



Cost Management 101



CM 101 Training Objectives



- **Section 1: Cost Management Overview**
 - What are costs and why is managing costs important?
 - Army's overall objectives
 - The process of Cost Management and how it differs from Budget Management
- **Section 2: Cost Object Definition**
 - Understanding what is an ERP (e.g. GFEBS, GCSS, etc.)
 - How to structure ERPs to build the Cost Model
 - Defining the various cost objects (which replace APCs/JONOs) within a Cost Model, e.g. organizations, products, services, jobs, etc.
- **Section 3: Cost Flow Methods**
 - How costs are captured and managed, e.g. travel (DTS), payroll (DCPS), Supplies (PRs, FMC), etc.
 - What level to manage costs to (individual org/UIC or higher in the command structure)
 - The difference between cost capturing, allocations, and assignment
- **Section 4: Analysis and Reporting**
 - Understanding of the results of the Cost Model
 - How to report/analyze Budget Execution data for budget status versus cost management
 - How various types of analysis and decisions are supported



Riddle Me This....?



- Could you tell your customers the full cost of providing them their products or services?
- Could you answer the same question by quarter or for the next quarter?
- Could you tell customers how changes in their behaviors might affect their costs?
- How would you determine the cost to operate your DOL or Course?
 - What costs would you include?
 - What is your “show me” source?
- Let’s view a real life example of Cost Management in action!



Pa & Ma Kettle Math Video

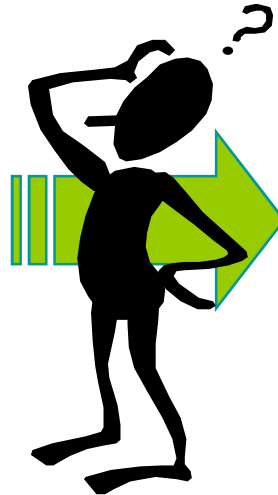




What is Cost?



.....”a **cost** is the value of money that has been used up to produce something”*

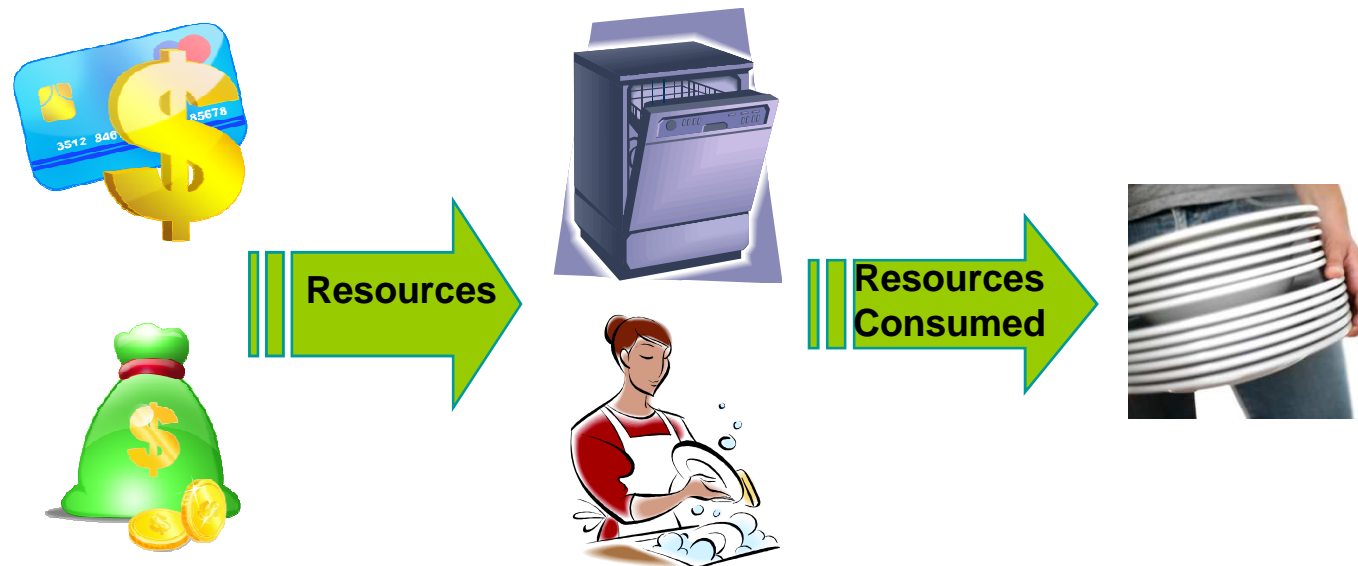


Clean Dishes

* en.wikipedia.com 11/26/09



What is Cost?



“**Cost** is a monetary measure of the sacrifice associated with:

- expending resource functionality to achieve a specific objective, or
- utilizing resource output required to achieve a specific objective, or
- the provision of resource functionality or resource output while not using it.

* www.rcainstitute.com - RCA Taxonomy



Objective & Agenda



Section 1: Cost Management Overview

- Understanding of why managing costs are important, Army's overall objectives, the process of Cost Management, how it differs from Budget, and key cost terms
 - **Lesson 1:** Cost Awareness
 - **Lesson 2:** Cost Culture
 - **Lesson 3:** Cost vs. Budget
 - **Lesson 4:** Cost Management
 - **Lesson 5:** Cost Terms



Lesson 1: Cost Mandates vs Cost Awareness

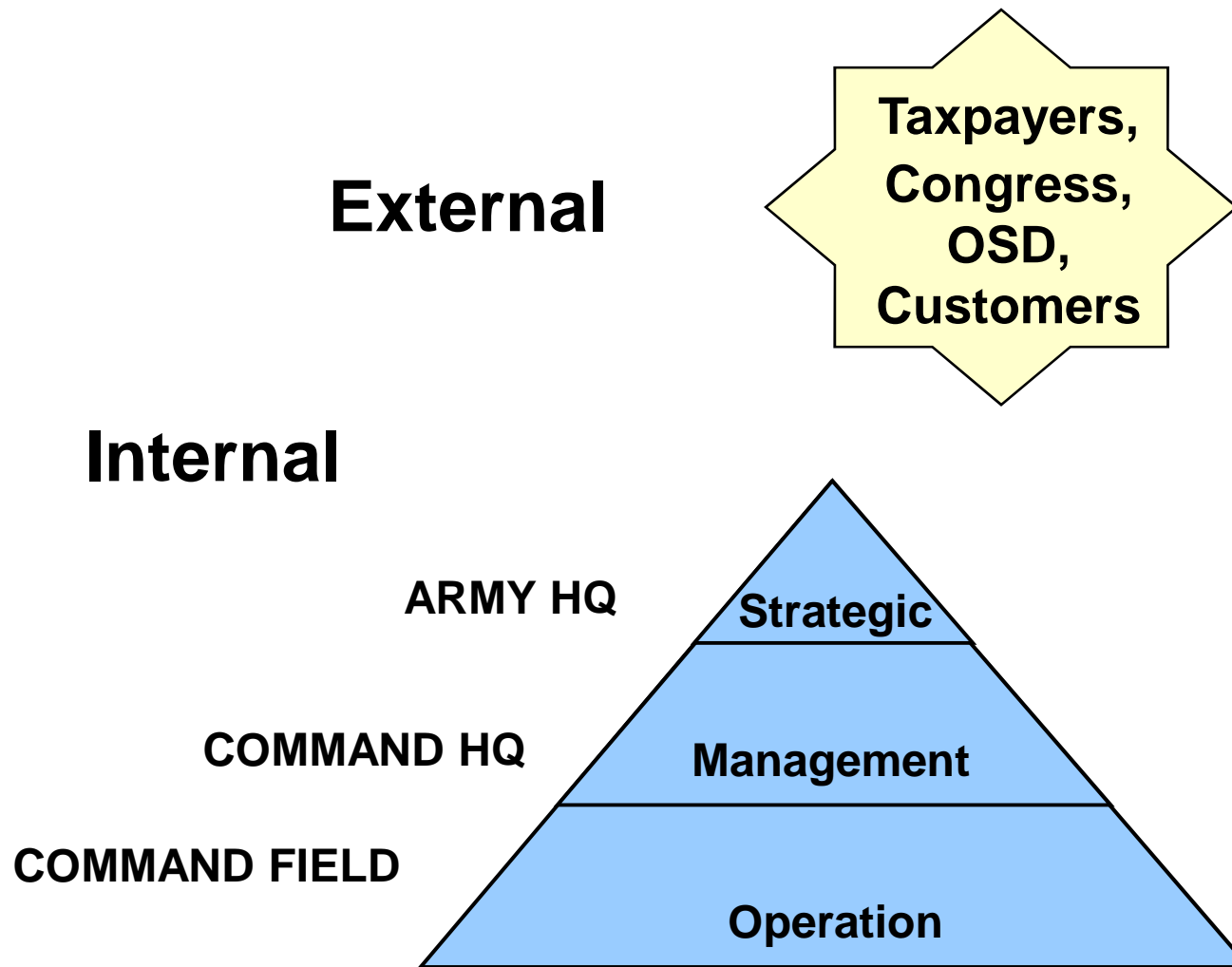


Objective(s):

- To understand the external and internal factors requiring the Army to instill Cost Management as a fundamental approach for day to day activities



Army Stakeholders





External Stakeholder Demands: Government Industry Mandates



- There Has Been A Push For The Past Decade for the Ability to Explain How Well An Organization Is Performing versus What It Is Performing
- More Questions Are Being Asked About - How Much Does It Cost To? How Efficient Are We At? Versus Where Did You Spend the Budget?
- Questions on Efficiency Fall Into the Domain of Management Accounting; Questions of Which Funds Were Expended Are the Domain of Budget Accounting



Cost – Government History



- **Actions Requiring Costs & Performance**
 - Chief Financial Officers Act (1990)
 - Government Performance Results Act (1993)
 - President's Management Agenda (2002)
 - OMB Performance Assessment Rating Tool
 - OSD Requires Army Performance Budget
- **Public Sector GAAP (SFFAS 4) Full Cost (1995)**
 - Army Developed GFEBS Costing Module
- **OSD Actions to Increases Cost Management**
 - Acquisition Reform (1997)
 - OSD (AT&L) Issues ABC Guidance (1999)
 - Business Transformation / Lean Six Sigma

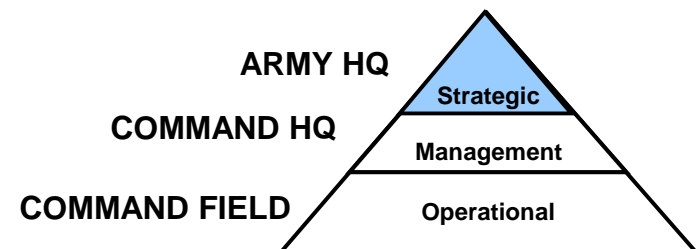
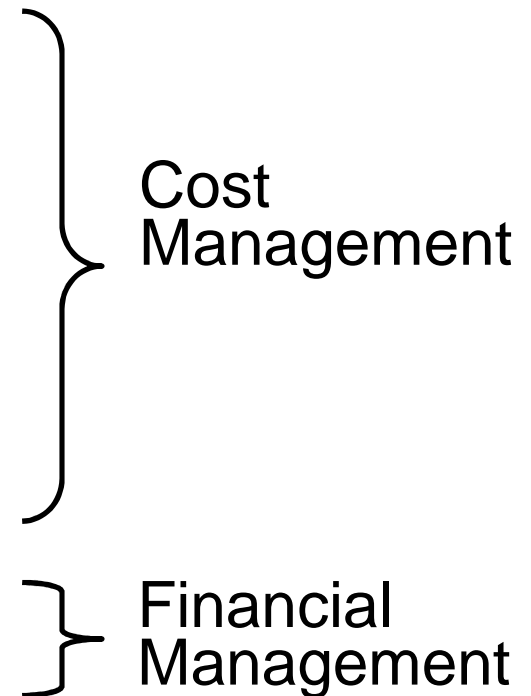
**Lessons Learned: Cost Measurement Difficult
Cultural Resistance**



ASA(FM&C) Operational Priorities



- Provide accurate, reliable, and timely financial information and integrated functional performance data to Army decision makers
- Improve Army accountability and enable full cost management
- Exchange information with customer and stakeholders
- Achieve efficiencies and operate effectively
- Enable the Army to receive and unqualified audit opinion on annual financial statements with respect to Army General Funds





Objective



In order to meet the first 4 operational priorities, the Army needs to establish a cost culture that:

- functions as a key and integral part of the Army's overall management process
- adds value to the organization by enabling the effective use of resources in dynamic and competitive contexts
- provides continuous feedback on effective use of resources to create value for stakeholders



Vision



By obtaining the objectives, the Army can meet its overall vision of:

- Leaders use cost information for effective decision-making and performance management by:
 - understanding both the near- and long-term cost implications of their decisions;
 - making effective trade-off decisions to achieve the best possible use of limited resources; and
 - holding subordinates accountable for improving the efficiency and effectiveness of their operations.
- Army soldiers/civilians along the value chain understand how their efforts contribute to the Army mission and impact Army resources

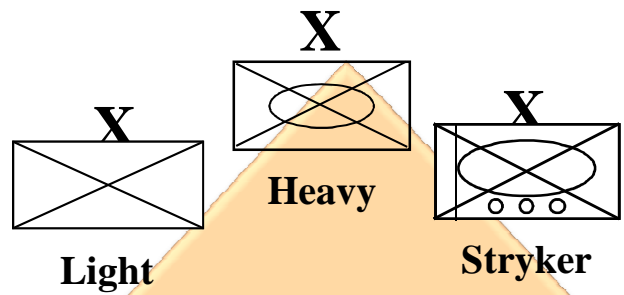


Need to Understand What the Resources Buy – The Army Product



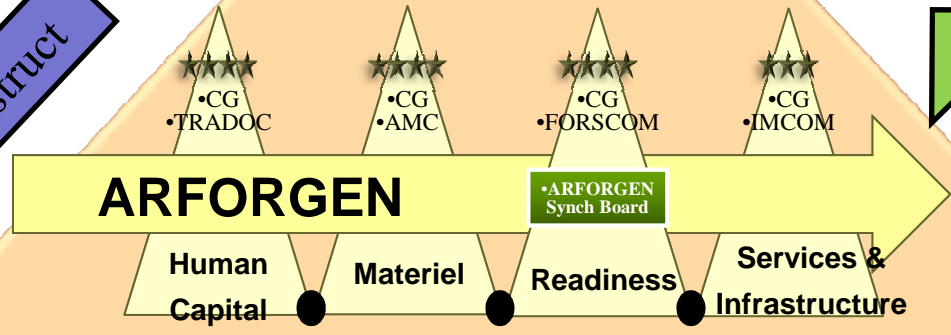
Ensure Strategic Objectives are Effectively Resourced

