

# RSM BUSINESS ADVISORY

## UNIT COSTING AND PRICING

Process Guide

## PURPOSES OF UNIT COSTING

There are many reasons to perform unit costing, some are:

- Identifying costs
- Cost cutting
- Revenue projection
- Pricing strategies

## UNIT COST DEFINED

A unit cost is simply the "average total cost" of producing one unit of output. A unit cost is calculated by dividing the total cost of production by the total number of units of output produced.

$$\text{Unit Cost} = \frac{\text{Total Cost}}{\text{Total Output}}$$

## TYPES OF COSTS

Generally costs can be either fixed or variable, and direct or indirect.

### Fixed Costs

These are costs or expenses that do not respond to changes in production output over a set time period. Some fixed costs change annually and increase overall fixed costs. For example, if your insurance premiums increase when you renew your policy, the production costs for each unit will likewise increase due to the additional insurance cost. Some fixed costs includes:

- Office Building/Factory Rent
- Amortisation and Depreciation
- Property Taxes
- Overhead Costs (if does not depends on the volume of output)

### Variable Costs

Variable Costs or Expenses change with each production run. Direct Costs such as direct materials and direct labour normally are the main components of variable costs. Some variable costs includes:

- Direct Labour
- Direct Material
- Franchise Fee (if it's depending on the volume of output)

### Direct Costs

Direct costs are costs/expenses that can be completely attributed to the production of a specific good or service. Some direct costs:

- Material costs required to produce a specific product or goods, for example steel in car manufacturing
- Direct labour costs required to produce a specific product or services

### Indirect Costs

Indirect costs are costs that are not directly attributable to a cost object (such as a particular project, facility, function or product). These are those costs which are not directly related to production. Some indirect costs may be overheads. Some overhead costs can be directly attributed to a project and are direct costs. Indirect costs may be either fixed or variable. Some indirect costs:

- Administration staff
- Security costs
- Rent

## USING THE UNIT COSTING TOOL

### Employee Expenses

- **Position** – Position/Classification of the employee
- **Total remuneration** - The total employee expenses which includes but not limited to wages, superannuation and other expense
- **Annual Working hours** – Actual output hours, this does not include paid entitlement hours such as public holidays and personal leave
- **Number of officers** – Number of the officers within the same position/classification and total annual remuneration.
- **Allocation of Working hours** – This is the allocation of working hours of employees in the same position/classification on the output. The unallocated portion will be automatically allocated to administration.

### Other Expenses

- **Expenditures** – The label/classification of the non-employee expense.
- **Amount** – The amount of the corresponding expenses.
- **Activities** – The allocation of the expenditure, indirect costs are to be allocated to administration.

### Summary

- **Activity/Product** – The label/classification of the services/product
- **Employee Hours** – The allocated working hours as calculated in the “Employee Expenses” section.
- **Other Expenses** – The allocated costs/expenses as calculated in the “Other Expenses” section.
- **Allocated Admin Expenses** – The admin expenses (employee expenses and other expenses) are allocated depending on the proportion of the output hours on each services/product.
- **Total Expenses** – The sum of allocated administration expenses, employee expenses and other expenses on each product/service.
- **Number of Units** – The number of allocated working/output hours of each product/service, working/output hours on administration are not taken into consideration.
- **Unit Cost** – Total expense divided by the number of units