs are computed in different ways for different purposes
15. Describe a framework for cost accounting and cost management

# **Answers to the questions below**

* 1. How does management accounting differ from financial accounting?

Management accounting is the process of identifying, measuring, analyzing, preparing, interpreting, and communicating information to adequately perform the function of the managers.' This means that in addition to financial information, the manager must also have non-financial information to be able to perform his task properly.

Financial accounting is a branch within the accounting world that deals with the preparation of financial statements that are drawn up to give external stakeholders (e.g., shareholders, lenders, and various government agencies) insight into the financial position of a company. Financial accounting is driven by prescribed accounting principles. These principles define the rules to be used about determine revenues and costs, and what is or is not considered to be assets, liabilities, or equity.

* 1. “Management accounting should not fit the straitjacket of financial accounting.” Explain and give an example.

Management accounting is not bound by regulations, it is internal and focused on forward-looking information. Financial accounting focuses on external reporting that is dictated by laws and regulations; it is external and focused on information from the past. An example is that in management accounting you must make budgets so that the managers of the different department can focus their expenses on this, while in financial accounting there must be an account of how the resources from the budgets have been spent.

* 1. How can a management accountant help formulate strategy?

The success of a company lies in the fact that the company creates value for the customer and distinguishes itself from its competitors. The way in which this is done is the strategy. First, the task of management accountant must be made clear. Developing a strategy is how the organization matches its own qualities with the opportunities and possibilities of the market so that it can realize its goals.

There are two strategies:

* Sell product at a low price with the corresponding quality.
* Sell unique product at a high price.

* 1. Describe the business functions in the value chain.

The value chain is a model that can help you develop the core activities of your organization. The Value Chain describes all the activities required to ultimately get a product of development, design, production, marketing, and distribution to the customer.

The business functions in the value chain are[[1]](#footnote-1):

1. Research and development: generating and experimenting with ideas related to new products, services, or processes.
2. Design of products and processes: the detailed planning and engineering of products, services, or processes.
3. Production: acquiring, coordinating, and assembling resources to produce a product or deliver a service.
4. Marketing: promoting and selling products or services to customers or prospective customers.
5. Distribution: delivering products or services to customers.
6. Customer service: providing after-sale support to customers.
   1. Explain the term supply chain and its importance to cost management.

A supply chain is the set of activities and goods that are transported between a supplier and a buyer. A supply chain provides the company with insight into where materials for products come from and which party supplies the materials in question.

Research and Development: generating and experimenting with ideas related to new products, services, or processes.

Design of products and processes: detailed planning, engineering, and testing of products and processes.

Production: purchasing, transporting, and storing (incoming logistics) and coordinating and assembling (assets) to produce a product or to deliver a product.

Marketing: sale of products or services to customers or potential customers.

Distribution: processing of orders and shipment of products or services to clientele.

Customer service: providing after-sales service to customers.

Supply chain costs are controlled by management and strategy. You can keep costs down by managing every step in the supply chain process. To find reductions in supply chain costs, supply chain strategies must align with customer expectations and business goals.

* 1. “Management accounting deals only with costs.” Do you agree? Explain.

Management accounting is not just about costs. Other dimensions such as production, logistics, personnel, growth, and innovation are also important. With a good Management Accounting system, management can make responsible decisions that are valuable to the organization.

* 1. How can management accountants help improve quality and achieve timely product deliveries?

Management accountants help improve quality and achieve timely product deliveries by using Total quality management (TQM).TQM is an approach that seeks to improve quality and performance which will meet [customer expectations](https://www.thebalancesmb.com/customer-service-guide-for-small-business-2948068).

* 1. Describe the five-step decision-making process.

The five-step decision-making process is[[2]](#footnote-2):

1. Identify the problem and uncertainties. The first step in the decision-making process is to establish the objective of the business enterprise.
2. Obtain information.

The second step-in decision-making process is one of defining or identifying the problem. Defining the nature of the problem is important because decision making is after all meant for solution of the problem.

1. Make predictions about the future.

Once the problem has been identified, the next step is to find out alternative solutions to the problem.

1. Make decisions by choosing among alternatives.

The next step in business decision making is to evaluate the alternative courses of action. This requires, the collection and analysis of the relevant data.

1. Implement the decision, evaluate performance, and learn.

The final step is to implement the decision. The implementation of the decision requires constant monitoring so that expected results from the optimal course of action are obtained.

* 1. Distinguish planning decisions from control decisions.

Planning:

* select the goals of the organization, predict the results in the different ways in which the goals can be achieved, decide how you want to achieve goals.
* communicate the goals and how to reach the entire organization. A planning tool is budgeting.

