

Testbank

to accompany

Management accounting

3rd edition

by

Eldenburg et al.

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Chapter 3: A costing framework and cost allocation

True/False questions

1. A cost object is anything for which a separate measurement of cost is required.

- *a. True
- b. False

LO 1

2. Understanding how costs are incurred help organisations to remain competitive and generate a profit.

- *a. True
- b. False

LO 1

3. The only cost object for a manufacturing firm is the finished product.

- a. True
- *b. False

LO 1

4. A geographic region could be a cost object for a service organisation.

- *a. True
- b. False

LO 1

5. Total costs for a firm vary depending on how many cost objects they have.

- a. True
- *b. False

LO 1

6. When calculating the total cost for a cost object it is necessary to include both direct and indirect costs.

- *a. True
- b. False

LO 2

7. Before determining whether a cost is direct or indirect it is necessary to know what the cost object is.

- *a. True
- b. False

LO 2

8. Direct costs do not have a cause and effect relationship with the cost object.

- a. True
- *b. False

LO 2

9. Costs that are common to many cost objects and cannot easily be traced to a specific cost object are known as indirect costs.

- *a. True
- b. False

LO 2

10. The cost object determines whether costs are classified as direct or indirect.

- *a. True
- b. False

LO 2

11. Direct costs can also be referred to as overhead costs.

- a. True
- *b. False

LO 2

12. The accuracy of costing a cost object is increased when more costs can be identified as direct costs.

- *a. True
- b. False

LO 2

13. The glue used on the spines of mass produced textbooks is an example of an indirect cost.

- *a. True
- b. False

LO 2

14. Entities use either manual or computerised tracking systems to trace direct costs.

- *a. True
- b. False

LO 2

15. Cost benefit analysis is used to determine whether a cost object has made use of a particular resource.

- a. True
- *b. False

LO 2

16. An example of a cost tracing system is the time card which indicates how much time an employee has spent working on a particular job.

- *a. True
- b. False

LO 2

17. Some costs are treated as indirect because it is too difficult or costly to trace them directly to the cost object.

- *a. True
- b. False

LO 2

18. Cost allocation is the process of assigning indirect costs to cost objects.

- *a. True
- b. False

LO 3

19. One reason that entities allocate indirect costs to cost objects is to encourage the use of central resources.

- *a. True
- b. False

LO 3

20. Only entities that are subject to accounting standards allocate indirect costs to cost objects.

- a. True
- *b. False

LO 3

21. A cost driver or allocation base provides a measure of activity that explains the cost object's use of the indirect cost.

- *a. True
- b. False

LO 3

22. Cost drivers are used to allocate indirect costs to direct cost pools.

- a. True
- *b. False

LO 3

23. The prime consideration when selecting a cost driver is the accuracy of the full cost measurement.

- *a. True
- b. False

LO 3

24. Cost drivers can be volume drivers or activity drivers.

- *a. True
- b. False

LO 3

25. Allocating indirect costs based on machine hours is an example of using an activity driver.

- a. True
- *b. False

LO 3

26. The first step in allocating indirect costs is to calculate the indirect cost rate.

- a. True
- *b. False

LO 3

27. To develop a cost allocation formula entities need to decide on the number of indirect cost pools.

- *a. True
- b. False

LO 3

28. As the number of cost pools decreases the accuracy of the cost information decreases.

- *a. True
- b. False

LO 3

29. To be consistent in the cost assignment process the same cost driver must be chosen for each indirect cost pool.

- a. True
- *b. False

LO 3

30. The indirect cost rate is determined by dividing the budgeted indirect cost by the budgeted cost driver usage in each indirect cost pool.

- *a. True
- b. False

LO 3

31. Organisations use budgeted costs so they can calculate a predetermined indirect cost rate prior to actual costs becoming available.

- *a. True
- b. False

LO 3

32. Indirect costs are allocated to cost objects while direct costs are traced directly via source documentation.

- *a. True
- b. False

LO 4

33. While the basic costing structure for entities is similar, the number of cost pools and types of cost driver used are dependent upon the entity's specific cost information needs.

- *a. True
- b. False

LO 4

34. The budgeted cost of maintenance for a production department is \$250 000. The organisation has decided to use machine hours as the cost driver for allocating indirect costs. The budgeted amount of machine hours for the production department is 125 000 machine hours. Therefore the indirect cost rate is calculated as $\$250\,000/125\,000 = \2 per machine hour.

- *a. True
- b. False

LO 5

35. The costs of the human resources department of an organisation are allocated to other departments at the rate of \$150 per employee in the department. If Department A has 38 employees and Department B has 90 the human resource costs allocated to Department B will be \$13,500.