Effectively & Efficiently Produce Outputs



Program / Budget Construct

Cost Management Construct



- Products/Services
- Organizations (Cost Centers)
- Resources (Labor, Equipment, Assets)



ARFORGEN Process

Optimization Impacts Multiple Programs

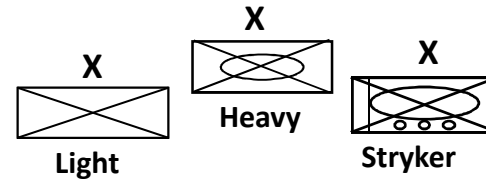
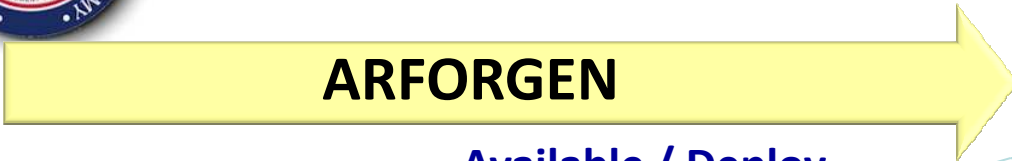


- Man
- Equip
- Train
- Sustain
- Operate

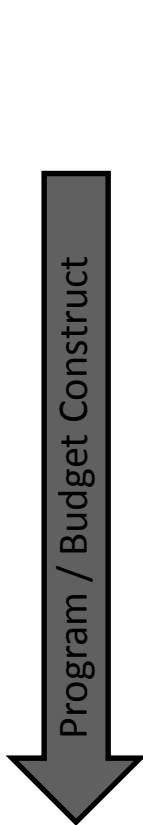
- HQDA
 - IMCOM / REGION
 - GARRISON
 - Population Shifts (Deployments, Training, Etc.)
 - Family Programs
 - Facilities Utilization
 - Maintenance & Repair
 - Etc. ..
- TRADOC
 - Infantry School
 - Course ABC
 - Course XYZ
 - National Training Center
 - Event 123
 - Event 456
 - Etc...



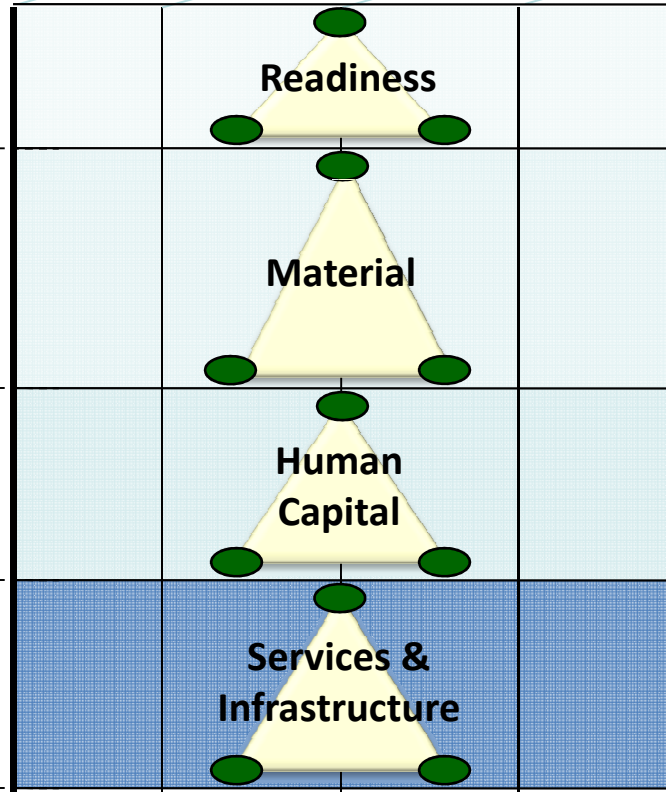
Army Cost Management Framework



Available / Deploy
Train / Ready
Reset



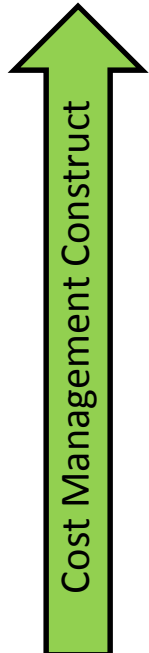
- Train Units
•Operations & Activities
- Research
•Procure
•Sustain
•Distribute
•Dispose
- Acquire & Train
•Manage (Pay) & Distribute
•Develop & Educate
•Force Development
- Facility
•Installation
•Command Programs
•Centrally Managed Programs



- Command & Intelligence
•Operating Forces
- Depot Maint / Repair of Mil Eqt
•Ordnance
•S&T & R&D
•Systems Acquisition, T&E, Engineering, & Contracting
- Civ Education / Training
•Civ Personnel Svcs
•Mil Education / Training
•Mil Personnel Svcs
•Prof. Development Educ.
- Community & Family Svcs
•Environmental Security & National Resource Svcs
•Health Svcs
•Installation / Facility Mgt

Common to CEs
Communications, Computing, & Info Systems
Financial Management / Budget
Operation Planning & Control

Unique to CE



S1L1_p11

Note: Program / Budget and Cost Management constructs shown represent subset of overall framework



Lesson 1: Wrap-Up

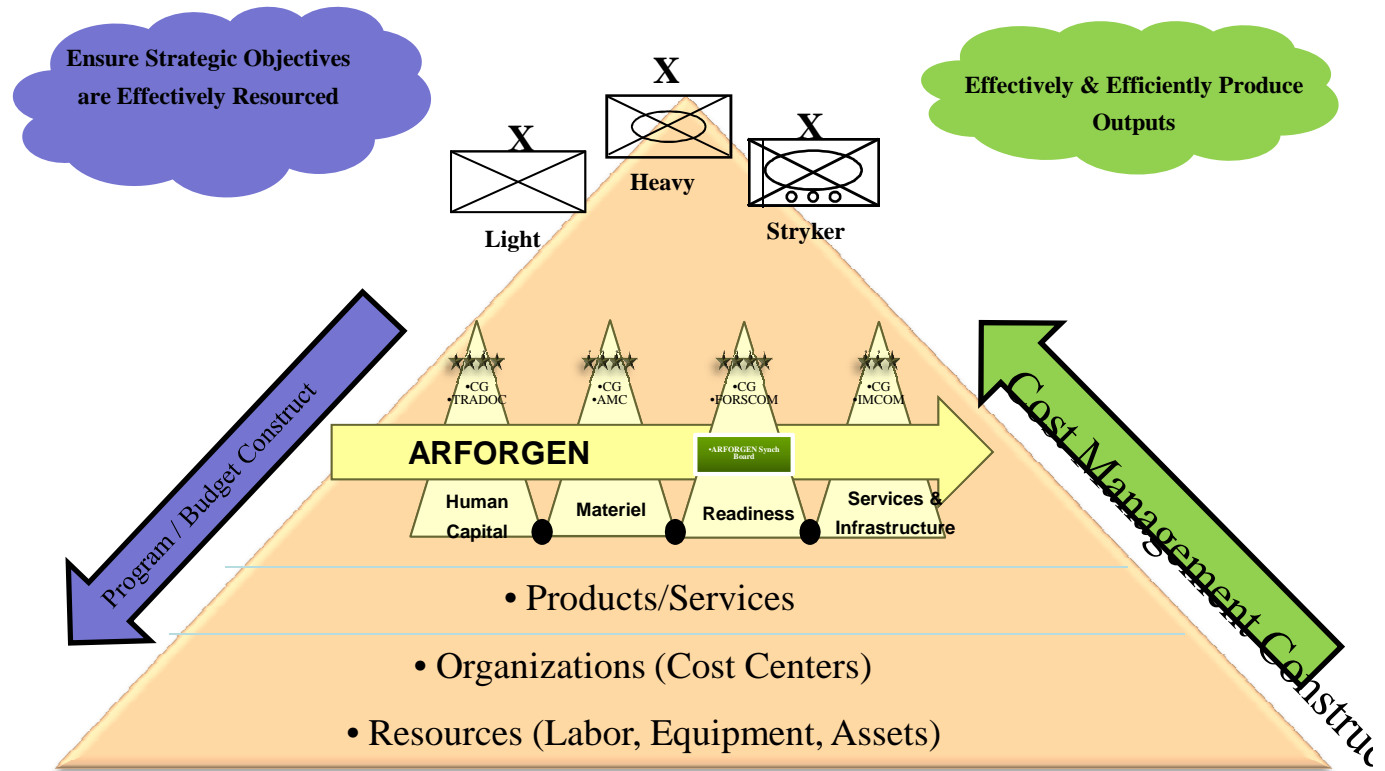


- **Cost** is the monetary sacrifice for a resource
- External Pressures provide an emotional trigger
- Each level of stakeholders have different objectives & vision which should align and support total objectives & visions
- Cost awareness and management as an approach will be used to shift the focus of budget only, e.g. what was spent, to performance, e.g. what did we do/get?
- The Army's product is the Brigade, the Brigade's lifecycle is the ARFORGEN process, and the Core Enterprises support the generation of the Army product



Question #1: Based on the HQDA Strategy of BCT being the Army Primary Product, How can Your Command Impact that Strategy through Cost Management?

ANSWER:





Question #2: What are some examples of how Your Command is impacted by the Army's optimization strategies, i.e. ARFORGEN Process?

Answer:



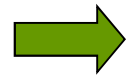
Reset/Train



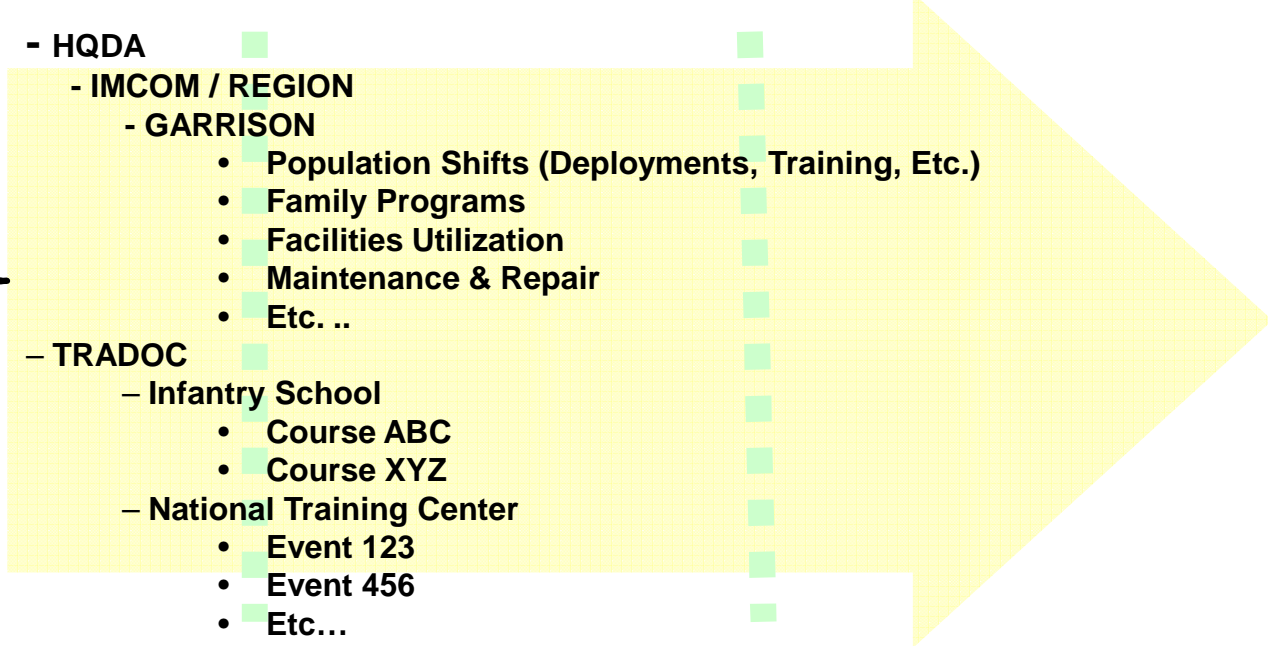
Ready



Available



- Man
- Equip
- Train
- Sustain
- Operate





Lesson 2: Cost Culture



Objective(s):

- Understand the level of effort for deploying cost awareness throughout the Army, i.e. generating a Cost Culture



What is a Cost Culture?



Organizational Culture:

- **Comprises the Attitudes, Experiences, Beliefs & Values of an Organization**
- **A Shared Behavior by People & Groups in an Organization**
- **Most Experts Agree that it is the Shared “Taken-For-Granted” Assumptions, Beliefs, Values, Expectations & Rules that Members of a Work Unit Team or a Corporate Organization Hold**

A Cost Culture is the Cultural Shift from “Accomplish the Mission at Any Cost” to “Accomplish the Mission Considering Cost”



Why Focus on Cost Culture?



Deploying Systems, Improving Cost Models, Issuing Policies, Training Staff, Recruiting Experts **will not Enhance** the Army's ability to manage costs **unless Army Soldiers / Civilians Understand & Value the Need to Manage Costs**

- **Knowing Our Costs & Managing Them To Increase Our Mission Capability Must Become Ingrained in Our Culture**
- **Leaders Must Demand Cost Information & Use It In Decision-making — Otherwise It Provides No Utility To The Army**
- **We Need A Lifestyle Change, Not A Diet!**



Leadership Statements on a Cost Culture



From Chief of Staff, Army:

- Most Army processes lack a cross-functional focus and *cost-benefit analysis* which leads to grossly inefficient application of resources.
- Large budgets in the past few years have produced a *consumption-based culture that focuses on accomplishing missions* without concern for more efficient delivery of capabilities.

