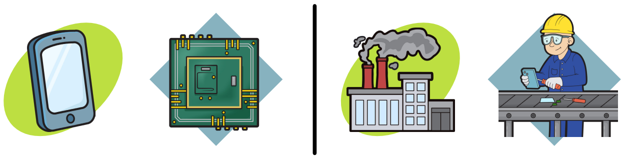
TOPIC: DIRECT AND INDIRECT COSTS

- Managers need to measure _______ so they can accurately set prices, measure profit, and control spending.
- A cost object is something for which cost data is needed (e.g. product, customer, department).

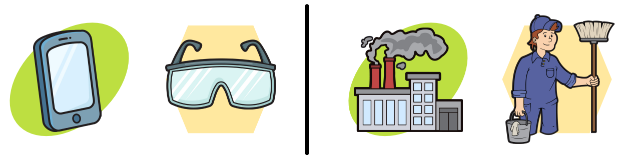
Direct Costs

- Cost only exists because of that cost object.
- If we eliminated the cost object, the cost would _______.



Indirect Costs

- If we eliminated the cost object, the cost would ________.
- Costs that support _________ objects are called common costs.



EXAMPLE

Bryan Clothing's most popular item is a hand-made heavy knit sweater. The cost object is one sweater. For each cost listed below, categorize it as either a direct cost or an indirect cost by writing D or I next to it.

_____ Heavy-weight wool yarn.

_____ A worker whose job is knitting sweaters.

_____ The sweater factory's manager.

_____ Knitting needles.

_____ Forklift.

TOPIC: DIRECT AND INDIRECT COSTS

PRACTICE

A manager is evaluating the cost of producing a loaf of bread. Which of the following should he consider an indirect cost of bread production?

a) Flour
b) Baker
c) Salt
d) Oven

PRACTICE

The table below gives the costs of producing a wooden desk. What is the total direct cost?

Cost of Manufacturing – Wooden Desk	
Cost Component	**Amount ($)**
Salary: Carpenters	$ 25,000
Salary: Factory Manager	$ 10,000
Wood Boards	$ 5,000
Brass Desk Handles	$ 5,000
Rent Factory	$ 10,000

a) $35,000
b) $30,000
c) $55,000
d) $45,000

TOPIC: DIRECT AND INDIRECT COSTS

Overhead, Manufacturing, and Non-Manufacturing Costs

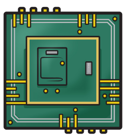
◆ Manufacturing companies categorize their **Manufacturing Costs** as either **direct** or **indirect**.

Raw Materials

Direct Materials | **Indirect Materials**

Labor

Direct Labor | **Indirect Labor**



Manufacturing Overhead = Indirect Materials + Indirect Labor + Other Manufacturing Costs

◆ **Non-Manufacturing Costs** (also called Selling, General, and Administrative Costs) are counted separately from Manufacturing Costs.

Selling Costs	Administrative Costs
Costs associated with _________ customers and ___________ products.	Costs associated with _____________ of the company.

EXAMPLE

Bryan Clothing would like to measure the costs associated with operating their primary sweater factory. Below are the cost data for this factory in August. Calculate their total direct costs and manufacturing overhead.

Bryan Clothing – Factory Costs (August)	
Cost Item / Description	**Amount ($)**
Salaries: Corporate Office	$150,000
Salaries: Knitting Staff	$170,000
Salaries: Factory Manager	$5,000
Salaries: Janitorial Staff	$5,000
Heavy-weight Wool Yarn	$10,000
Knitting Needles	$14,000
Factory Utilities	$35,000
Factory Depreciation	$70,000
Factory Lease	$50,000

TOPIC: DIRECT AND INDIRECT COSTS

PRACTICE

Which of the following would not be considered a selling cost?

a) The cost of an advertising campaign.

b) Delivery driver salaries.

c) HR salaries.

d) Sales commissions.

PRACTICE

The table below gives the costs of producing a wooden desk. What is the total manufacturing overhead?

Cost of Manufacturing – Wooden Desk	
Cost Component	**Amount ($)**
Salary: Carpenters	$ 25,000
Salary: Factory Manager	$ 10,000
Wood Boards	$ 5,000
Brass Desk Handles	$ 5,000
Rent Factory	$ 10,000

a) $25,000

b) $15,000

c) $20,000

d) $30,000

TOPIC: DIRECT AND INDIRECT COSTS

Prime, Conversion, and Average Costs

- Manufacturing firms use direct materials, direct labor, and manufacturing overhead to calculate additional useful measures of cost.

Prime Cost = Direct Materials + Direct Labor → Used to estimate cost of additional production.

Conversion Cost = Direct Labor + Manufacturing Overhead → Used to estimate the cost of turning materials into products.

- Businesses are often interested in average, or ________ costs.

Average ________ **Cost** = Total ________ Cost / Quantity Sold

Prime	Conversion	Direct	Indirect	Materials,
Labor	Product	Period	Common	etc.

EXAMPLE

If Bryan Clothing sells 10,000 sweaters in August, use the August cost data below to calculate their prime cost per unit, and conversion cost per unit.

Bryan Clothing – Factory Costs (August)

Cost Item / Description	Amount ($)
Salaries: Corporate Office	$150,000
Salaries: Knitting Staff	$170,000
Salaries: Factory Manager	$5,000
Salaries: Janitorial Staff	$5,000
Heavy-weight Wool Yarn	$10,000
Knitting Needles	$14,000
Factory Utilities	$35,000
Factory Depreciation	$70,000
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TOPIC: DIRECT AND INDIRECT COSTS

PRACTICE

Imagine that a bakery had planned to produce 3,000 bagels in the coming week. During the week, they receive a catering order for an additional 300 bagels, and they would like to estimate the cost per bagel of completing this order. The bakery assumes that if they produce additional bagels their overhead costs will not change. Which of the following would best estimate the cost of each additional bagel produced by the bakery?

a) Total Conversion Cost.
b) Total Prime Cost.
c) Average Conversion Cost.
d) Average Prime Cost.

PRACTICE

Which of the following would not be included in Conversion Cost for a construction company?

a) Maintenance staff salaries.
b) The cost of tools used by workers.
c) Monthly electric bill.
d) The cost of wood beams.