



# Cost Accounting

2nd Edition

**by Ken Boyd**

for  
**dummies**<sup>®</sup>  
A Wiley Brand

# Contents at a Glance

<b>Introduction</b> .....	1
<b>Part 1: Understanding the Fundamentals of Costs</b> .....	5
CHAPTER 1: So You Want to Know about Cost Accounting .....	7
CHAPTER 2: Brushing Up on Cost Accounting Basics .....	17
CHAPTER 3: Using Cost-Volume-Profit Analysis to Plan Your Business Results .....	31
CHAPTER 4: Estimating Costs with Job Costing .....	53
CHAPTER 5: More Activity, More Cost: Activity-Based Costing .....	75
<b>Part 2: Planning and Control</b> .....	99
CHAPTER 6: What's the Plan, Stan? Budgeting for a Better Bottom Line .....	101
CHAPTER 7: Constant Change: Variance Analysis .....	125
CHAPTER 8: Focusing on Overhead Costs .....	149
CHAPTER 9: What's on the Shelf? Inventory Costing .....	163
<b>Part 3: Making Decisions</b> .....	185
CHAPTER 10: Cost Drivers and Cost Estimation Methods .....	187
CHAPTER 11: Making Smart Business Decisions with Relevant Information .....	203
CHAPTER 12: Making Smart Pricing Decisions: Figuring Total Costs .....	227
<b>Part 4: Allocating Costs and Resources</b> .....	249
CHAPTER 13: Analysis Methods to Improve Profitability .....	251
CHAPTER 14: Behind the Scenes: Accounting for Support Costs and Common Costs .....	271
CHAPTER 15: Joint Costs, Separable Costs, and Using Up the Leftovers .....	295
CHAPTER 16: Tracing Similar Products with Process Costing .....	313
<b>Part 5: Considering Quality Issues</b> .....	335
CHAPTER 17: What a Waste! Getting the Most from Spoilage, Scrap, and Reworked Products .....	337
CHAPTER 18: Making Smart Ordering Decisions .....	359
CHAPTER 19: Quality: Building a Better Mousetrap .....	381
<b>Part 6: The Part of Tens</b> .....	401
CHAPTER 20: Ten Common Costing Mistakes and How to Avoid Them .....	403
CHAPTER 21: Ten Ways to Increase Profits Using Costing .....	409
<b>Index</b> .....	415

# Table of Contents

<b>INTRODUCTION</b> .....	1
About This Book .....	1
Foolish Assumptions .....	2
Icons Used in This Book .....	2
Beyond the Book .....	3
Where to Go from Here .....	3
<b>PART 1: UNDERSTANDING THE FUNDAMENTALS OF COSTS</b> .....	5
<b>CHAPTER 1: So You Want to Know about Cost Accounting</b> .....	7
Comparing Accounting Methods .....	8
Considering your shareholders .....	8
Mulling over creditors .....	9
Addressing concerns of regulators .....	9
Using management accounting .....	9
Fitting in cost accounting .....	10
Using Cost Accounting to Your Advantage .....	11
Starting with cost-benefit analysis .....	11
Planning your work: Budgeting .....	12
Controlling your costs .....	12
Setting a price .....	13
Improving going forward .....	14
<b>CHAPTER 2: Brushing Up on Cost Accounting Basics</b> .....	17
Understanding the Big Four Terms .....	17
Comparing direct and indirect costs .....	18
Mulling over fixed and variable costs .....	20
Fitting the costs together .....	21
Covering Costs in Different Industries .....	22
Reviewing manufacturing costs .....	22
Considering costs for retailers .....	23
Adding up costs for e-commerce firms .....	23
Finding costs most companies incur .....	24
Why Are You Spending? Cost Drivers .....	25
Pushing equipment too hard and relevant range .....	25
Previewing inventoriable costs .....	26
Following the Rules of the Cost Accounting Road .....	27
Understanding generally accepted accounting principles (GAAP) .....	27
Deciding on accrual basis or cash basis .....	29
Finishing with conservatism .....	30