- *a. True
- b. False

LO 5

36. The costs of the human resources department of an organisation are allocated to other departments at the rate of \$150 per employee in the department. If Department A has 38 employees and Department B has 90 the human resource costs allocated to Department A will be \$5,700.

- *a. True
- b. False

LO 5

37. The full cost of a cost object includes direct costs plus allocated indirect costs.

- *a. True
- b. False

LO 5

38. Operating departments are the departments within an organisation responsible for providing goods or services to external customers.

- *a. True
- b. False

LO 6

39. Support departments provide internal services to each other and the operating departments.

- *a. True
- b. False

LO 6

40. Organisations typically allocate costs from operating departments to support departments.

- a. True
- *b. False

LO 6

41. The three methods of allocating support department costs to operating departments are called the direct method, the step down method and the proportional method.

- a. True
- *b. False

LO 6

42. Regardless of method adopted the first step in allocating support department costs to operating departments is to choose the allocation basis.

- a. True
- *b. False

LO 6

43. The direct method of allocating support department costs ignores the fact that support departments provide services to other support departments.

- *a. True
- b. False

LO 6

44. Once the total cost pool for each support department has been determined the next step is to choose the allocation basis.

- *a. True
- b. False

LO 6

45. The step down method allocates support department costs, one department at a time, to remaining support departments and operating departments in a cascading manner until all support department costs have been allocated.

- *a. True
- b. False

LO 6

46. The step down method requires a ranking of support departments based on the amount of service provided to other support departments.

- *a. True
- b. False

LO 6

47. The department which provides the least amount of services to other support departments should be allocated first in the step down method.

- a. True
- *b. False

LO 6

48. The allocation order of support department costs does not matter if the step down method of allocation is used

- a. True
- *b. False

LO 6

49. There are two support departments, Accounting and Catering. Accounting provides 5% of its services to Catering. Catering provides 10% of its services to Accounting. Catering should be allocated first in the step down method.

- *a. True
- b. False

LO 6

50. The step method recognises some interaction between support departments but not all because it only allocates support department costs in one direction.

- *a. True
- b. False

LO 6

51. The reciprocal allocation method simultaneously allocates costs between support departments and then from support departments to operating departments.

- *a. True
- b. False

LO 6

52. The reciprocal method is the simplest method of allocating support department costs when there is more than two support departments.

- a. True
- *b. False

LO 6

53. The reciprocal method of allocating support departments uses simultaneous equations to mathematically allocate costs between support departments.

- *a. True
- b. False

LO 6

54. The total cost allocated is the same under the direct method, step down method and the reciprocal method.

- *a. True
- b. False

LO 6

55. Dual rate allocation methods separate support costs into direct and indirect cost pools.

- a. True
- *b. False

LO 6

56. It is not important to use the dual rate method for support department allocations because most support department costs are variable.

- a. True
- *b. False

LO 6

57. One limitation of support department cost allocations is that it is subject to judgement when making decisions about allocation bases and the allocation method.

- *a. True
- b. False

LO 7

58. To improve the reliability and quality of allocated costs, accounting systems can be redesigned to more accurately trace costs to activities and generate better allocation base data.

- *a. True
- b. False

LO 7

59. The allocation of indirect costs to cost objects is likely to be inaccurate if the allocation base used is not a cost driver.

- *a. True
- b. False

LO 7

Multiple-choice questions

60. A cost object **cannot** be:

- a. a geographic region
- b. a customer
- c. a department
- *d. none of the above, i.e. all can be cost objects

LO 1

61. Which of the following is least likely to be a cost object for a car manufacturer:

- a. Human Resources Department
- b. Assembly Division
- *c. Gordon Lee – a part time employee in the cafeteria.
- d. Charlie's Car Company – a long term customer.

LO 1

62. The distinction between direct costs and indirect costs depends on their traceability to:

- a. an activity
- b. a manufacturing operation
- *c. a cost object
- d. a product

LO 2

63. Indirect costs are:

- a. costs that it is impossible to trace to a cost object
- b. costs that cannot be traced to a cost object in an economic manner
- c. also known as overhead costs.
- *d. B and C

LO 2

64. If the cost object is the production department in a large manufacturing firm which of these would be a direct cost?

- *a. The raw materials cost of the products produced
- b. A share of the building space occupied based on percentage of floor space used
- c. The payroll department manager's yearly bonus payment
- d. Research and development costs for future products.