From 2008 Army Posture Statement:

- Integral to achieving our goals is the development of an *Army-wide cost-management culture* in which leaders better understand the *full cost* of the capabilities they use and provide and incorporate cost considerations into their planning and decision-making. This approach will enable us to achieve readiness and performance objectives more efficiently.

From HONORABLE Nelson Ford, ASA (FM&C):

- The cultural change that is essential to Army financial management, and without which all the other improvements will leave us short of achieving our goals, is the adoption and integration of *cost management* into the Army culture.



Creating A Cost Culture



Cost Culture Vision:
Leaders Use Cost Information for Effective Decision-Making & Performance Management by ...

- ✓ Understanding Both Near & Long-Term Cost Implications of Their Decisions
- ✓ Making Effective Trade-Off Decisions to Achieve Best Use of Limited Resources
- ✓ Holding Subordinates Accountable for Improving the Efficiency & Effectiveness of operations

Cost Culture Take - Aways:

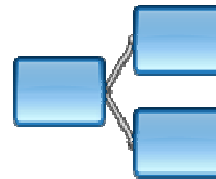
- Know the True Cost of What You Do - Not Knowing Cost Makes Everything Appear Free -- *“Free Goods Have Infinite Demand”*
- Cost Management is Not Easy -- You Have to Know What Drives Costs & Take Action to Control Costs
- Cost Management Goes Beyond “Do More With Less” - It Is Optimizing Resources to Efficiently and Effectively Meet Mission -- *“Focused on Continuous Improvement”*



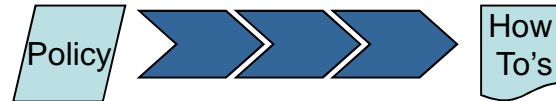
Business Culture Change Process “Making a Square a Circle”



- The Culture Is Defined By What, Who, Why, And How Business Is Conducted
- The Culture Is Imbedded in People, Processes and Technologies
- “We’ve Always Done It This Way”



**People &
Other Resources**



**Processes,
Policies & Procedures**

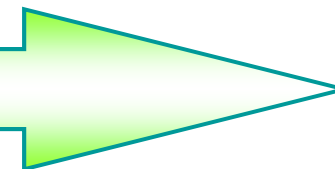


**Tools &
Technologies**

- Influencing A Culture Requires Changes To The Components Of A Culture
- Visualize and Define What You Want To Be
- “We’re going to be...”



Enablers of Change





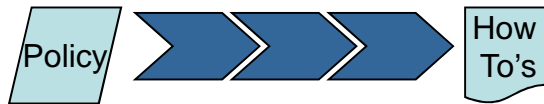
Army Cost Culture Change “Making a Square a Circle”

“A Culture of Entitlement”



- Budget-focused
- Spend rate driven – inputs
- Performance objective - 99.9% obligated
- Free goods has infinite demands

- **Develop/Recruit Analysts**
- **Enhance Training**
- **Performance Focus**



- **Process Improvement (Lean 6-Sigma)**
- **Integrated Business Design**



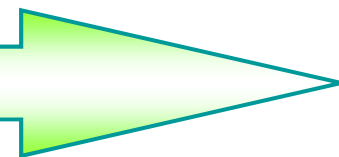
- **ERP Applications e.g. (GFEBs, LMP, GCSS)**
- **Business Warehouses**
- **Executive Scorecards**

“A Culture of Influence”

- Cost and performance focused
- Results driven - output & outcome
- Performance objective – resource consumption optimization (efficiency & effectiveness)
- Use what is necessary to obtain the objective

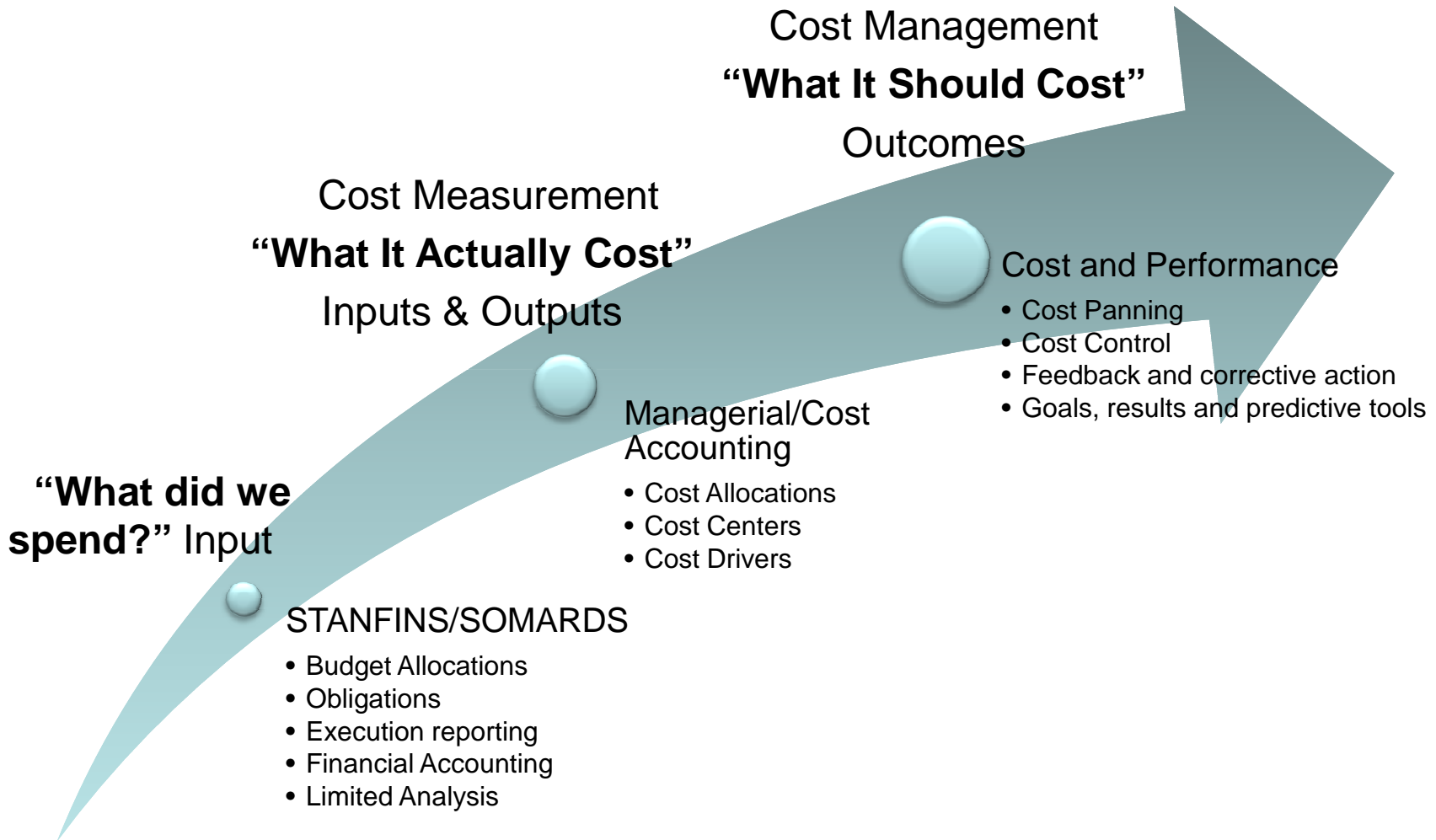


Enablers of Change





Growing into the Cost Culture





Cultural Change Video





Lesson 2: Wrap-Up



- Culture is the Shared “Taken-For-Granted” Assumptions, Beliefs, Values, Expectations & Rules that Members of a Work Unit Team or a Corporate Organization Hold
- Change management is required to move towards a Cost Culture
- Change management impacts the areas of People & Other Resources, Processes, Policies & Procedures, and Technology
- Cultural shift to a Cost Culture is a maturation process moving from “What We Spent”, to “What It Actually Costs”, to “What It Should Costs”



Question #1: What are the Enablers of Business Culture Change





Answer #1: What are the Enablers of Business Culture Change



- People/Other Resources
- Processes, Policies & Procedures
- Tools & Technologies



Question #2: What is the biggest obstacle to establishing a cost culture in the Army for you?



Answer #2: What is the biggest obstacle to establishing a cost culture in the Army for you?

Answer: Discussion

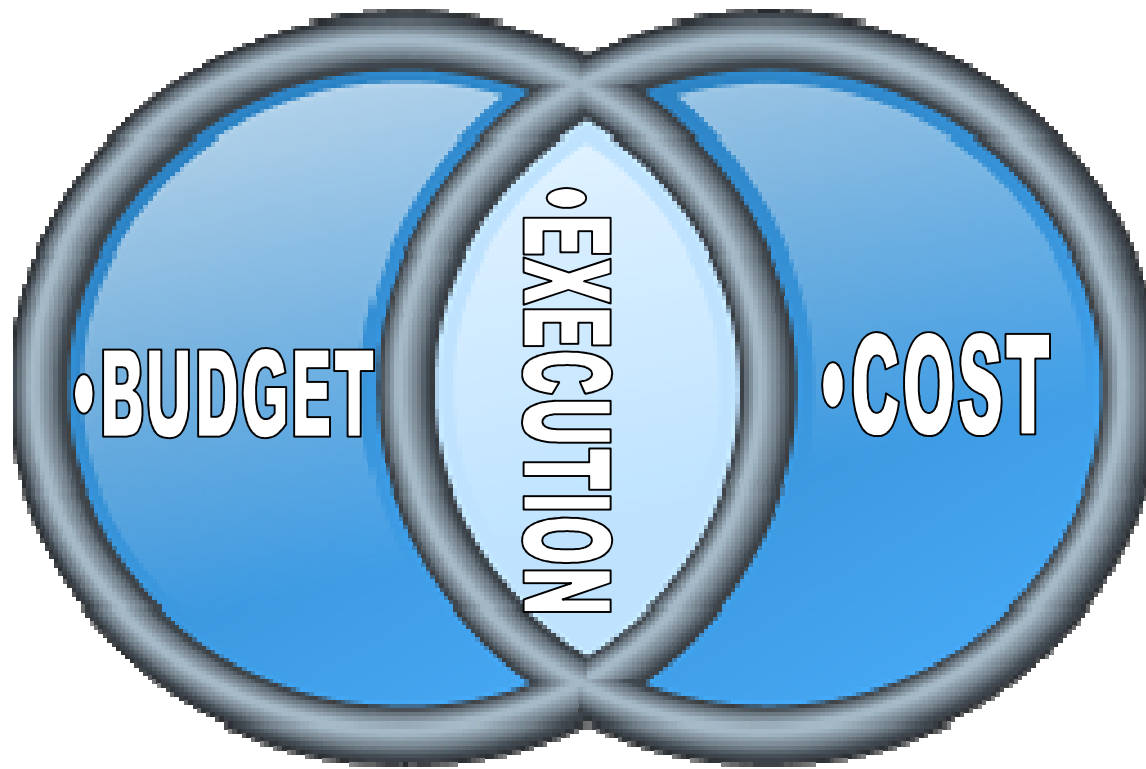


Lesson 3: Cost vs Budget



Objective(s):

- Understand how Costs differ from Budget





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Where We Are Currently



- Focused on the “Budget” domain
- The “Budget” domain consists of creation of the Budget requests/submissions, determination of the year of execution Budget (e.g. availability control and informal Budgets), actual execution, and reporting of the status of execution against the Budget (i.e the PPB&E process)
- Primary focus of budget execution is the Obligation (consumption of the Budget)
- Budget Accounting focuses on 4 series accounts – status of Budget and consumption
- Budget Management focuses on the status of available funds, which includes both current and prior years funds



Budget Terms



- Budget = What Can Be Spent
- Obligation = a promise to procure a product/ service (e.g. to spend)
- Budget \neq Obligations
- Budget – Obligations = Availability (e.g. what is left to spend)
- Expenditure is the receipt of the product/service which was obligated (e.g. what was spent)
- Expenditures or collection of expenses/expenditures determines Costs



Cost versus Budget



Knowing your Obligations is **not** the same as knowing your Costs!

Obligations

A legally binding commitment by the federal government that will result in outlays, immediately or in the future. Budgetary resources must be available before obligations can be incurred legally.

Costs

The price or cash value of resources used (expenditures) to produce a program, project or activity. All relevant costs may not appear in the organization's budget.

Full cost can exceed individual business unit budget allocations



Cost \neq Obligation

Cost will contain expenses from different years, source of funds, organizations, etc.



