Farabi University

- Theme Cost Management – main approaches
- Management Department
- “Cost Management” Course
- Dr., professor Adambekova A.A.

2. Accounting and analysis of labor cost deviations.

an employee sewed a dress according to incorrect drawings, the employer must pay for the time spent by the employee, despite the fact that this dress will not be sold and will be recognized as a defect

1) errors in drawings and technological documentation;
2) discrepancy between the type of work and the level of the worker;
3) performing additional operations not provided for by technological processes;
4) performing work on less productive equipment not provided for by the technological process;
5) unsatisfactory adjustment of equipment;
6) performing additional operations caused by materials not meeting established standards and specifications;
7) replacement of one type of raw material or material with another;

2. Accounting and analysis of labor cost deviations.

- 8) use of tools and devices that do not correspond to the technological process;
- 9) replacement of semi-finished products and parts of own production with purchased ones and vice versa;
- 10) other deviations from normal working conditions (overtime, work on weekends and holidays);
- 11) discrepancy between the actual accrued wages of temporary workers for the time worked and the standard wages;
- 12) other reasons.

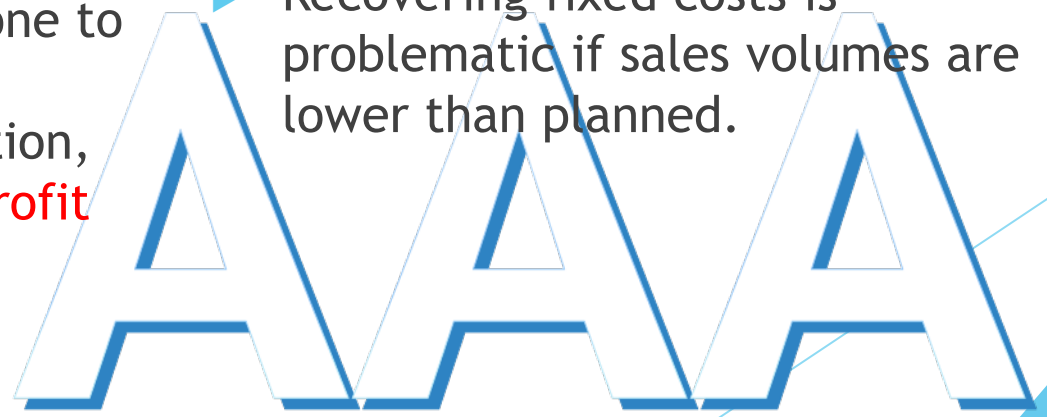
Overhead absorption rates (OAR)

- *Businesses may use different bases when allocating overhead costs to orders. However, whatever bases are chosen, overhead rates must be constantly monitored, especially where* overhead *costs tend to increase relative to fixed costs. Depending on the established rates, the following methods of distributing overhead costs for orders are used:*
- *1) calculation of rates based on natural indicators (basic wages of production workers, direct labor hours, machine hours, etc.);*
- *2) use of actual or standard rates;*
- *3) assignment of rates to the entire enterprise ("general plant"), to a division or cost center;*
- *4) inclusion or exclusion of fixed overhead costs in the cost of the order.*

- To assign manufacturing overhead to orders or units of output, *overhead absorption rates* are used and are calculated as follows:
- $$OAR = \frac{Overhead\ Amount}{Allocation\ Base\ Amount}$$

Impotent

- When used for the purpose of making pricing decisions, the full absorption cost method includes the "full cost" of the product
- The absorption cost method ensures that all costs incurred are recovered within the specified selling prices.
- The use of the normative method (the method of complete absorption of costs) allows one to determine profit using the method of complete absorption, which is called absorption profit
- Any cost-plus pricing strategy does not guarantee that a profit will be made on the product. Many other factors, including sales volume, determine whether a product will be profitable. If the price is too high, it may not be competitive and may not sell in sufficient quantities to make a profit.
- Recovering fixed costs is problematic if sales volumes are lower than planned.



