



Management Accounting

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Practical Class #3

Agenda

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Exercise 7

The DoceAroma Company

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THEORETICAL RECAP

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EXERCISE 8

The Beta Company



01

Exercise 7

The DoceAroma Company

02

Theoretical Recap

Direct vs Indirect cost and its Allocation

DIRECT VS INDIRECT COSTS

- **Direct costs:** can be traced easily and accurately to a cost object. The more direct costs that can be traced to a cost object, the more accurate is the cost assignment. (e.g. DM and DL)
- **Indirect costs:** cannot be traced to cost objects. An **estimate must be made** of the resources consumed by cost objects using cost allocations. (e.g. MOH)

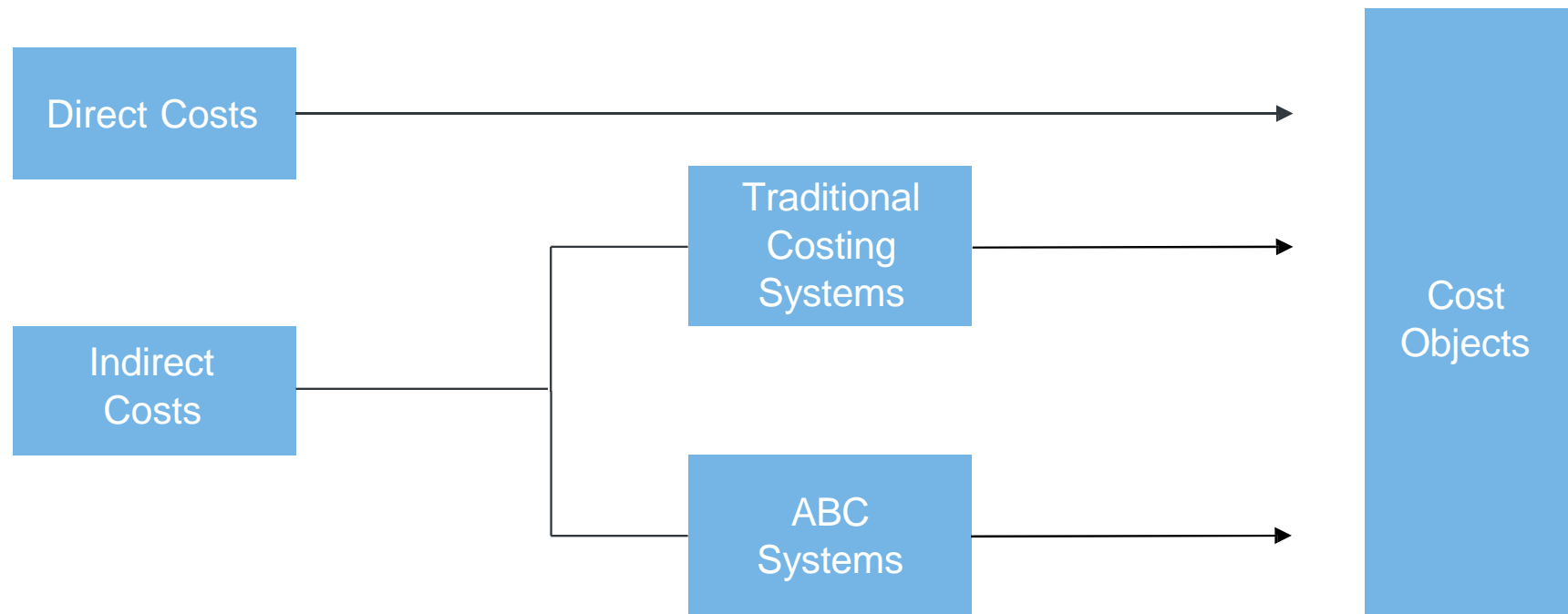
How do we know how much indirect costs go for each product?

Cost Tracing: where a cost can be directly assigned to a cost object (Direct Costs are traced to the cost object)

Cost Allocation: where a cost cannot be directly assigned to a cost object (Indirect Costs cannot be directly traced to a cost object therefore are assigned to cost objects using cost allocations)

DIRECT VS INDIRECT COSTS

Cost allocations: process of assigning costs to cost objects that involve the use of allocation bases (or cost drivers) rather than direct measures.



Traditional Costing Systems

→ Single Overhead Rate

Blanket rate used by the organization to assign every indirect cost (may make sense when resources are consumed proportionately in the entire organization)

$$\text{Single Overhead Rate} = \frac{\text{Total Overheads}}{\text{Total Cost Driver}}$$

Cost Allocation

While so far we have been computing all MOH in order for us to get the Cost of Goods Manufactured for the whole company, since:

$$\text{Cost of Goods Manufactured} = \text{Manufacturing Costs} - \Delta \text{WIP stocks}$$

We now aim to split Manufacturing Overheads between products so we can compute the COGM for different products. This allows the firm to reach more interesting conclusions than before.

Now we can compare the COGM of products and even the profit of each product produced and make decisions, such as:

- Stop producing a certain product
- Increase production of a more profitable product

03

Exercise 8

The Beta Company