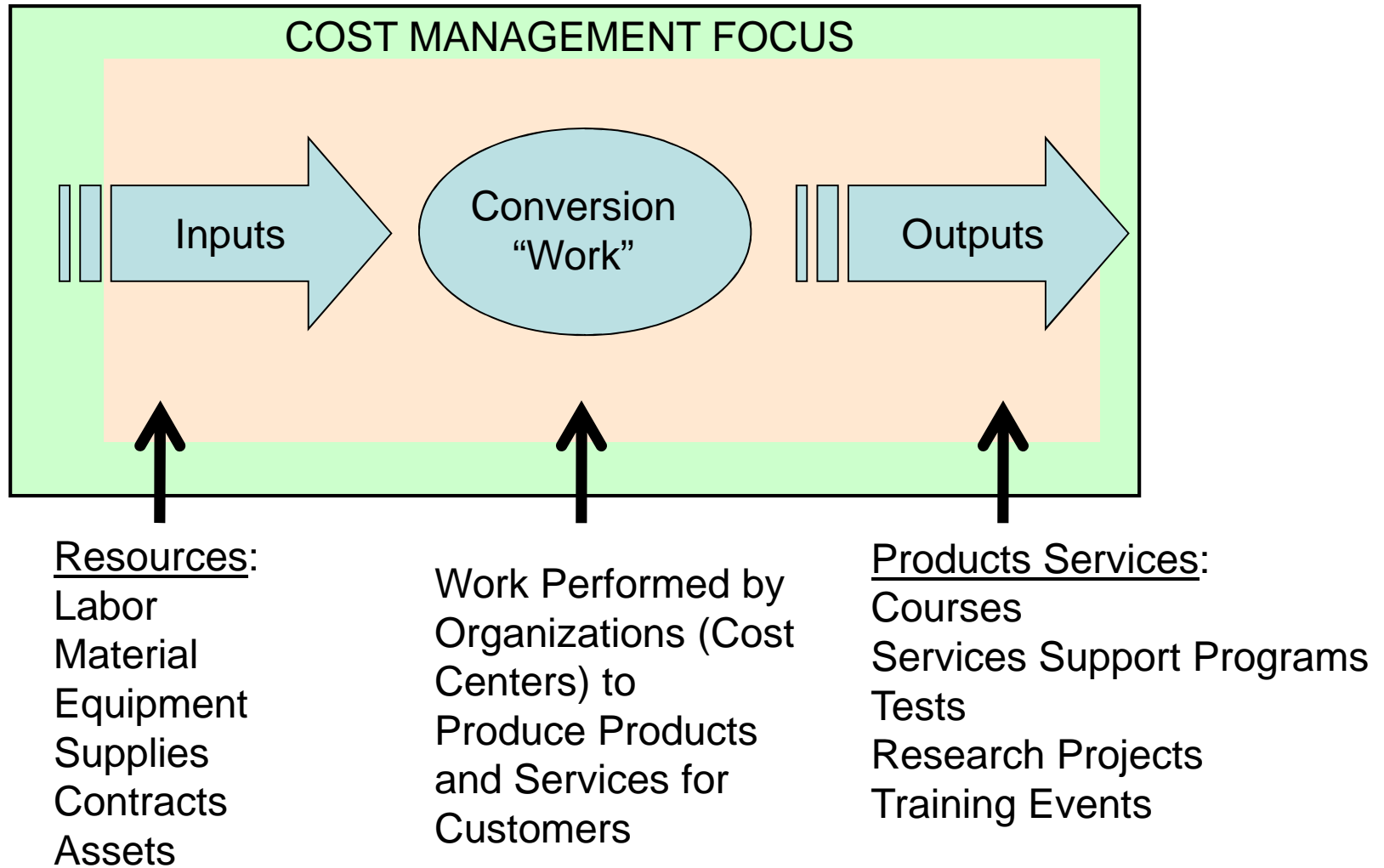
Budget ≠ Obligations ≠ Cost...



- Cost Accounting / Management is New to Most of Army as a formalized process
- Provides Financial and Managerial Information
- Cuts Across financial and operational organizations
- Is Driven by Information Needs of the Operational Army not solely the Financial Community

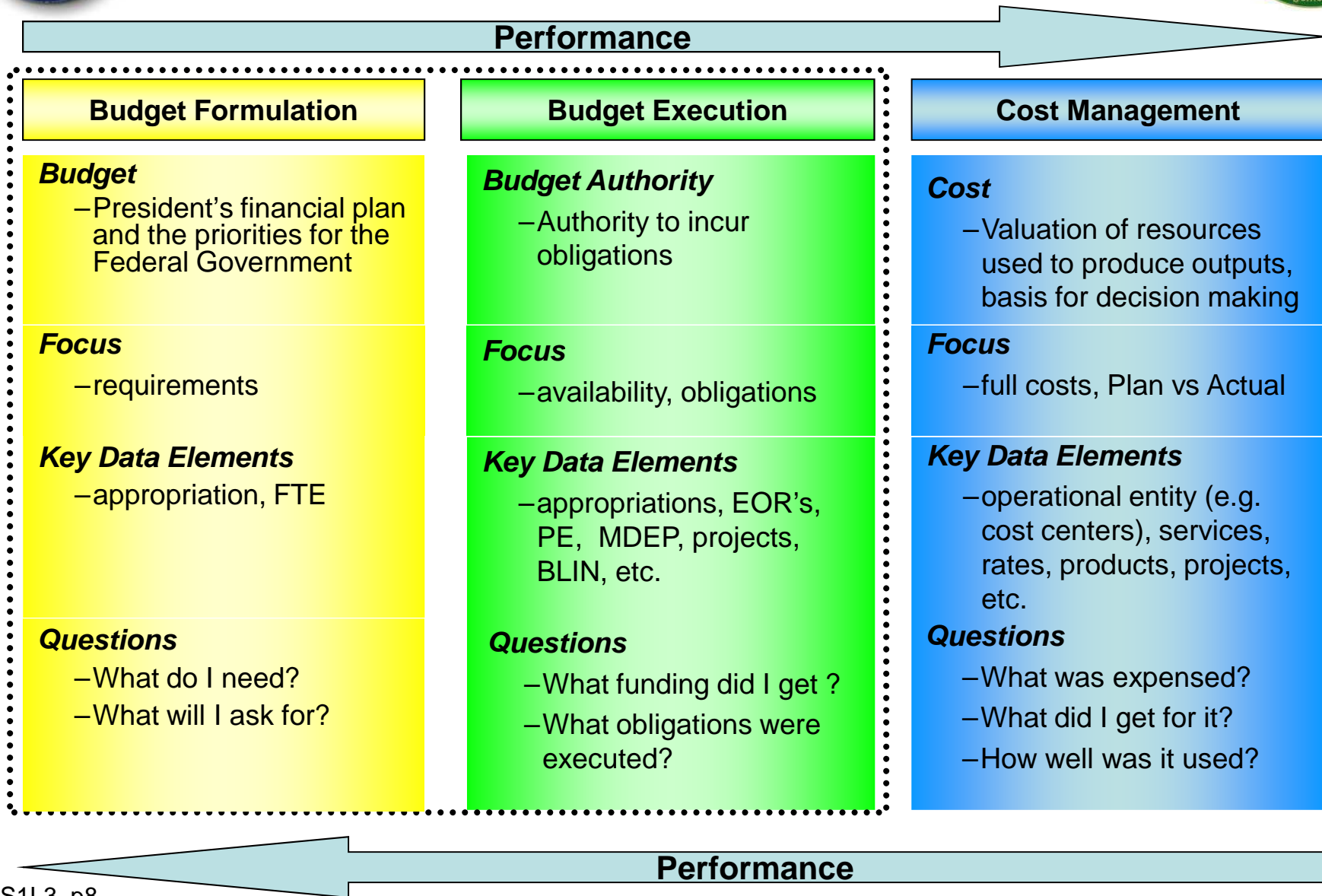


Cost Management Focus





Budget vs Cost Domains





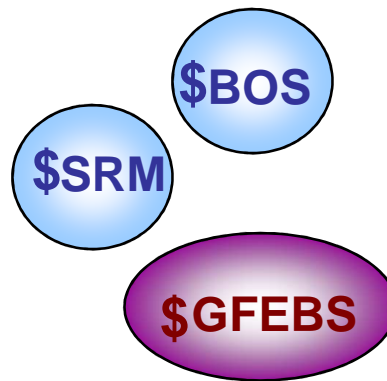
Budget - Color of Money



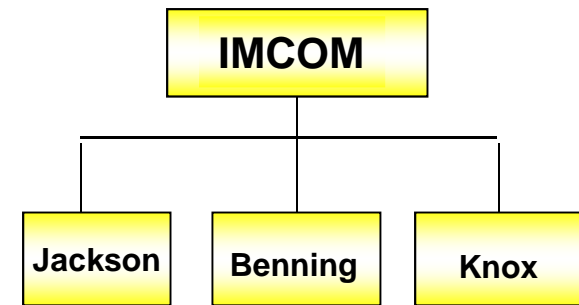
Appropriations



Program Elements



Fund Centers



Elements Of Resources





Cost-Conversion of Work



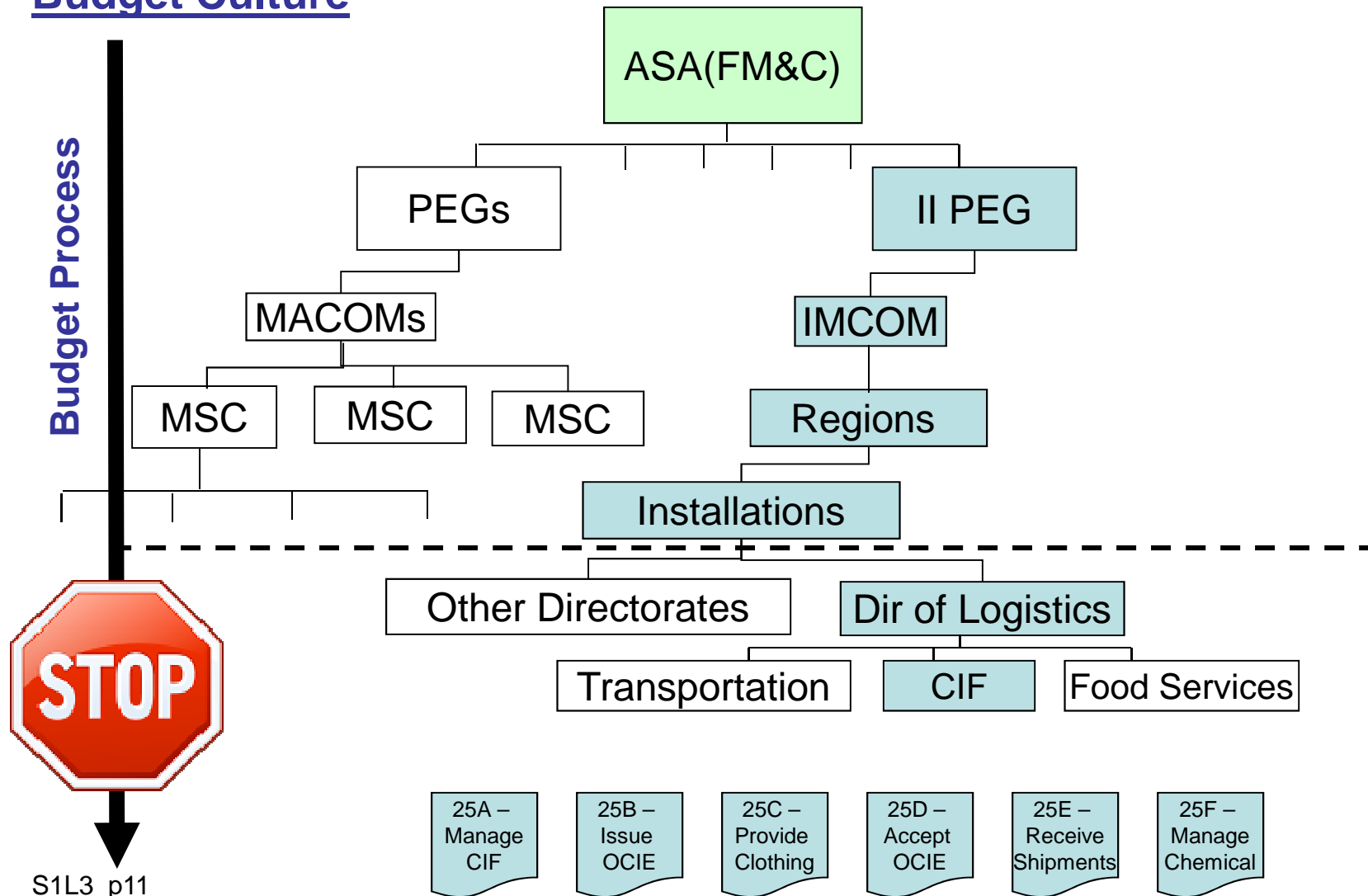


Transforming The Army

Enhance Budgeting with a Cost Culture



Budget Culture





Lesson 3: Wrap-Up



- Budget \neq Obligations \neq Costs
- Budget Management is primarily “input” focused (color of money) where Cost Management is primarily “output” focused (products/services)
- The Budget and Cost domains have different purposes, focuses, questions, optimization goals, while sharing the “expenditure” data stream
- Budget – Type or “Color” of Money
- Cost – Conversion of resources to outputs



Quiz



Question #1: Cost = Budget

- True
- False

Question #2: Cost = Obligation

- True
- False



Quiz Answers



Question #1: Cost = Budget

- True
- False

Question #2: Cost = Obligation

- True
- False



Quiz



Question #3: _____ provides 'authority' and control of the conversion activity in order to provide the agreed upon outputs of the agency (primarily input focused)

Question #4: _____ provides 'efficiency and effectiveness' and control of the conversion activity in order to provide the agreed upon outputs of the agency (primarily output focused)



Quiz Answers



Question #3: Budget provides 'authority' and control of the conversion activity in order to provide the agreed upon outputs of the agency (primarily input focused)

Question #4: Cost Management provides 'efficiency and effectiveness' and control of the conversion activity in order to provide the agreed upon outputs of the agency (primarily output focused)