Control:

* action whereby implementation of the planned activities takes place.
* decide how to carry out the evaluation and what feedback is needed to make better decisions in the future.
  1. What three guidelines help management accountants provide the most value to managers?

Three guidelines that help management accountants provide the most value to managers is[[3]](#footnote-3):

1. cost benefit approach: management accounting is constantly looking at the best uses of capital goods.
2. behavior and technical considerations: a management accounting system must fulfill 2 missions at the same time for the purpose of providing information helping managers in such a way that they make the right economic decision and motivating managers and employees to pursue the goals of the organization.
3. different cost for different purposes.
   1. “Knowledge of technical issues such as computer technology is a necessary but not sufficient condition to becoming a successful management accountant.” Do you agree? Why?

Knowledge of technical issues such as computer technology is a necessary but not sufficient condition to becoming a successful management accountant, because part of a manager's tasks is to achieve goals. To achieve goals, you are working with people to get them to be motivated to perform.

* 1. As a new controller, reply to this comment by a plant manager: “As I see it, our accountants may be needed to keep records for shareholders and Uncle Sam, but I don’t want them sticking their noses in my day-to-day operations. I do the best I know how. No bean counter knows enough about my responsibilities to be of any use to me.”

The duty of an accountant is not only to keep records for shareholders, but they must also provide advice, support, and assistance other managers

* 1. Where does the management accounting function fit into an organization’s structure?

The management accounting function is a staff function. Staff management has a supporting task towards the line management. There is a chief financial officer (CFO). Under the CFO you have the chief accounting officer and under the chief accounting officer you have management accounting and financial accounting.

* 1. Name the four areas in which standards of ethical conduct exist for management

accountants in the United States. What organization sets forth these standards?

four areas in which standards of ethical conduct exist for management

accountants in the United States are competence, confidentiality, integrity, and credibility. The organization sets forth these standards is the Institute of Management Accountants.

* 1. What steps should a management accountant take if established written policies provide insufficient guidance on how to handle an ethical conflict?

steps that a management accountant should take if established written policies provide insufficient guidance on how to handle an ethical conflict are[[4]](#footnote-4):

1. making it negotiable with the superior if the superior is not involved in the case. If the superior is involved in the case, he must go to higher management.
2. bring more clarity to the case by discussing it with an IMA Ethics Counselor or other impartial advisor to get a better picture of how to handle the case.
3. take control of your own lawyer.

2-1 Define cost object and give three examples.

A cost object is anything for which a separate determination of **costs** is desired. Examples include a product, a machine, a service, a project, a customer, an activity, a department, a program

2-2 Define direct costs and indirect costs.

direct costs are costs that you can assign directly to something.

Indirect costs are costs that cannot be directly assigned to something

2-3 Why do managers consider direct costs to be more accurate than indirect costs?

Managers consider direct costs to be more accurate than indirect costs because the direct costs are the costs incurred to make a product while the indirect costs must be allocated.

2-4 Name three factors that will affect the classification of a cost as direct or indirect.

Three factors that will affect the classification of a cost as direct or indirect[[5]](#footnote-5).

1. The materiality of the cost in question. The smaller the amount of a cost—that is, the more immaterial the cost is—the less likely it is economically feasible to trace it to a particular cost object.
2. Available information-gathering technology. Improvements in information-gathering technology make it possible to consider more and more costs as direct costs.
3. Design of operations. Classifying a cost as direct is easier if a company’s facility (or some part of it) is used exclusively for a specific cost object, such as a specific product or a particular customer (Rajan, Madhav, Datar and Horngren 2015, 31).

2-5 Define variable cost and fixed cost. Give an example of each.

This includes all costs that depend on the production quantity or simply change monthly. An example is flour for the baker. If the baker produces 1,000 loaves of bread, he needs much less flour than if he makes 100,000 loaves of bread.

Fixed costs are costs that do not change if is produced. An example of fixed costs is the rent of a business premises: it does not matter how many products are produced in the building; the rent is the same.

2-6 What is a cost driver? Give one example.

cost drivers can be defined as activities that make a substantial contribution to the incurrence of costs. An example of a cost driver is the square footage used

2-7 What is the relevant range? What role does the relevant-range concept play in explaining how costs behave?

A relevant range is the range of the cost driver (= factor that affects the total costs) in which a specific relationship between the costs and the activity level or volume is valid. Fixed costs are only fixed in relation to a given relevant range of the cost driver and a given duration.

2-8 Explain why unit costs must often be interpreted with caution.

because unit costs are subject to change. The number of products produced last year does not have to be the same number of products this year. Attention must be paid to this because when the volume changes, the costs also change.

2-9 Describe how manufacturing-, merchandising-, and service-sector companies differ from one another.

The manufacturing company differs from the merchandising company in that the manufacturing company transforms the purchasing products and resells them in a form other than the basic form.