<b>CHAPTER 3:</b>	<b>Using Cost-Volume-Profit Analysis to Plan Your Business Results</b> .....	31
	Understanding How Cost-Volume-Profit Analysis Works .....	32
	Calculating the breakeven point .....	32
	Financial losses: The crash of your cash .....	34
	Contribution margin: Covering fixed costs .....	35
	Lowering the breakeven point to reach profitability sooner .....	36
	Target net income: Setting the profit goal .....	37
	Using operating leverage .....	38
	Assessing e-commerce businesses .....	40
	Timing is everything when it comes to costs .....	41
	Using Cost-Volume-Profit Analysis to Make Savvy Business Decisions .....	42
	Deciding to advertise .....	43
	Lowering your price without losing your profit .....	44
	Combining the results of two products .....	45
	Costing and pricing a new product .....	48
	The Tax Man Cometh, the Profits Goeth .....	51
	Understanding pre-tax dollars .....	51
	Adjusting target net income for income taxes .....	52
<b>CHAPTER 4:</b>	<b>Estimating Costs with Job Costing</b> .....	53
	Understanding How Job Costing Works .....	54
	Cost objects: The sponges that absorb money .....	55
	Charging customers for direct and indirect costs .....	56
	Implementing job costing in manufacturing: An example .....	57
	Deciding on costing for IT consulting projects .....	61
	Taking a Closer Look at Indirect Costs using Normal Costing .....	64
	Budgeting for indirect costs .....	65
	Following a normal job costing system .....	66
	Following the Flow of Costs through a Manufacturing System .....	67
	Control starts with control accounts .....	67
	Explaining the debit and credit process .....	68
	Walking through a manufacturing cost example .....	70
	Applying the methodology to other control accounts .....	73
<b>CHAPTER 5:</b>	<b>More Activity, More Cost: Activity-Based Costing</b> .....	75
	Avoiding the Slippery Peanut Butter Costing Slope .....	76
	Recognizing a single indirect cost allocation .....	77
	A fly in the peanut butter: Dealing with different levels of client activity .....	77
	Missing the mark: Undercosting and overcosting .....	79

Designing an Activity-Based Costing System . . . . .	81
Refining your approach . . . . .	81
Grouping costs using a cost hierarchy . . . . .	82
Testing your ABC design . . . . .	83
Using Activity-Based Costing to Compute Total Cost, Profit, and Sale Price . . . . .	87
Allocating indirect costs evenly by product . . . . .	88
Analyzing and reallocating cost activities . . . . .	88
Changing allocations to cost pools . . . . .	89
Changing prices after ABC . . . . .	90
Implementing ABC Costing for a Business Pivot . . . . .	91
Deciding whether to pivot . . . . .	92
Mulling over a pivot example . . . . .	93
Using ABC Costing for a New Business Model . . . . .	94
Considering sunk costs . . . . .	94
Reviewing food and labor costs . . . . .	95
Allocating new overhead costs . . . . .	95
Applying ABC costing to overhead costs . . . . .	96
Evaluating your results . . . . .	98

**PART 2: PLANNING AND CONTROL . . . . . 99**

<b>CHAPTER 6: What's the Plan, Stan? Budgeting for a Better Bottom Line . . . . .</b>	<b>101</b>
Brushing Up on Budgeting Basics . . . . .	102
Seeing the master budget and its component parts . . . . .	102
Why budgeting is important . . . . .	103
Considering the costs and benefits of data collection . . . . .	104
Leveraging AI and data analytics for effective budgeting . . . . .	106
Planning strategically . . . . .	107
Planning How to Plan: Factors That Impact Your Budgeting Process . . . . .	108
Experience counts . . . . .	109
Timing is everything . . . . .	109
People get you headed in the right direction . . . . .	110
Sales projections pay off . . . . .	111
The Nuts and Bolts (and Washers) of Budgeting . . . . .	112
Understanding the budgeting financials . . . . .	113
Reviewing revenue and production budgets . . . . .	116
Budgeting with Cash Accounting or Accrual Accounting . . . . .	119
Cash basis accounting: Using your checkbook to budget . . . . .	119
I accrue, you accrue, we all accrue with accrual accounting . . . . .	121
Budgeting to Produce the Income Statement and Balance Sheet . . . . .	122
The well-balanced balance sheet . . . . .	122
The incredible income statement . . . . .	123