Exercise #1



1. Define Area (Organizations)
2. Identify Resources Used
3. Activities/Tasks Performed
4. Products/Services Produced

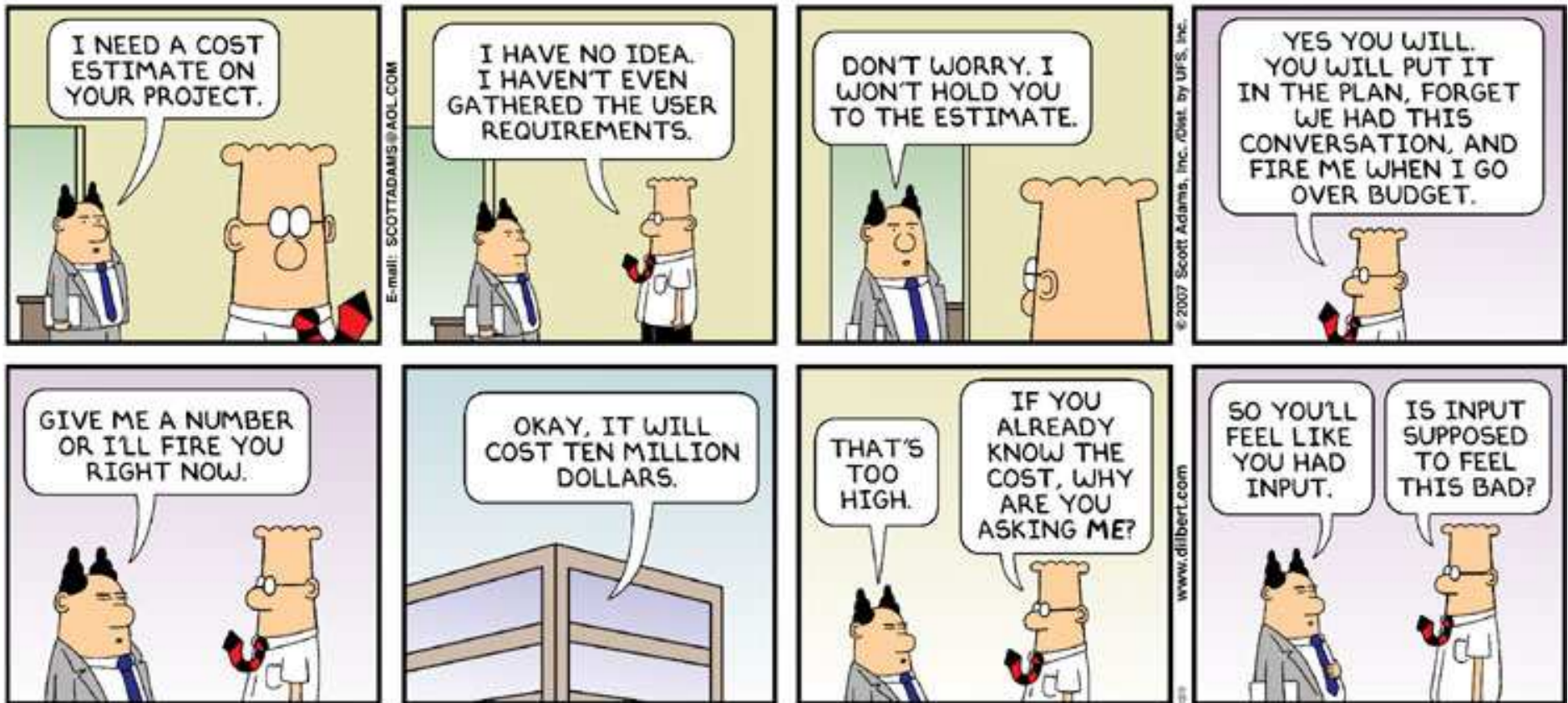


Lesson 4: Cost Management



Objective(s):

- Understand the definition of Cost Management
- Understand the key components of the Cost Management Process
- Identify who is involved in performing Cost Management





Cost Management



Managing Business Operations *Efficiently* & *Effectively* Through the Accurate Measurement & Thorough *Understanding of the "Full Cost"* of an Organization's Business Processes, Products & Services in Order to Provide the *Best Value* to *Customers*.

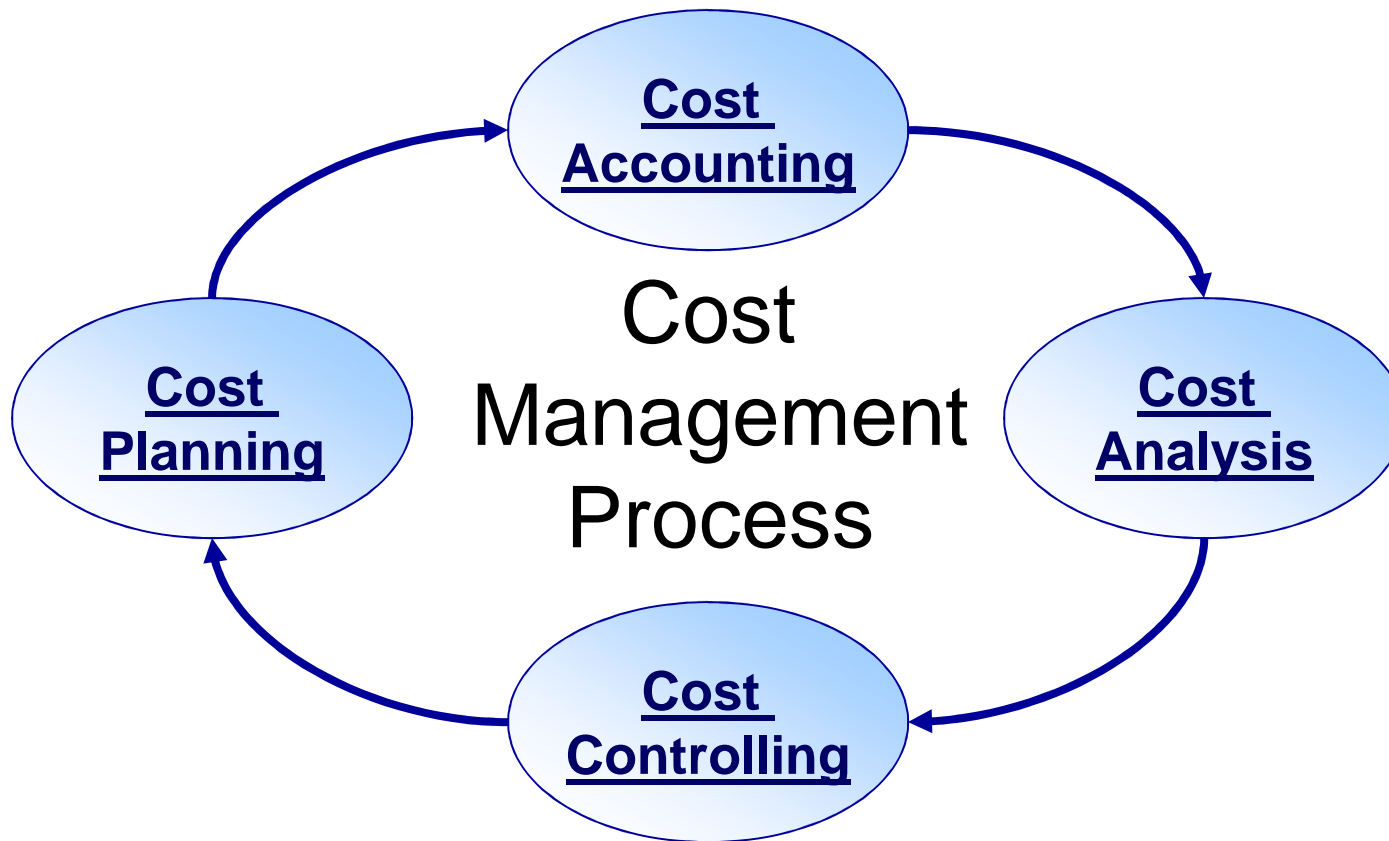
- *Efficiently* is to doing things "right", e.g. in the best and most economical way, wasting no resources
- *Effectively* is to do the "right" things, e.g. setting targets to achieve an overall goal (the *effect*) and attaining the goal
- *Full Costs* is the inclusion of all and only those costs related to generating the output
- *Best Value* is a qualitative measurement to be taken into consideration



Cost Management



Managing Business Operations *Efficiently* & *Effectively* Through the Accurate Measurement & Thorough *Understanding of the "Full Cost"* of an Organization's Business Processes, Products & Services in Order to Provide the *Best Value* to *Customers*.

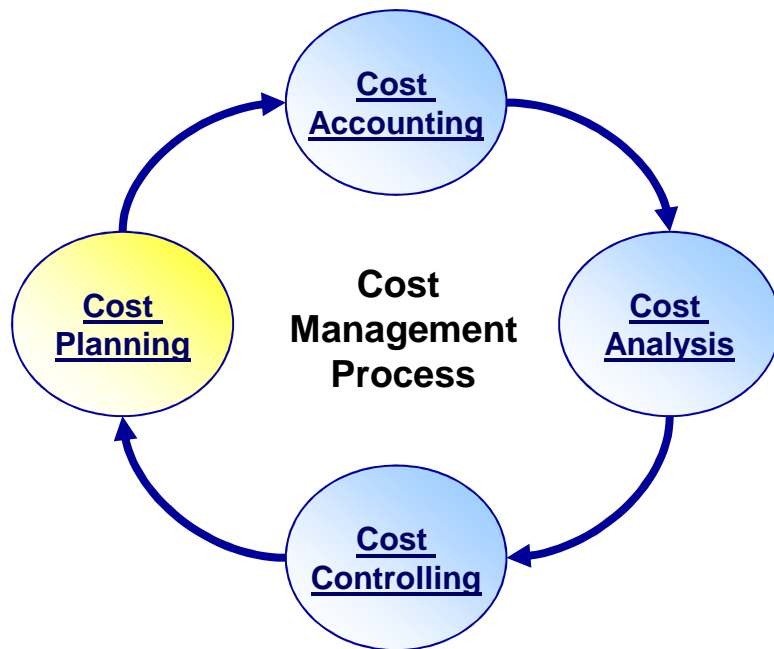




Cost Planning



Cost Planning is the use of a Cost Model for “should-cost” forecasting to make informed decisions



Often Performed for:

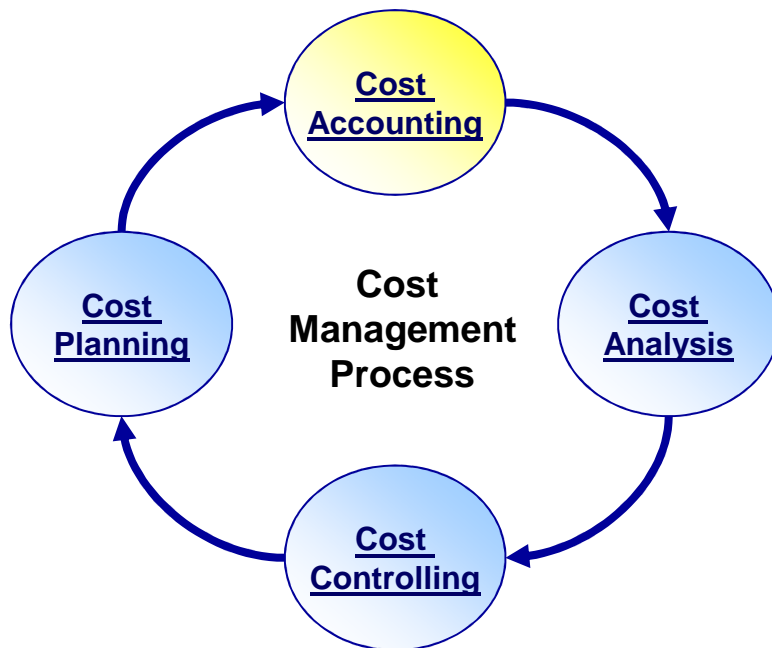
- Budget Requirements Requests
- Costs Estimations
- Output Quantities
- Capacity Management
- Risk Analysis
- Various Time Frames: Out year / Current year, Quarterly, Monthly
- Standard Rates
- Defining Targets to Measure Efficiency and Effectiveness



Cost Accounting



Cost Accounting translates the operational value chain into financial values



- Cost Accounting is the dollar valuation of the cost measurements resulting from business operations
- Cost Measurement has meaning only when considering its purpose
- Defining Cost Measurement should be carefully considered and evaluated
- Alternative cost methods should be evaluated under operating environment



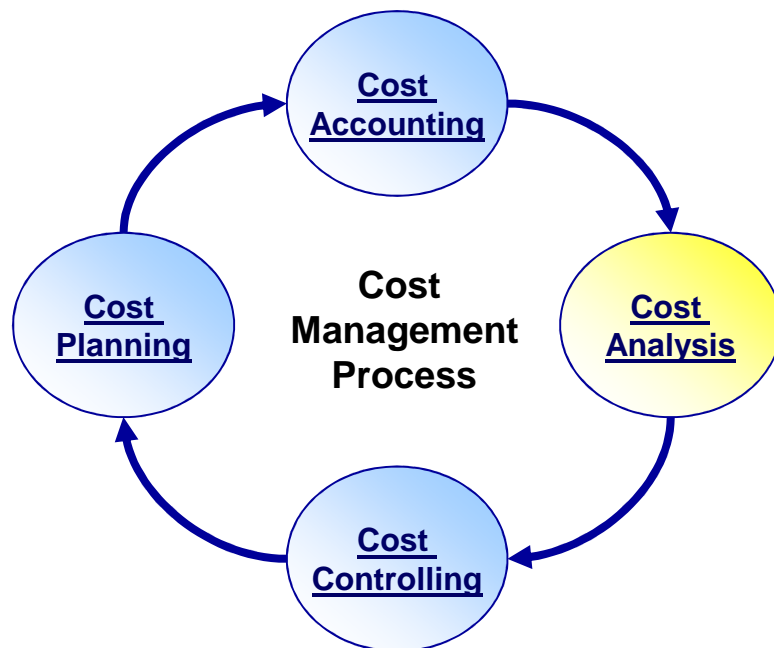
Purpose Is the key to Understanding the Army ERP Cost Design (GFEBS): To Provide Operational Managers With Relevant “True” Cost Information to Make Sound Economic Decisions*



Cost Analysis



Cost Analysis is the integration of functional outcome data with cost data to produce valid and verifiable information to conduct various forms of analysis



Sample types of analysis include:

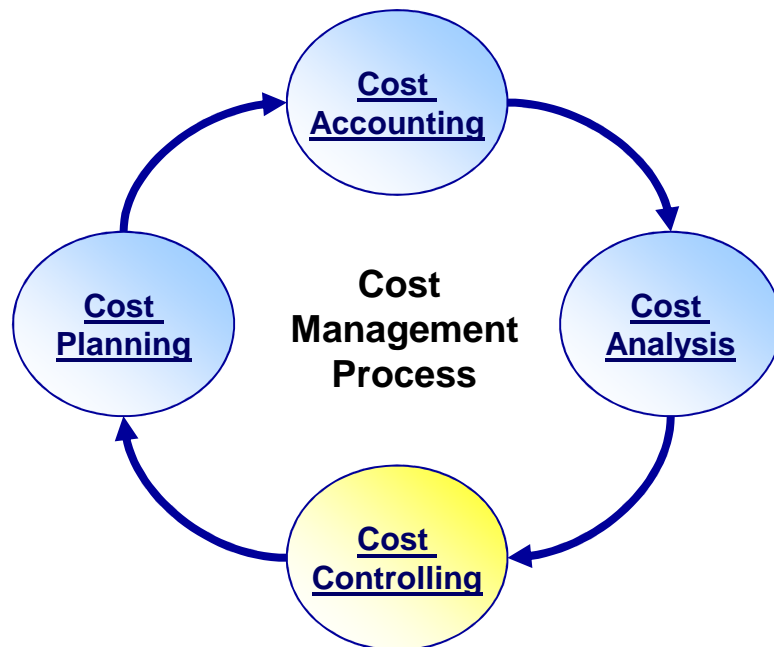
- Organizational performance
- Analysis of alternatives
- Variance analysis
- Economic analysis
- Cost / Risk assessments
- Trending