LO 2

65. Which of these is an example of an indirect cost if Department M is the cost object?

- a. Insurance on the organisation's building, part of which is occupied by Department M
- b. Rent on the organisation's building, part of which is occupied by Department M
- c. Commission paid to the sales persons in Department M
- *d. A and B

LO 2

66. If the cost object is the cosmetics department of a large department store which of the following is a direct cost?

- a. Advertising costs for the store's annual stock take sale.
- *b. Brand specific cosmetic product training.
- c. The payroll department manager's yearly bonus payment
- d. Security staff wages for the store.

LO 2

67. Paws Pet Resort and Spa is located in Christchurch. The company employs three pet attendants, four pet groomers and two front office staff who book appointments and keep records. The spa provides a range of services for dogs and cats including boarding, grooming, and obedience training. The grooming area includes a small retail section that carries dog and cat food, pet supplies, and toys.

If the cost object is cost per day of boarding, which of the following is an indirect cost?

- a. Pet food
- *b. Front office staff salaries
- c. Cleaning costs for the kennels.
- d. Maintenance on the kennels.

LO 2

68. Paws Pet Resort and Spa is located in Christchurch. The company employs three pet attendants, four pet groomers and two front office staff who book appointments and keep records. The spa provides a range of services for dogs and cats including boarding, grooming, and obedience training. The grooming area includes a small retail section that carries dog and cat food, pet supplies, and toys.

If the cost object is the total cost of the grooming product line, which of the following is a direct cost?

- a. Front office staff salaries
- *b. Labour cost of employees who groom pets
- c. Public liability insurance.
- d. Rent on the premises.

LO 2

69. The reason for allocating indirect costs is:

- a. to set product prices
- b. to comply with external reporting requirements
- c. to help with making decisions about which products to produce
- *d. all of the above

LO 3

70. Which of these cost drivers is **not** a criteria for allocating costs?

- a. benefits received
- b. fairness
- *c. standardisation
- d. behavioural

LO 3

71. The cost driver that is a volume based cost driver is:

- *a. number of units
- b. number of set-ups
- c. number of employees
- d. all are volume based cost drivers

LO 3

72. In determining the amount of indirect costs to be allocated to the cost object the first step is:

- a. to develop a cost allocation formula
- b. to develop a predetermined cost rate
- c. to select a cost driver
- *d. to decide on the number of cost pools

LO 3

73. The formula for calculating a predetermined indirect cost rate is:

- a. actual indirect costs/actual usage of the cost driver
- b. budgeted indirect costs/actual usage of the cost driver
- *c. budgeted indirect costs/budgeted usage of the cost driver
- d. actual indirect costs/budgeted usage of the cost driver

LO 3

74. Mollie's Lollie Manufacturer has budgeted total overhead to be \$269 500 and the expected cost driver is 55 000 machine hours. Last year actual machine hours was 50 000. The predetermined indirect cost rate is.

- a. \$5.39
- b. \$1.10
- c. \$.20
- *d. \$4.90

LO 3

75. In relation to product costing the indirect cost rate is:

- *a. the rate used to assign indirect costs to the cost object
- b. added to direct costs to calculate the full product cost
- c. the input or activity that causes changes in total costs for a cost object
- d. the method used to allocate the costs of each support department to the operating departments

LO 3

76. Which of these statements concerning the determination of the full cost of a cost object is **not** true?

- a. direct costs are traced via source documentation
- b. overheads are included
- c. indirect costs are allocated via the use of a cost driver
- *d. full cost includes only manufacturing costs

LO 4

77. Smart Choices allocates advertising expenses to its two departments, Lifestyle and Storage Solutions, using sales as the cost driver. For the current year the sales for Lifestyle are estimated to be \$450,000 and for department Storage Solutions \$900,000 and total advertising expenses are budgeted at \$110,000. The indirect cost rate is:

- a. Lifestyle: \$0.24 per sales dollar: Storage Solutions: \$0.12 per sales dollar
- b. \$.036 per sales dollar
- *c. \$.081 per sales dollar
- d. \$12.27 per sales dollar

LO 5

78. Smart Choices allocates indirect labour costs to its two departments, Lifestyle and Storage Solutions using number of employees per department as the cost driver. For the current year the number of employees in department Lifestyle are estimated to be 50 and for Storage Solutions department 30 and total indirect labour costs for the departments are budgeted at \$1,400,000. The amount allocated to the departments are:

- a. Lifestyle \$48,000: Storage Solutions \$80,000
- *b. Lifestyle \$875,000: Storage Solutions \$525,000
- c. Lifestyle \$525,000: Storage Solutions \$875,000
- b. Lifestyle \$875,000: Storage Solutions \$80,000

LO 5

79. Jones Plumbing estimates that its overhead costs for the year will be \$800,000 and it has decided to use direct labour hours as the cost driver. Its mark-up is 20% on cost. If a job for Martin Z used \$800 of direct materials and 5 labour hours at \$50 per hour how much will Jones Plumbing charge Martin Z?