Case 1

- CV Company uses a Normative method (standard costing) based on the total absorption method. The standard allocation rate for fixed manufacturing overhead is based on Volume of production. The company's reports for last month are shown below:

	budget	fact
Fixed overhead costs	$480,000	$558,000
Volume of production	60000 un	62000 un
Direct labor hours	960 000	1 110 000

- How were fixed manufacturing overhead costs allocated for last month?

Solution

- Standard distribution rate = $480,000/60,000 units. = $8 per unit products.

Absorbed (distributed) ($8 × 62,000 units)	496000
Actually incurred	(558000)
Insufficiently absorbed (distributed)	(62000)

This means that these costs will not be distributed if the distribution rate is left as it was calculated for the planned production volume. In this case, the deviation will be 62,000 and they will form the basis of our future losses.

answer: $62,000 unallocated.

Our decision - we must change the absorption rate / or increase production and sales / or reduce our costs

Case 2

Adambekova Ainagul

Inventory balances at the beginning of the period were 48,500 units and at the end - 45,500 units.
Profit using the margin method for the period amounted to $315,250, and according to the total absorption method - $288,250.
What is the fixed overhead absorption rate (OAR)?

Solution

Profit using the margin method	$315250
Change in inventory × overhead rate (balancing)	(27000)
Profit using the total absorption method	$288250

Overhead absorption rates = ($27,000)/(45,500 – 48,500) = $9 per unit.

Correct answer: $9.00

1 Step – to find difference between two method for calculate profit

2 step – to identify formula of OAR

3 step – to calculate OAR

Case 3

Adambekova Ainagul

- After applying the full absorption cost method, JK Company reported a profit of $14,000 for the period when 12,000 units were produced and 13,100 units were sold.
- JK Company sells one product with unit costs as follows:

Direct materials	**$16**
Direct labor	**$22**
Variable manufacturing overhead	**$15**
Fixed manufacturing overhead (OAR)	**$5**

- What profit will JK Company report using the marginal costing method?

Solution

Marginal profit is the difference between sales revenue and variable costs. Marginal profit is the sum of fixed costs and profit

- Marginal Profit = Absorption Profit ± (Period Inventory Change * OAR) = $14,000 + ((13,100 units - 12,000 units) * $5) = $19,500

- Correct answer: 19500

if marginal profit is equal to fixed costs, this means that the company covers all its expenses and is at the break-even point.

Case 4

A manufacturing worker receives a wage of $650 per month, plus an additional 5 cents for each unit produced during the month.
Which category would be most appropriate for the following costs?

Solution

Part of the salary is fixed ($650 per month), and part is variable (5 cents per unit). Therefore, these are conditionally variable costs (they are also called semi-fixed).

Correct answer: Conditionally variable costs

Case 5

- KT's budget contains the following data for the coming quarter:

Unit price	$114
Variable manufacturing costs per unit	$44
Fixed production costs per unit	$25
Other variable costs per unit	$12
Volume of sales	11500
Volume of production	12250
Incoming finished goods stocks (finished goods inventories at the beginning of the production period)	580

- If, based on these data, budgetary income statements are prepared using the absorption method and the marginal method, what will be the profit under the absorption method (standard method)?

Solution

- Difference between marginal and absorption profit = difference between opening and closing inventory × overhead allocation rate per unit
- Outgoing inventories = incoming 580 + production 12,250 - sales 11,500 = 1,330 units, or the change in inventories can be found by simply comparing production and sales: if they produced more, it means that inventories for the period increased by 12,250 - 11,500 = 750 units.
- Inventories increased by 750 units, which means that under the absorption method, part of the fixed overhead costs will be carried forward to the next period. Fewer expenses in this period - the profit will be greater than in the marginal method.
- How much more? 750 units × $25 = $18,750
- Correct answer: Profit under the full absorption method will be higher by $18,750