Cost Controlling



Cost Controlling is to take “Best Value” and/or “Best Practice” actions to realign the organization to achieve the defined objectives



- Actions taken based on information provided from Cost Analysis results
- Redeployment of resources between outputs
- Change outputs (e.g. do more or less)
- Update/revision of plan information, e.g. updated Std. Rate
- Execution of trade-off decisions, e.g. OT versus external support



Cost Management Involves

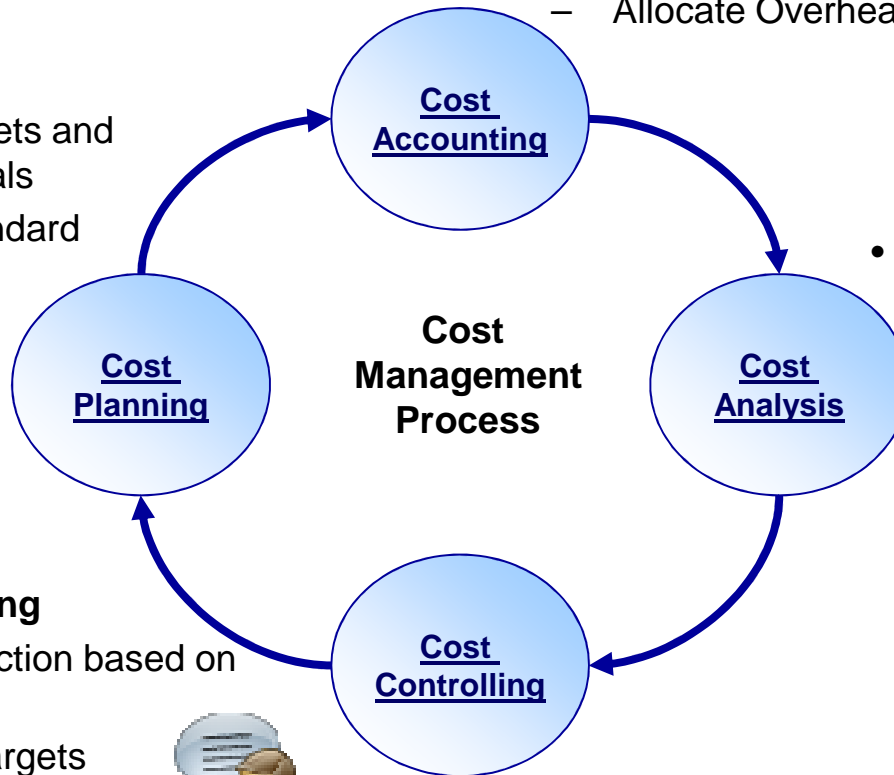
- **Capture and Valuate Data**



- Accurate, timely and relevant data
- Connecting operational output/performance data to financial data
- Allocate Overhead

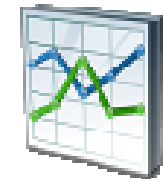
- **Cost Planning**

- Set Cost Targets and Efficiency Goals
- Compute Standard Rates



- **Cost Analysis**

- Variances
- Depreciation
- Trends and forecasting
- Product, service or activity cost by element (labor, contract etc)
- Understanding full costs of organizations, operations, products and services



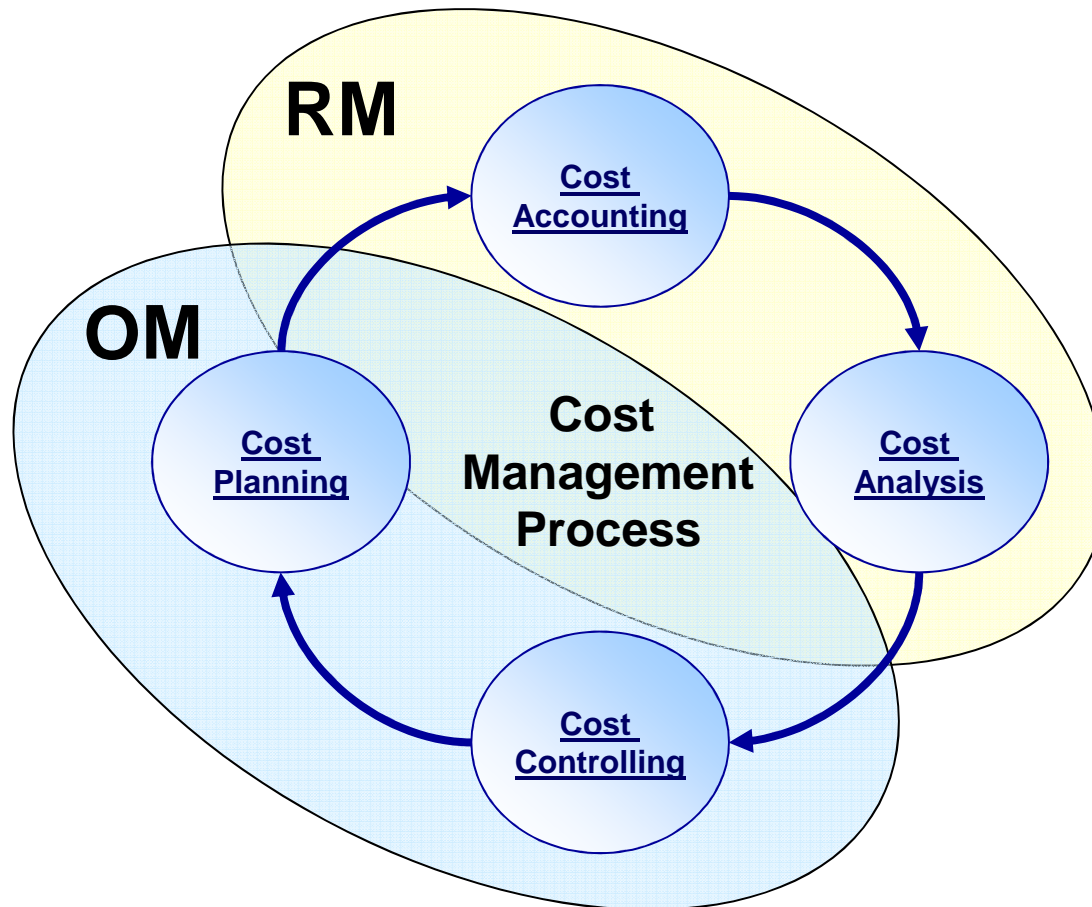
- **Cost Controlling**

- Move to action based on analysis
- Change targets
- Change resources
- Change quality





Cost Management Process (Who Is Involved?)



- Resource Managers (RM)
- Operational Managers (OM)



Lesson 4: Wrap-Up



- **Cost Management = Managing Business Operations *Efficiently & Effectively* Through the Accurate Measurement & Thorough *Understanding of the "Full Cost"* of an Organization's Business Processes, Products & Services in Order to Provide the *Best Value* to *Customers*.**
- Cost Management Process consists of Cost Planning, Cost Accounting, Cost Analysis, and Cost Controlling
- Cost Management involves Operational Managers and Resource Managers



Question #1: What are the 3 Key Components of the Cost Management Definition?





Answer #1: What are the 3 Key Components of the Cost Management Definition?



ANSWER:

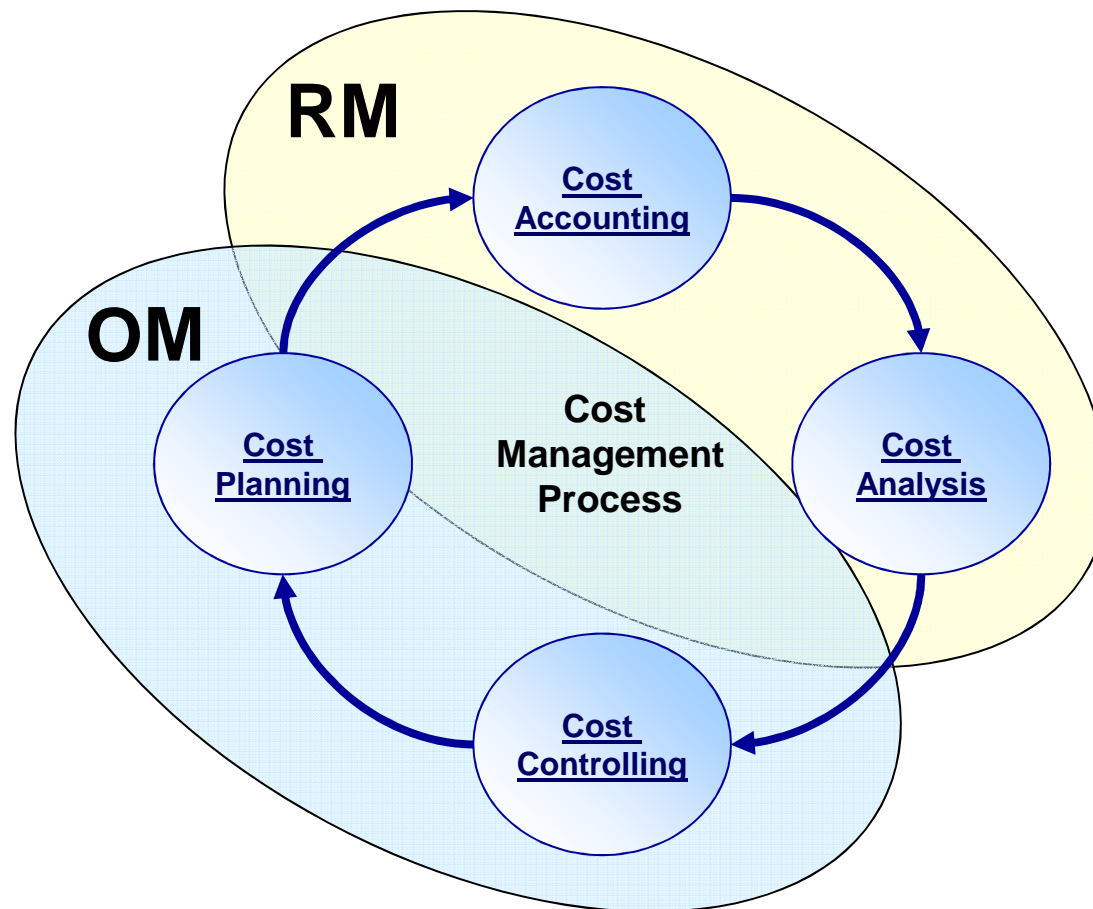
- *efficiently and effectively*
- *"full cost"*
- *best value to customers.*

Cost Management: Managing business operations *efficiently and effectively* through the accurate measurement and thorough *understanding of the "full cost"* of an organization's business processes, products and services in order to provide the *best value* to *customers*.



Question #2: Which Sections of the Cost Management Process Primarily Involve:

- Resource Managers (RM)?
- Operational Managers (OM)?





Question #3: Which Sections of the Cost Management Process Primarily Involve:

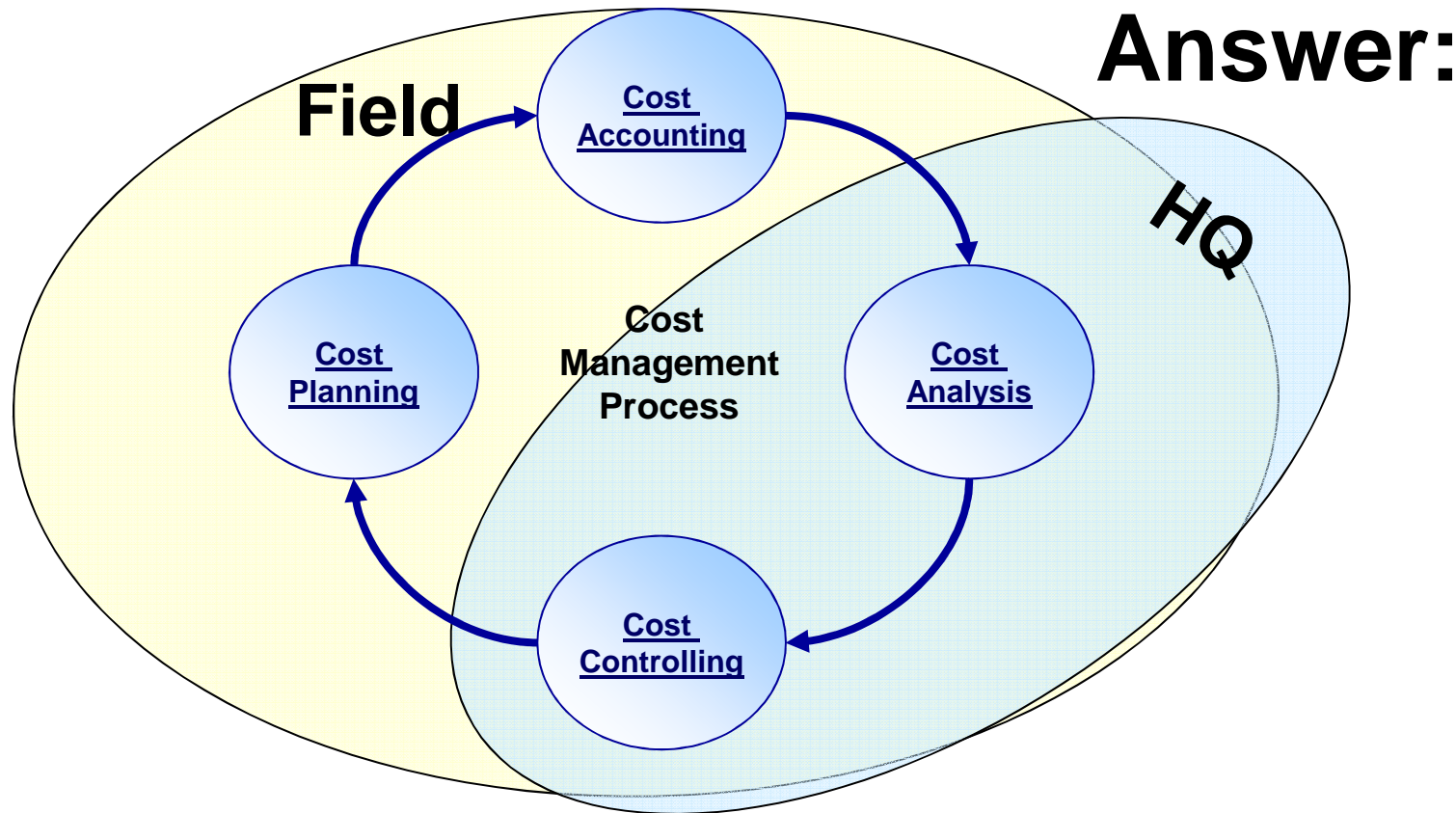
- HQDA/COMMAND HQ?**
- FIELD LEVEL - Garrisons, Schools, MSEs ... & Below?**





Answer #3: Which Sections of the Cost Management Process Primarily Involve:

- HQDA/COMMAND HQ?
- FIELD LEVEL - Garrisons, Schools, MSEs ... & Below?



