

COST ANALYSIS

DR. RADHIKA MEENAKSHI SHANKAR

Core Cost Concepts

- **Direct Cost** A cost that can be assigned specifically to a given or particular service.
- **Indirect Cost** A cost necessary for the functioning of the organization as a whole, but which cannot be directly assigned to one service.
- **Total Cost** The sum of all costs, direct and indirect, associated with the provision of a given or particular service.
- **Fixed Cost** A cost that does not change with increases or decreases in the amount of service provided (e.g., rent).
- **Variable Cost** A cost that increases or decreases with increases or decreases in the amount of service provided (e.g., salary).
- **Sunk Cost** A cost that has already been incurred (e.g., the cost of a previously purchased vehicle)

Direct costs

- Directly traceable to product(sorting dept in post office)
- Assignable
- E.g cost of materials,(sorting software)(sorting boxes) direct labour (cost of sorters salaries in a post office)

Indirect costs

- Costs not directly assignable to product
- ALLOCATE ON certain BASIS.
- Electricity- no of points
- Water- consumption
- Watchman/peon salaries-hrs spent in each deptt.

COST ANALYSIS

Provides a MANAGEMENT PROCESS methodology that facilitates the objective evaluation of what has occurred in the past (reporting, analyzing), what is occurring in the present (the stewardship of resources), and what might occur in the future (estimation, anticipation of events).

As such, cost analysis is a tool to improve the impact of reason on decision-making.

For government decisions

Cost analysis is the combined process of

- defining a service,
- establishing the volume of the service,
- settling on the relevant cost concept to address the perceived problem, and
- determining the cost of some alternative to the existing service deliver pattern.

PROCEDURE

- Step One: Define the Service
- Step Two: Determine the Total and Avoidable Cost of the Service
- Step Three: The Case for In-house Delivery
- Step Four: Solicit Bids
- Step Five: Selecting a Provider
- Step Six: Administer the Contract
- Possible Problems With Contracting Out

BENEFITS

- measure productivity,
- determine unit costs,
- monitor the implementation of the annual budget,
- establish indirect cost rates for federal grant reimbursement,
- utilize life-cycle costing in procurement
- evaluate contracting with the private sector as an alternative to in-house provision of a service, and
- set fees and charges.
- Cost analysis is a management process which can be used to provide information useful to effective decision-making.

focus

- The focus of a cost analysis may be on the past—determining the cost of traffic control last year.
- It may be on the present—estimating the cost this year of collecting a ton of refuse.
- It may be on the future—forecasting the marginal cost of a new batch of uniforms

Accounts & Analysis

The information that might be provided by a cost accounting system (if one is available) or Financial Accounting and sourcing information from primary and secondary sources are used in Cost Analysis.

A cost analysis has the added dimension of a major focus on a definition of the service (based on number of activities) to be provided.

In addition, cost analysis is used to provide information that will assist management in making decisions that will affect the future.

Past experience is used to provide a reasoned basis for change and post mortem of the past helps to understand avoidable problems .

Eg: Questions to Ponder on for decision making on a service

- How much should we charge for this service so that we are reimbursed for all the costs of providing it?
- Would it be more cost effective to contract out this service?
- If we increase/decrease the volume of this service, what impact on our costs will it have?
- What are the costs of this service that we must pay this year versus future years.
- If we change the volume of this service a little, what costs will not change? What costs will change and by how much?
- What costs for this service have already been paid?

What it does

Cost analysis can be an effective tool for controlling costs and increasing productivity because it provides a methodology for understanding what is actually happening.

A cost analysis does more than flag a problem: it provides a basis for understanding the problem and its causes.

A problem that is understood is a problem that can be solved.

uses

Cost analysis provides an analytical tool whose wide range of uses share a common characteristic — the use of factual cost data as a basis for informed decision making in services.