<b>CHAPTER 7: Constant Change: Variance Analysis</b>	125
Variance Analysis and Budgeting	126
Using management by exception to recognize large variances	126
Seeing the problem in using a static budget	127
Opting for a flexible budget	131
Investigating budget variances	134
Analyzing in Material Price and Efficiency Variances	135
Applying price variances to direct materials	136
Applying efficiency variances to direct materials	137
Implementing price variances for direct labor	139
Sizing up efficiency variances for direct labor	139
Using Your Findings to Make Decisions	140
Following up on variances	141
Judging the effectiveness of your employees	143
Tying supply chain concepts to variance analysis	145
Attaching ABC costing concepts to variance analysis	145
<b>CHAPTER 8: Focusing on Overhead Costs</b>	149
Using Cost Allocation to Minimize Overhead	150
Paying for the Security Guard: Fixed Overhead Costs	151
Planning fixed overhead costs	151
Allocating fixed overhead costs	152
Assessing potential causes of fixed overhead variances	155
Those Vexing Variable Manufacturing Costs	156
Working with variable overhead costs	156
Implementing variance analysis	159
Finding the reasons for a variable overhead variance	161
<b>CHAPTER 9: What's on the Shelf? Inventory Costing</b>	163
Working with Inventoriable Costs	164
Using the matching principle to calculate profit on sale	164
Erring on the conservative side	166
Costing Methods for Inventory	166
Using the first-in, first-out (FIFO) method	168
Accounting with the last-in, first-out (LIFO) method	169
Weighing the merits of weighted-average cost	170
Considering specific identification method	171
Analyzing profit using FIFO and LIFO	171
Using Variable and Absorption Costing to Allocate Fixed Manufacturing Costs	173
Defining period costs and product costs	174
Applying variable and absorption costing	175
Relating Capacity Issues to Inventory	177
Reviewing theoretical and practical capacity	178
Understanding capacity issues for e-commerce firms	179

Using normal and master-budget capacity . . . . .	181
Choosing a capacity level . . . . .	182
<b>PART 3: MAKING DECISIONS . . . . .</b>	<b>185</b>
<b>CHAPTER 10: Cost Drivers and Cost Estimation Methods . . . . .</b>	<b>187</b>
Working with Cost Behavior. . . . .	188
Understanding linear and nonlinear cost functions. . . . .	188
Discovering how cost drivers determine total costs . . . . .	189
Considering Cost Estimation Methods. . . . .	190
Walking through the industrial engineering method. . . . .	190
Agreeing on the conference method . . . . .	191
Reviewing the account analysis method . . . . .	191
Checking out the quantitative analysis method . . . . .	192
Choosing a cost estimation method. . . . .	196
Exploring Nonlinear Cost Functions . . . . .	197
Changing cost functions and slope co-efficients. . . . .	198
Understanding the impact of quantity discounts . . . . .	198
Assessing the Impact of Learning Curves . . . . .	198
Considering how AI and Data Analytics Impact Learning Curves. . . . .	200
Reviewing AI and data analytics . . . . .	200
Throwing in the learning curve . . . . .	200
Simplifying a procedure . . . . .	201
Finding and using better data . . . . .	201
<b>CHAPTER 11: Making Smart Business Decisions with Relevant Information . . . . .</b>	<b>203</b>
Navigating the Geography of Relevance . . . . .	204
Introducing the decision model . . . . .	205
Applying a model to an equipment decision. . . . .	206
Understanding IT purchasing issues . . . . .	208
Considering relevant qualitative factors in decision-making . . . . .	210
Special Orders Don't Upset Us, Do They? . . . . .	211
Deciding between Outsourcing and In-house Production . . . . .	213
Weighing opportunity costs. . . . .	217
Contemplating the carrying cost of inventory. . . . .	218
Maximizing Profit When Capacity Is Limited . . . . .	220
Managing capacity and product mix. . . . .	220
Analyzing customer profit and capacity. . . . .	222
<b>CHAPTER 12: Making Smart Pricing Decisions: Figuring Total Costs . . . . .</b>	<b>227</b>
Understanding Influences on Prices. . . . .	228
Customers . . . . .	228
Competitors . . . . .	228