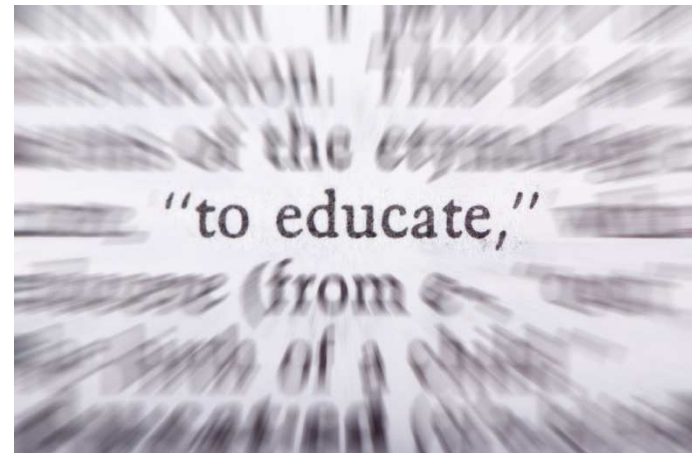


Lesson 5: Cost Terms



Objective(s):

- Understand the key terms involved with Cost Management





Cost Terms



- There is a language to Cost Management, however there are many dialects!
- There is an inconsistency of cost terms in the market driven by outgrowth from manufacturing to the introduction of service costing
- Cost terms additionally differ based on costing philosophy (e.g. standard costing, activity-based costing, theory of constraints, etc.)
- Army has determined the Cost Terms to be propagated to provide a level set language for understanding Cost information



Many Types Costs



- **Direct costs**— A cost such as labor, materials/supplies that can be directly traced to producing a specific output of an organization, product/service.
- **Indirect costs** – A cost that cannot be directly traced to a specific organization, product/service output.
- **Funded Costs** -- The value of goods or services received because of an obligation of funds (obligation authority), by the organization performing the work.
- **Unfunded costs** -- A cost that are financed by another organization's or activity's appropriations.
- **Variable Costs** -- A cost that changes with change in output.
- **Fixed Cost** -- A cost that remains the same regardless of the change in output.
- **Recurring Cost** -- A cost that is incur repeatedly for each organization and/or product/service produced .
- **Non-Recurring Cost** -- A cost that is unusual and unlikely to occur again.
- **Avoidable Costs** -- A cost incurred on an object that will no longer be incurred due to a decision to change the output.
- **Unavoidable Cost** -- A cost incurred on an object that will be incurred regardless of the decision to change.

- **Common Understanding of Types of Cost is Necessary for Informed Decision Making**

- **Each Decision Should be Focused on Only Relevant Cost that Impact the Decision**



Type of Cost Functions



Type Cost is a Function of ...	Direct or Indirect	Recurring or Non Recurring	Fixed or Variable	Funded or Unfunded	Avoidable or Unavoidable
Output Qty	X	X	X		X
Product Produced	X	X	X		X
Source of Funds		X		X	
Overhead	X	X	X		X
Provider		X			
Relevant Time Range		X	X		X



Funded vs Unfunded



- The terms Funded and Unfunded define the relationship of the appropriation dollars consumed to the organization utilizing those funds.
- Classification of the dollars input (utilized) in relationship to the organization responsible for the output



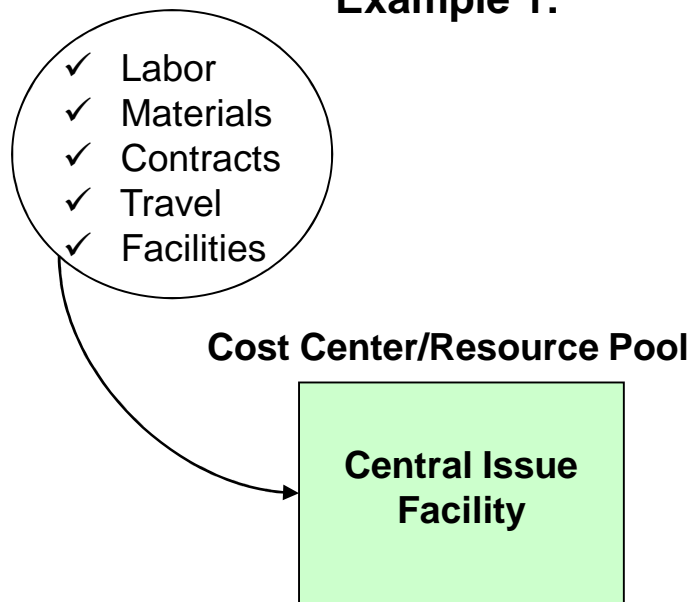


Funded Costs

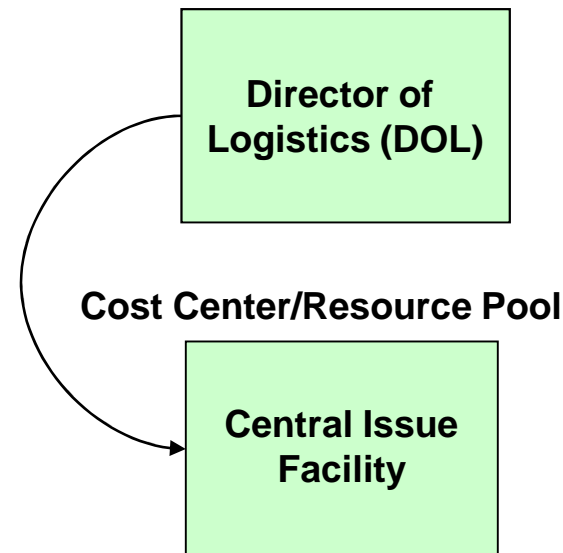


Funded Costs – The value of goods or services received because of an obligation of funds (obligation authority), by the organization performing the work. (e.g. civilian labor, building and grounds maintenance). These costs are funded in the Annual Operating Budget of the organization.

Example 1:



Example 2:

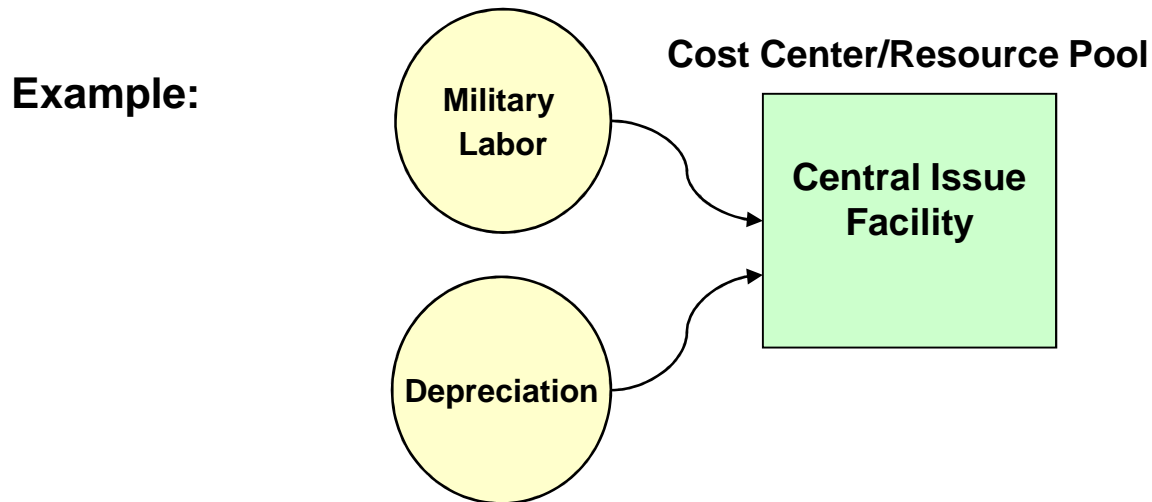




Unfunded Costs



Unfunded Costs – Costs that are financed by another organization's or activity's appropriations. These costs do not result in any obligation of funds by the organization; examples include depreciation, military labor, and military rations.

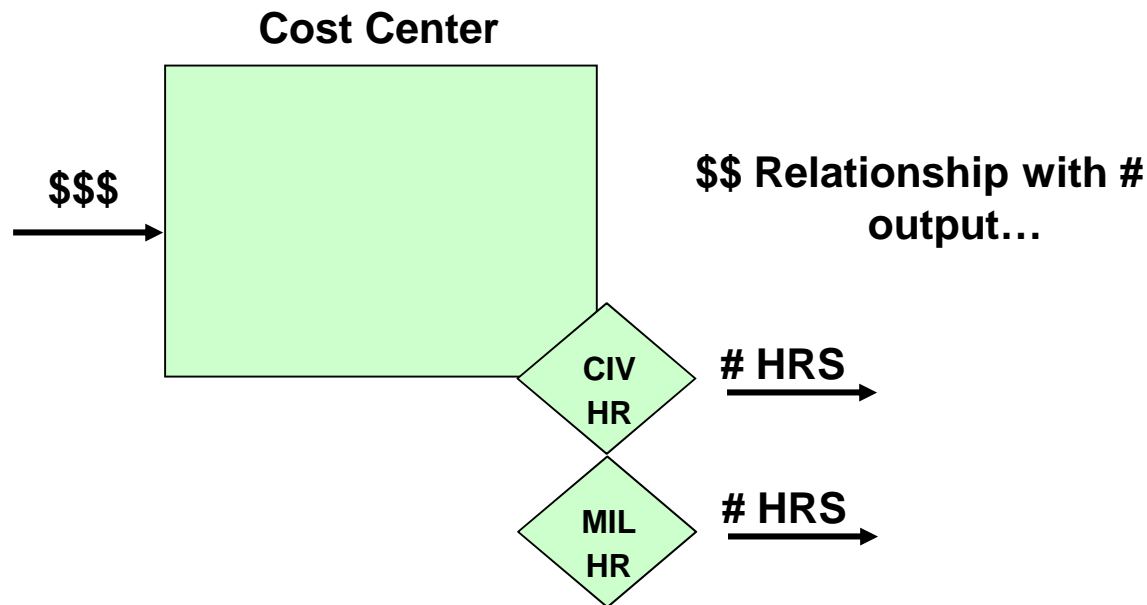




Direct vs. Indirect Costs



- Direct and Indirect define the relationship of the cost incurred to the output provided
- Direct and Indirect are often contentious terms since they imply responsibility for control (view changes depending on where you sit in the organization)

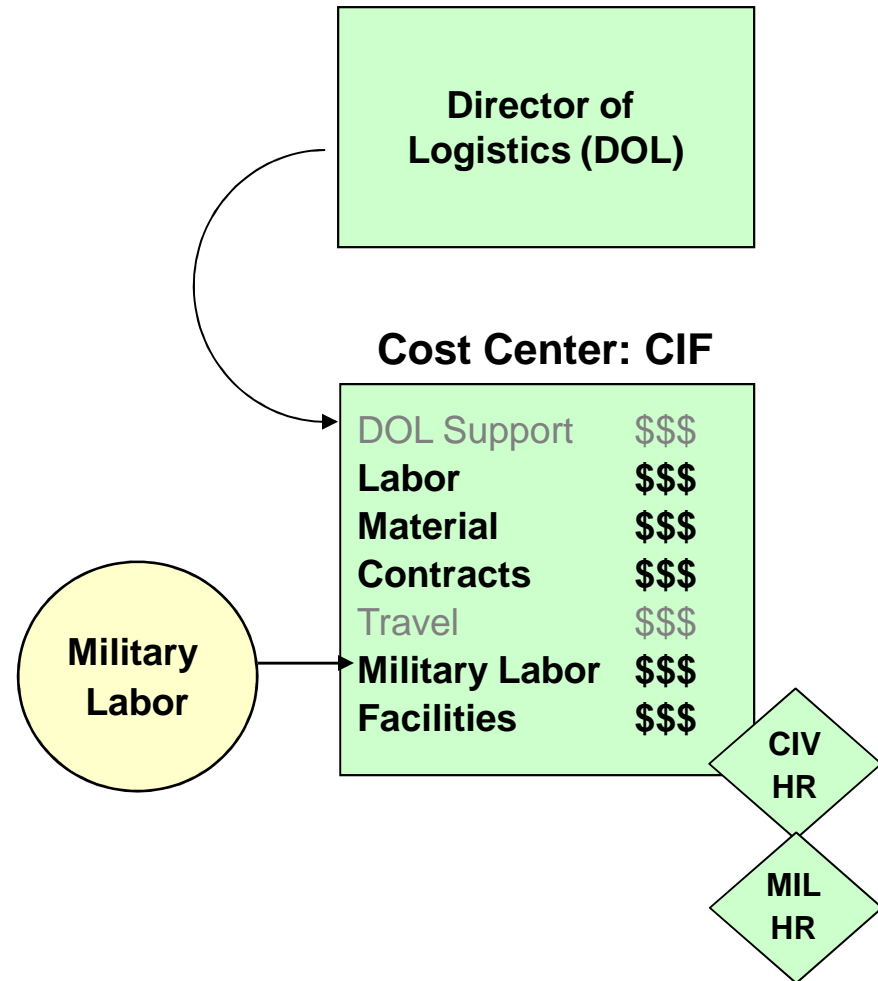




Direct Costs



Direct Costs – A cost such as labor, materials/ supplies that can be directly traced to producing a specific output of an organization, product/service