- a. \$960
- b. \$800
- c. \$2,460
- *d. cannot be calculated from the information given

LO 5

80. Which of these departments would **not** be considered a support department for a manufacturer of bathroom fittings?

- a. accounts
- b. security
- c. computing departments
- *d. laminating department

LO 6

81. Which of these is **not** an allocation method commonly used to allocate support department costs to operating departments?

- *a. indirect method
- b. direct method
- c. step-down method
- d. reciprocal method

LO 6

82. The method that allocates support department costs by ignoring all services rendered between support departments is:

- a. the single rate method
- b. the step-down method
- *c. the direct method
- d. the dual rate method

LO 6

83. The allocation method for support department costs that allocates fixed and variable costs separately is:

- a. the reciprocal method
- b. the step-down method
- *c. the dual rate method
- d. the direct method

LO 6

84. The allocation method for support department costs that can manipulate the costs allocated by changing the order of the support department cost allocation is:

- a. the direct method
- b. the dual-rate method
- c. the reciprocal method
- *d the step-down method

LO 6

85. Molten Works Ltd provides the following information about departmental consumption of allocation bases for its 3 support and 2 operating departments.

	Support Departments			Operating Departments	
	Personnel	Cafeteria	Maintenance	Machining	Assembly
Personnel		10%	10%	50%	30%
Cafeteria	10%		10%	40%	40%
Maintenance	10%	20%		50%	20%

For the direct method, what proportion of the Personnel's costs will be allocated to the Machining Department?

- *a. 62.5%
- b. 10%
- c. 42.9%
- d. 37.5%

LO 6

86. Molten Works Ltd provides the following information about departmental consumption of allocation bases for its 3 support and 2 operating departments.

	Support Departments			Operating Departments	
	Personnel	Cafeteria	Maintenance	Machining	Assembly
Maintenance		10%	20%	30%	40%
Cafeteria	10%		20%	40%	30%
Personnel	10%	20%		50%	20%

For the step-down method, what proportion of the Maintenance Department's costs will be allocated to the Assembly Department if the allocation order is Personnel, Cafeteria and Maintenance?

- a. 60%
- b. 40%
- *c. 57.1%
- d. 42.9%

LO 6

87. Molten Works Ltd provides the following information about departmental consumption of allocation bases for its 3 support and 2 operating departments.

	Support Departments			Operating Departments	
	Personnel	Cafeteria	Maintenance	Machining	Assembly
Personnel		10%	20%	30%	40%
Cafeteria	10%		20%	40%	30%
Maintenance	10%	20%		50%	20%

For the step-down method, what proportion of the Cafeteria's costs will be allocated to the Maintenance Department if the allocation order is Personnel, Cafeteria and Maintenance?

- a. 20%
- b. 14.3%
- *c. 22.2%
- d. 30%

LO 6

88. Molten Works Ltd provides the following information about departmental consumption of allocation bases for its 3 support and 2 operating departments.

	Support Departments			Operating Departments	
	Personnel	Cafeteria	Maintenance	Machining	Assembly
Personnel		10%	20%	30%	40%
Cafeteria	5%		5%	40%	50%
Maintenance	10%	20%		50%	20%

For the reciprocal method, what proportion of the Cafeteria Department's costs will be allocated to the Machining Department?

- a. 44.4%
- b. 5%
- c. 20%
- *d. 40%

LO 6

89. To avoid passing on inefficiencies of the support departments, support department costs should be allocated using:

- a. an actual cost allocation rate
- *b. a budgeted cost allocation rate
- c. only fixed costs per unit of service
- d. only variable costs per unit of service

LO 7

90. Which of these is **not** an uncertainty when allocating support department costs?

- a. deciding whether to use dual or single rate allocations
- b. identifying the appropriate cost driver
- *c. knowing which departments are support departments and which are operating departments
- d. selecting the most appropriate allocation method

LO 7

Testbank to accompany: Management accounting 3e by Eldenburg et al.

91. Allocated indirect cost information can sometimes be low quality. Allocating indirect costs can be improved by:

- *a. cross divisional co-operation
- b. using the same cost driver for every cost pool
- c. Neither A or B
- d. Both A and B

LO 7