Suppliers . . . . .	229
Special orders . . . . .	229
Pricing for Profits Down the Road . . . . .	231
Reviewing market-based and cost-based pricing . . . . .	231
Aiming at the target: Target costing . . . . .	232
Arriving at a Reasonable Profit . . . . .	236
Using cost-plus pricing . . . . .	237
Using product life-cycle budgeting . . . . .	239
Managing IT product costs and pricing . . . . .	245
<b>PART 4: ALLOCATING COSTS AND RESOURCES . . . . .</b>	<b>249</b>
<b>CHAPTER 13: Analysis Methods to Improve Profitability . . . . .</b>	<b>251</b>
Processing Cost Allocation . . . . .	252
Why bother? Purposes of cost allocation . . . . .	252
Justifying cost allocation decisions . . . . .	253
Implementing Cost Allocation . . . . .	254
Using cost hierarchy to allocate costs . . . . .	254
Allocating tricky corporate costs . . . . .	256
Keeping track of customer revenues and costs . . . . .	260
Going Over Sales Mix and Sales Quantity Variances . . . . .	264
Remembering variances and contribution margin . . . . .	265
Getting the story about sales mix variance . . . . .	265
Calculating sales quantity variance . . . . .	269
<b>CHAPTER 14: Behind the Scenes: Accounting for Support Costs and Common Costs . . . . .</b>	<b>271</b>
Not Everyone Generates Revenue: Support Costs . . . . .	272
Introducing single rate cost allocation method . . . . .	272
Checking out dual rate cost allocations . . . . .	275
Using practical capacity to determine cost allocation rates . . . . .	277
Going Over Variance Analysis and Department Costs . . . . .	281
Choosing budgeted versus actual rate of usage . . . . .	281
Implications for the rate of usage selected . . . . .	284
Allocating to multiple departments . . . . .	285
Focusing on Common Costs . . . . .	290
Mulling over stand-alone cost allocation . . . . .	290
Stepping up to incremental cost allocation . . . . .	291
Making a Commitment: Contracts . . . . .	292
Contracting with the government . . . . .	292
Thinking about reasonable and fair costs . . . . .	293



<b>CHAPTER 15: Joint Costs, Separable Costs, and Using Up the Leftovers</b>	295
Working with Joint Costs	296
Explaining joint cost terms	296
Appreciating the importance of allocating joint costs	297
Considering joint cost allocation methods	298
Continuing Production: Computing Separable Costs After Splitoff	301
Exploring the net realizable value method	301
Introducing the constant gross margin percentage NRV method	303
Choosing a Joint Cost Allocation Method	308
Making the case for sales value at splitoff	308
Falling back to other joint costing methods	308
Deciding to sell or process further	309
Holding a Garage Sale: Making the Most of Byproducts	310
<b>CHAPTER 16: Tracing Similar Products with Process Costing</b>	313
Process Costing: Presenting the Basic Approach	314
Leading off with direct material costs	314
Following up with conversion costs	315
Sitting on the Factory Floor: Dealing with Work in Process	315
Using Equivalent Units to Compare Apples to Apples	316
Counting the units for equivalent units	317
Hunting down the total costs of production	318
Putting units and costs together	319
Seeing different percentages of completion	321
Using the Weighted Average Method for Process Costing	325
Handling beginning work in process	325
Continuing with equivalent units	326
Introducing the First In, First Out Method of Process Costing	328
Comparing Processing Costing Methods	331
Mulling over weighted average and FIFO methods	331
Debating transferred-in costs	333
<b>PART 5: CONSIDERING QUALITY ISSUES</b>	335
<b>CHAPTER 17: What a Waste! Getting the Most from Spoilage, Scrap, and Reworked Products</b>	337
Accounting for Waste	338
Determining the inspection point	338
Understanding spoilage and scrap	338
Spoilage and process costing	341
Reworking a product to recoup some profit	346