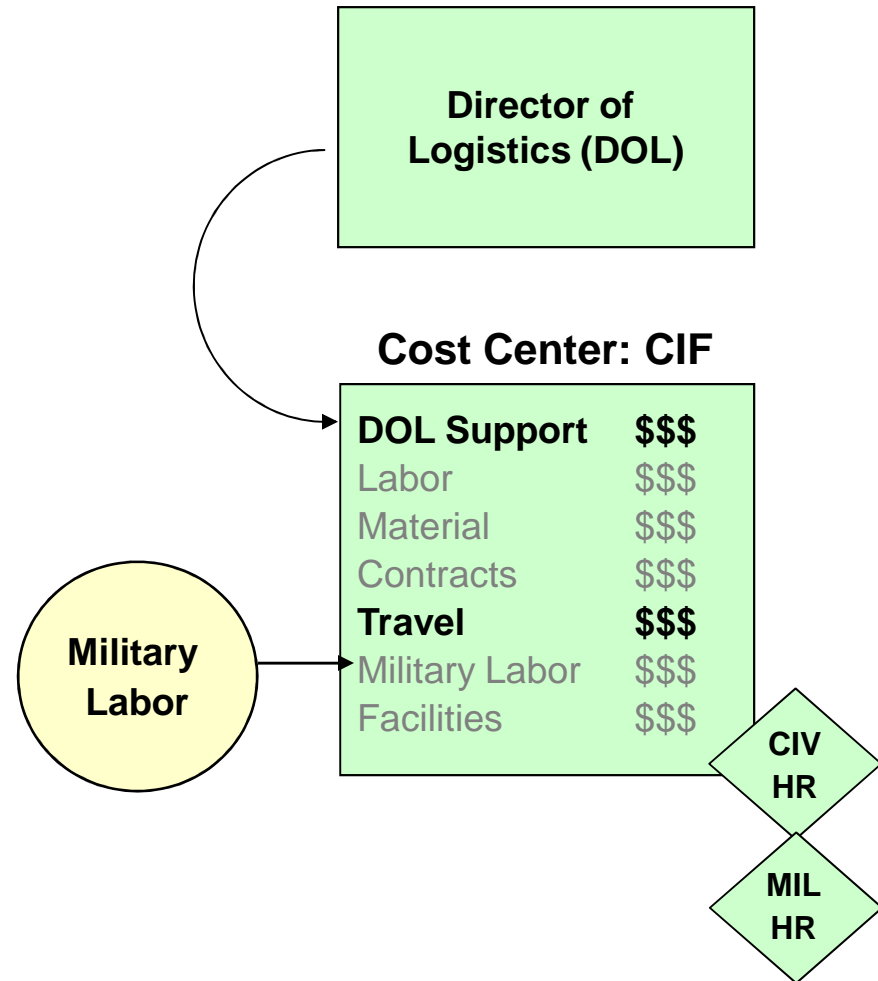




Indirect Costs



Indirect Costs – Costs that cannot be directly traced to a specific output. They are often allocated on some predetermined basis and are generally synonymous with overhead, such as general and administrative expenses.





Recurring vs Non Recurring

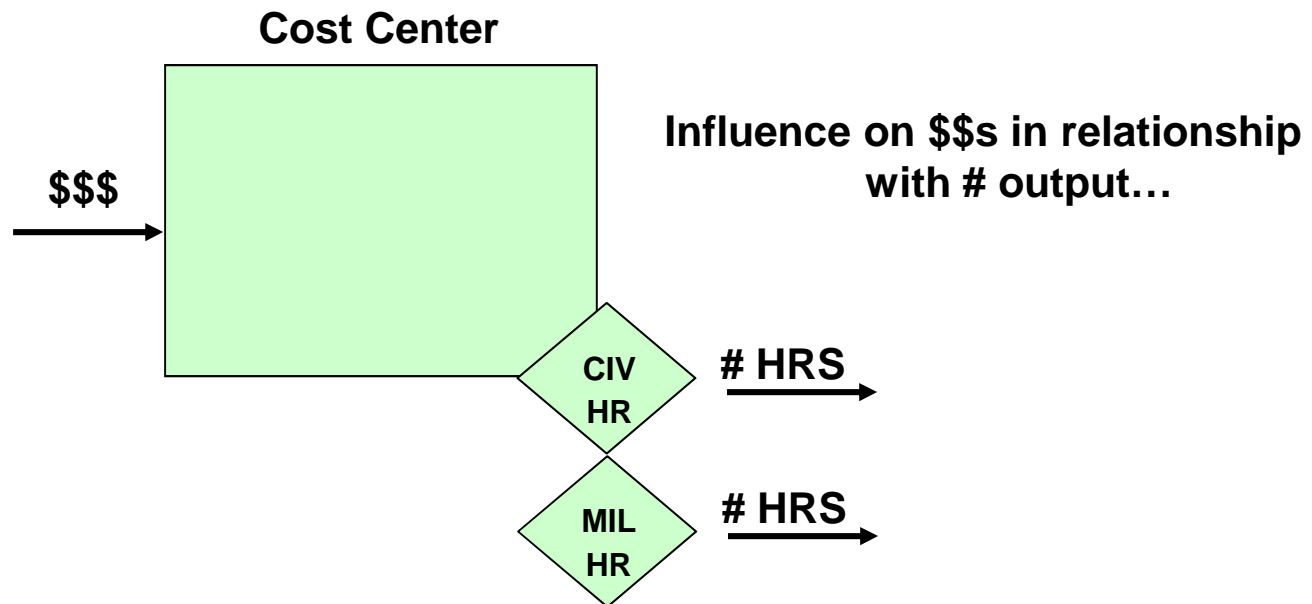


- The terms Recurring and Non-Recurring define regularity of the occurrence of the expense
- **Recurring Costs** are those that incur repeatedly for each organization and/or product/service produced (e.g. payroll, materials)
- **Non-Recurring Costs** are those that are unusual and unlikely to occur again (e.g. Hurricane, GFEBs deployment)



Fixed vs Variable

- Fixed and Variable define the influence on the dollar relationship of the cost incurred to the output provided
- Are defined within a relevant time, such as the plan cycle (i.e. 1 year.)



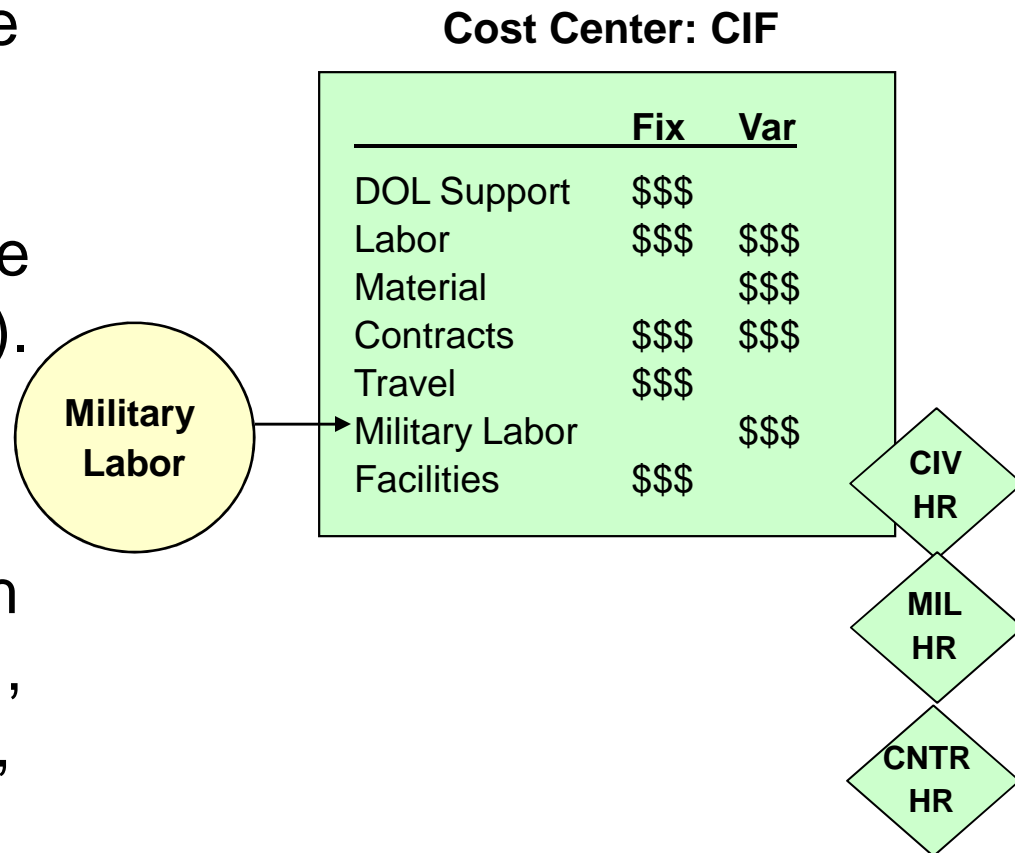


Fixed and Variable Costs



Fixed Cost - A cost that remains the same regardless of the change in output, within a relevant range (e.g., rent, supervisor).

Variable Costs - A cost that changes with change in output (e.g., cost of material, labor, utilities).





Fixed and Variable Cost & Quantities



Inputs are considered **Fixed** if they do not change as a result of differences in output measures.

Inputs are considered **Variable** if they increase or decrease as a result of changes in output.

Help Desk		Mgr. Alice Red
Output: Help Desk Hours		3,000
	<u>Fixed</u>	<u>Variable</u>
Staff Salaries	\$ 0	\$ 15,000
Mgr. Salaries	\$10,000	\$ 0
Licenses	\$ 30	\$ 0
Supplies	\$ 0	\$ 598
	<u>Qty</u>	
Disk Space (MB)	0	46,000
CPU Time (Mins)	0	4,000
Facilities (Sqft)	300	0



Decision Specific Cost Concepts



Avoidable Costs - A cost incurred on an object that will no longer be incurred due to a decision to change the output, such as contract labor to operate the test range

Unavoidable Cost - A cost incurred on an object that will be incurred regardless of the decision to change output, such as depreciation on equipment



Lesson 5: Wrap-Up



- **Cost Management = Managing Business Operations *Efficiently* & *Effectively* Through the Accurate Measurement & Thorough *Understanding of the "Full Cost"* of an Organization's Business Processes, Products & Services in Order to Provide the *Best Value* to *Customers*.**
- Cost Management Process consists of Cost Planning, Cost Accounting, Cost Analysis, and Cost Controlling
- Cost Management involves Operational Managers and Resource Managers
- A common understanding of the types of costs in order to make informed decisions



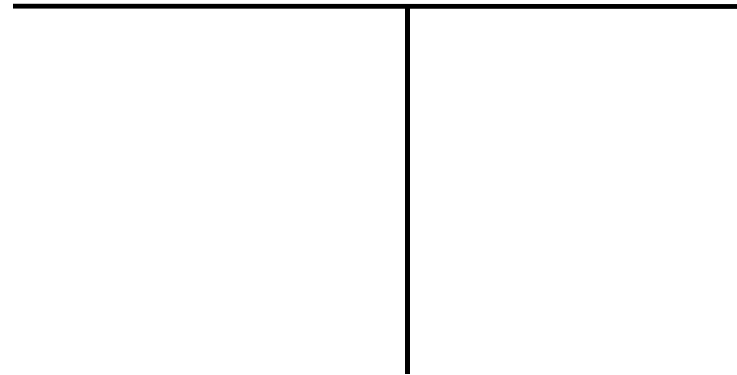
Exercise # 2: List Cost Differences



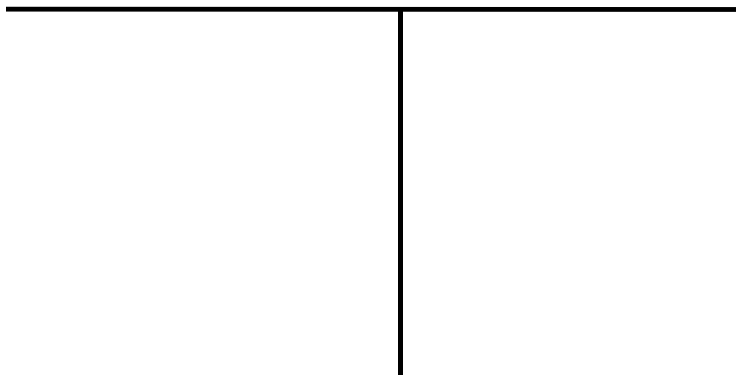
Funded vs. Unfunded



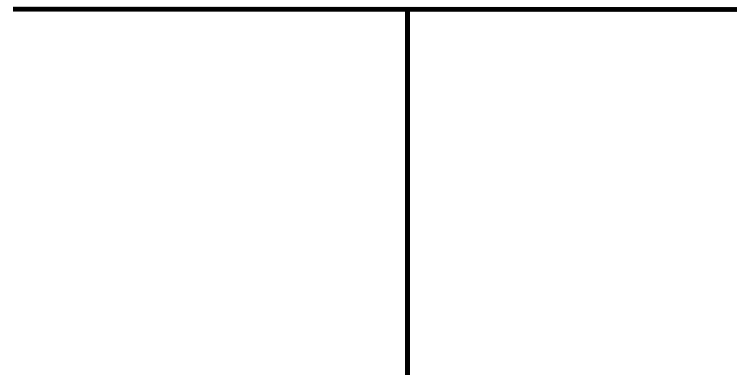
Recurring vs. Non-recurring



Fixed vs. Variable



Available vs. Unavailable





Answers to 1 through 4



- **Direct costs** - directly traced to producing a specific output
- **Indirect costs** - cannot be directly traced to a specific output
- **Recurring Costs** – those costs that occur year over year
- **Non-Recurring Costs** – one time within the year of execution and not planned to happen again
- **Variable Costs** - changes with change in output
- **Fixed Cost** - remains the same regardless of the change in output (within a relevant range)
- **Avoidable Costs** - will no longer be incurred due to a decision to change the output
- **Unavoidable Cost** - will be incurred regardless of the decision to change output



Question #5: Provide Examples of When Labor is?



- Direct
- Indirect
- Funded
- Unfunded
- Recurring
- Non-Recurring
- Variable
- Fixed
- Avoidable
- Unavoidable

Answer: Discussion

