

How much does it cost to type a letter?

Typist's salary	£25.00 per week
Employer's stamp and pension contribution	<u>3.00 per week</u>
	£28.00
Typist's share of overheads	5.00 per week
3p postage stamp and 4p cost of stationery based on average output of 70 letters per week: $70(3p + 4p)$	<u>4.90 per week</u>
	<u>£37.90</u>

The cost per letter is therefore $\frac{£37.90}{70} = 54p$

The cost of a phone call is 30p

Does it make sense to type a letter?

Full cost: $30p - 54p = -24p$

Conclusion: Make only phone calls.

Incremental cost: $30p - 7p = 23p$

Conclusion: Send letters, forget the phone.

**Bottom Line: Wrong cost allocation
leads to wrong decisions**

Full (absorption) cost accounting

Closing down a department

Below is the annual profit statement of a catering business which has three departments:

	Dept. 1 £	Dept. 2 £	Dept. 3 £	Total £
Sales	8,000	18,000	10,000	36,000
<i>Less: Total costs</i>				
Food	3,000	3,000	2,000	8,000
Direct labour	2,000	4,000	2,000	8,000
Variable overhead	1,000	2,000	1,000	4,000
Fixed overhead	3,000	3,000	2,000	8,000
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	9,000	12,000	7,000	28,000
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Net profit (loss)	(1,000)	6,000	3,000	8,000
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...and its disadvantage!!!

	(A) Retain Dept. 1 £	(B) Close Dept. 1 £	(A) – (B) Difference £
Sales	36,000	28,000	8,000
<i>Less: Variable costs</i>	20,000	14,000	6,000
Contribution margin	16,000	14,000	2,000
<i>Less: Fixed overhead</i>	8,000	8,000	Nil
Net profit	8,000	6,000	2,000

Beware of the Sunk Costs...

Printing of brochure advertising course (10,000 copies)		£150
10,000 envelopes at £7 per 1,000		70
Typing and stuffing brochures into envelopes at £10 per 1,000		100
Postage at 3p per letter less 15% discount (x 10,000)		<u>255</u>
	Total advertising cost	£575
Hire of premises	£150	
Speakers' fees	250	
Speakers' expenses	50	
Printing handout notes and buying folders, pens and stationery for 200 delegates	200	
Sundry expenses in running course	<u>100</u>	
		<u>750</u>
	Total fixed costs if course is run	<u>£1,325</u>
Delegate's fee	£40	
Cost of feeding each delegate	<u>6</u>	
Contribution per delegate	<u>£34</u>	
Expected number of delegates (75) times contribution per delegate (75 x £34)		£2,550
<i>Less:</i> Total fixed costs		<u>1,325</u>
Contribution to costs and profit of training co.		<u>£1,225</u>

Where is the breakeven?

- Before the campaign:

- $£1,325 / £ 34 = 39$

- After the campaign:

- $£750 / £ 34 = 23$

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- Example: 30 people registered after the campaign:

- If we do the course: $£1,020 - £1,325 = - £305$

- If we don't do the course: $- £575$