Applying Process Costing Methods to Spoilage . . . . .	346
Weighing in on the weighted average costing method . . . . .	347
Doing the FIFO Hokey Pokey: Put your first in first, take your first out first . . . . .	349
Job Costing for Spoilage, Reworked Products, and Scrap . . . . .	352
Making adjustments for normal and abnormal spoilage . . . . .	352
Reworking and selling a product. . . . .	355
Making allocation decisions about scrap. . . . .	357
<b>CHAPTER 18: Making Smart Ordering Decisions. . . . .</b>	<b>359</b>
Considering the Costs of Inventory . . . . .	360
Going through the ordering sequence. . . . .	361
Taking a closer look at stockout costs . . . . .	362
Calculating Inventory Quantity with the Economic Order Quantity Formula. . . . .	363
Figuring a Favorable Reorder Point . . . . .	365
Introducing safety stock: Creating a cushion . . . . .	366
Computing safety stock . . . . .	366
Evaluating Prediction Error . . . . .	367
Calculating relevant total costs . . . . .	367
Acting on a prediction error. . . . .	369
Buying more and ignoring EOQ. . . . .	370
Practicing Just-In-Time Purchasing . . . . .	371
Kicking around JIT benefits and risks . . . . .	371
Putting in a JIT purchasing system . . . . .	373
Adjusting total purchasing cost. . . . .	376
SCM and Customer Demand Issues. . . . .	377
Pulling apart the supply chain . . . . .	378
Analyzing demand. . . . .	378
<b>CHAPTER 19: Quality: Building a Better Mousetrap. . . . .</b>	<b>381</b>
Considering Quality Benefits and Costs. . . . .	382
Listing the benefits of quality . . . . .	382
Listing the costs of quality . . . . .	383
Taking steps to ensure quality. . . . .	384
Compiling a Cost of Quality Report. . . . .	385
Putting Quality Practices in Place . . . . .	387
Quality in job costing. . . . .	387
Taking a spin through inventory. . . . .	388
Customer Satisfaction: Measuring and Improving It . . . . .	389
Customer satisfaction's non-financial measurements. . . . .	389
Is measuring customer satisfaction worth the effort? . . . . .	391

Doing More in Less Time . . . . .	392
Analyzing performance related to time . . . . .	392
Calculating average waiting time . . . . .	394
Adding in manufacturing lead-time . . . . .	395
Eliminating the Constraint of the Bottleneck . . . . .	396
Fewer bottlenecks mean increased contribution margin . . . . .	396
Clearing bottlenecks . . . . .	397
<b>PART 6: THE PART OF TENS</b> . . . . .	<b>401</b>
<b>CHAPTER 20: Ten Common Costing Mistakes and How to Avoid Them</b> . . . . .	<b>403</b>
Pricing a Product Incorrectly . . . . .	403
Listing Fixed Costs As Variable Costs . . . . .	404
Labeling Period Costs As Product Costs . . . . .	404
Misusing Target Net Income . . . . .	404
Forgetting About Taxes . . . . .	405
Assigning Costs to the Wrong Product . . . . .	405
Not Reviewing Variances Correctly . . . . .	406
Redlining: Pushing Production Activity Above Relevant Range . . . . .	406
Ignoring the Timing of Costs . . . . .	407
Not Implementing Activity-Based Costing . . . . .	407
<b>CHAPTER 21: Ten Ways to Increase Profits Using Costing</b> . . . . .	<b>409</b>
Selling More Of The Right Products . . . . .	409
Implementing Sales Mix Analysis to Increase Total Profits . . . . .	410
Building a Higher Margin of Safety . . . . .	410
Deciding How Much You Need: Production and Scheduling Issues . . . . .	410
Who Does What: Handling Costs and Employee Issues . . . . .	411
Reducing and Managing Scrap . . . . .	411
Moving It off the Shelf: Inventory Issues . . . . .	411
Effectively Taking Special Orders . . . . .	412
Making Accurate Cost Allocations . . . . .	412
Addressing the Issue of Spoilage . . . . .	412
<b>INDEX</b> . . . . .	<b>415</b>