Companies in the service sector provide services or non-material products to their customers – for example, legal advice. They have no stock of material products at the end of the accounting period. Labor costs are their most significant cost category.

Trading companies sell tangible products that they first bought in the same form from suppliers – examples are bookstores, chain stores, hardware stores. Goods that they have not sold at the end of the period, they keep as stock.

Production companies supply tangible products that they have converted into a different form than as they received them – examples are computer and textile companies and companies in food processing. At the end of the period, their stock consists of, among other things, direct materials, work in progress, end products.

2-10 What are three different types of inventories that manufacturing companies hold?

Three different types of inventories that manufacturing companies hold[[6]](#footnote-6).

1. Raw Material: This is basic goods procured which will be converted into finished goods.
2. Work-In-Progress: Type of inventory on which the production process is applied partially but is not wholly converted into finished goods at any point of time.
3. Finished Goods: Finished goods are form of inventories on which the entire production process is applied, and the product is in sellable condition.

2-11 Distinguish between inventoriable costs and period costs.

The main difference between period costs and product costs is that period costs are an expense charged for a period in which they are incurred, while product costs are costs related to products that a company produces and sells.

2-12 Define the following: direct material costs, direct manufacturing-labor costs,

manufacturing overhead costs, prime costs, and conversion costs.

* Direct material costs is the cost of the raw materials and components used to create a product.
* Direct labor costs refer to the total cost incurred by the company for paying the wages and other benefits to the employees of the company against the work performed by them which are related directly to the manufacturing of the product of the company or for the provision of the services.
* The manufacturing overhead cost is the cost that business owners incur outside the expenses associated with direct labor or the cost of raw and direct materials.
* Prime costs are all direct production costs.
* Conversion costs are all production costs that are not direct material costs. These costs are for converting direct materials into finished products.

2-13 Describe the overtime-premium and idle-time categories of indirect labor.

Overtime-premiums is usually considered to be a part of indirect costs or overhead. Idle time is when wages are paid for unproductive time caused by lack of order, machine or computer breakdowns, work delays, poor scheduling, and the like.

2-14 Define product cost. Describe three different purposes for computing product costs.

Product costs are the direct costs involved in producing a product. These are direct costs, such as materials or ingredients, but also indirect costs such as wage costs or the use of machines.

Three different purposes for computing product costs.

1. Pricing and product mix decisions.
2. contracting with government agencies
3. preparing financial statements for external reporting under Generally Accepted Accounting Principles (GAAP).

2-15 What are three common features of cost accounting and cost management?

Three features of cost accounting and cost management.

1. calculating the costs 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.

# **Conclusion**

The main difference between financial accounting and management accounting is that the financial accounting information is provided externally and in management accounting information is provided for internal use. In chapter, the task of a management accounting is explained in detail. Management accounting isn't just about numbers as one might think at first. Management accounting provides not only financial but also non-financial information that helps managers make decisions to achieve the company's goals.

Management accountants have ethics obligations such as Honesty, Fairness, Objectivity, and Responsibility. Management accountants must also comply with the following standards: competence, confidentiality, integrity, and credibility. Failure to comply with these standards can lead to disciplinary action.

I work for the telecommunications regulator of Suriname. We have a financial manager. However, we do not have a management accountant. It is more due to the nature of the organization that we do not have management accounting. 2 years ago, we did have an internal auditor. He was more concerned with the administrative organization of the company. Including describing the processes that apply to the services offered by the organization. The organization is also small, so at least there is no need for a management accountant.

What is very important is that rates are calculated for the services that the organization offers and then it is important that the persons who are charged with this do consider the various costs that play a role in this. The information for calculating the rates is generated at the financial department. I am responsible for calculating the rates of the organization's services. Very important in the calculation of the services is how the different costs are allocated to the different services. When it comes to direct costs, that's easy. For indirect costs, we use distribution keys to allocate the direct costs to the services. Our cost types therefore differ considerably when it comes to services. And, not just service, but service with a non-profit eye brand. When calculating the rates, it is assumed that the organization must be able to cover the costs it incurs. If there is a surplus, it must be paid to the state. You could say that the services we make available are wholesale services. They are used by third parties to provide commercial services.

Due to the purpose of the organization and the fact that it concerns services, we do not have much to do with the many costs that are incurred at a production company. It is important to know different cost formats and how they are used. In Chapter 2, the various costs are discussed in detail.

# **Bibliography**

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2. Horngren, 10 [↑](#footnote-ref-2)
3. Horngren, 13 [↑](#footnote-ref-3)
4. Hornhren, 19 [↑](#footnote-ref-4)
5. Horngren, 31 [↑](#footnote-ref-5)
6. Horngren, 38 [↑](#footnote-ref-6)