

Case 7

COST CLASSIFICATION EXERCISE

Attached is a list of cost items which do not necessarily relate to a single company. Classify each cost item as indicated below:

- A. On a functional basis, that is manufacturing (M), selling (S), and administration (A). Items not falling in any of these three categories should be classified as other (O). Specify your answer in column 2 by inserting the appropriate letter (M), (S), (A), or (O) against each item. If it is (O), specify what it is, to the extent you can.
 - B. On a traceability basis, that is direct or indirect cost. The terms 'direct' and 'indirect' relate to the traceability of the cost item to the final product. Direct cost can be traced directly and easily to a particular job or product, while indirect cost may have to be allocated using some apparently rational basis to trace its effect on individual products. Indicate your answer in column 3 by inserting the letter (D) for direct cost, and (I) for indirect costs.
- Note:** This classification is required only for those items which you have classified as manufacturing costs in column 2. For this exercise, all non-manufacturing costs are deemed to be indirect costs, though not true in some situations.
- C. On a behavioural basis, that is, variable or fixed cost. The terms 'variable' and 'fixed' refer to the variability of the cost item in relation to the volume of activity. It is easier to identify a true variable cost which directly, proportionately and almost automatically varies with fluctuations in volume, whereas fixed costs remain the same irrespective of changes in the level of activity, within a relevant range. Specify your answer in column 4 by inserting the letter (V) for variable costs and (F) for fixed costs against each cost item.

This first eight items in Part I have already been classified; you should classify the remaining items and be prepared to explain and defend your logic for the chosen classification.

Sl. No.	Example	Functional M/S/A/O	Traceability D/I	Behaviour V/F
Part I: Illustrative Answers				
1.	Wheat flour in bread	M	D	V
2.	Tailoring charges in garment making	M	D	V
3.	Factory rent	M	I	F
4.	General Manager's salary	A	-	F
5.	Salesmen's commission	S	-	V
6.	Interest paid on deposits (Finance charges)	O	-	F
7.	Loss due to theft			Loss, not a cost.
8.	Cost of installing machinery			Capital (Asset); not a cost till it is depreciated.
Part II: Home Work for Practice				
9.	Pulp in paper making			
10.	Daily wages paid for road construction			
11.	Salesmen's salary			
12.	Salesmen's samples			
13.	Depreciation of machinery (common for all products)			
14.	Monthly rental for leased computer			
15.	Fire loss			
16.	Commission paid to sales agency			
17.	Commission paid to raw material buying agency			
18.	Rent for head office building			
19.	Depreciation of delivery truck with a fixed schedule of trips every month			

Sl. No.	Example	Traceability	Functional	Functional	Traceability	Behaviour
		D/I	M/S/A/O	M/S/A/O	D/I	V/F
20.	Auditors' fee					
21.	Batteries for a car manufacturer					
22.	Insurance premium on company car					
23.	Dividend paid to shareholders					

Part III: For Class Discussion

24. Cloth in garment making
25. Thread in garment making
26. Lubricating oil for the sewing machine
27. Depreciation of a chemical processing plant and machinery
28. Power to run the machinery
29. Electricity for lighting the shop floor
30. Freight-in
31. Customs duty on raw materials
32. Royalty to author in book publishing
33. Royalty (lumpsum payment) for using a foreign brand name
34. Helpers' wages in a furniture firm
35. Nails used in a furniture firm
36. Advertising expenses
37. Trade discount (margin to outlets)
38. Cash discount (for prompt payment)
39. Expense account for government liaison

a. Works office costs on the basis of direct labour hours.

b. Maintenance costs on the basis of book value of plant and machinery.

Contd . . .

Sl. No.	Example	Traceability	Functional	Traceability	Behaviour
No.	V/F	D/I	M/S/A/O	D/I	V/F
40.	Bribes paid				
41.	Donations		M		
42.	Overtime (factory workers)				
43.	Idle time (accounts clerks)		M		
44.	Waste of raw material in manufacturing		M		
45.	Bottled perfume: the perfume		S		
46.	Bottled perfume: the bottle		O		
47.	Bottled perfume: the fancy carton for each bottle				
48.	Cardboard boxes to pack and deliver large orders of perfumes and other toiletries to the retail shops				
49.	Civil Engineer's salary in a construction firm				
50.	Advanced basic research				

DISCUSSION QUESTIONS

- On a functional basis, that is manufacturing (M), selling (S), and administration (A). Items not falling in any of these three categories should be classified as other (O). Specify your answer in column 2 by inserting the appropriate letter (M), (S), (A), or (O) against each item. If it is (O), specify what it is, to the extent you can.
- Fire loss
- Commission paid to sales agency
- Commission paid to raw material buying agency
- Rent for head office building
- Depreciation of delivery truck with a fixed schedule of trips every month
- Freight-in
- Customs duty on raw materials
- Helpers' wages in a furniture firm
- Nails used in a furniture firm
- Advertising expenses
- Trade discount (margin to outlets)
- Cash discount (for prompt payment)
- Expense account for government liaison