**The Standard Cost Accounting at Hitchcock, Kubrick, and Lean Inc.**

The **standard cost accounting** system was the driving force behind manufacturing enterprises' management control and decision-making processes during the 20th century. Managers of large, complex enterprises relied – and still rely – on this system to provide correct information to help them make critical operational decisions.

The standard cost accounting method uses **a cost driverthat drives or allocates overhead costs to specific products**. For example, a cost driver often used by standard cost accounting is **direct labor cost**. In this case, the **overhead is allocated among the various products in proportion to the labor cost** incurred in building these products. In general, **the cost driver's choice depends on the business's nature.**

Standard cost accounting is an **absorption costing****method that attempts to absorb all production costs into the product cost.** Absorption accounting is a Generally Accepted Accounting Principle (GAAP) requirement in the U.S. for external financial reporting and tax returns. Most countries follow the International Financial Reporting Standards (IFRS) for external financial reporting and tax returns. The IFRS also encourages the use of absorption costing for external reporting.

The following case study is based on an incident reported in The Haystack Syndrome3 and Synchronous Management, Volume 14.

In standard cost accounting, indirect costs are allocated to the product based on the volume of the cost driver they have consumed. There may be more than one single cost driver. The cost driver could be other than labor costs based on the nature of the business.

**HKL, Inc.** Three home-maintenance specialists, A. Hitchcock, S. Kubrick, and D. Lean, have banded together to form HKL, Inc., based in New Orleans, Louisiana, where demand for home maintenance services is high. HKL offers the following types of services: Plumbing (Product-1), Window Cleaning (Product-2), Gutter Guard Installation (Product-3), and Landscaping (Product-4).

The total monthly wages for these three men is $18,000, including benefits. These wages are categorized as administrative overhead costs. The non-administrative overhead costs, including rental charges, truck fleet maintenance, marketing & advertising, and depreciation, amount to $9,000 monthly.

**Administrative costs = 18,000 per month. Non-administrative costs =9,000 per month.**

HKL is seeing ample demand for all its products, but there is a shortage of qualified workers. Adhering to a motto, "Teach Your Children Well," that they have preached ever since their younger days, Hitchcock, Kubrick, and Lean have employed their children, five high-school graduates, to run their home maintenance operations.

These **five employees** are **each** paid a competitive salary of **$2,000** **per month,** including benefits. In return, the employees are each expected to work **200 hours a month**, giving HKL a **total of 1,000 hours of available capacity**. **HKL has thus fixed its labor rate to be $2,000/200 = $10 per labor hour**. The following table presents the current demand, the average time per job, and some revenue/cost data for the services offered by HKL based on data gathered over the past six months and the current number of jobs that HKL completes each month for each type of service.



HKL currently completes an average of 90 Plumbing, 70 Window Cleaning, 80 Gutter Guards, and 60 Landscaping jobs monthly. For this output level, HKL uses up (90 x 2 + 70 x 4 + 80 x 3 + 60 x 5) = 1,000 hours of labor, which effectively accounts for all the available capacity.

Based on this data, HKL assigns labor costs to the four products as follows: Plumbing takes 2 hours per job, so the labor cost for a Plumbing job at a labor rate of $10 per hour is $10 x 2 = $20 per job. The labor costs for the other three products are, Window Cleaning: $40, Gutter Guards: $30, and Landscaping: $50.

HKL uses standard cost accounting to spread the administrative and non-administrative overhead costs. The cost driver chosen by HKL is the monthly production volume. Currently HKL is completing (90 + 70 + 80 + 60) = 300 jobs a month. Hence, each job is allocated an administrative overhead cost of $18,000/300 = $60.00. Similarly, each job is allocated a non-administrative overhead cost of $9,000/300 = $30.00.

1. Using Standard costing, compute the profit of each of the four products under the current production plan of Prod-1 (90), Prod-2 (70), Prod-3 (80), and Prod-4(60).
2. Compute the total profit under this plan.
3. Given the available market of Prod-1 (250), Prod-2 (160), Prod-3 (145), and Prod-4 (120), in the framework of standard costing, what is your proposed optimal production plan? How many of each job do you accept and deliver? Prod-1 (?), Prod-2 (?), Prod-3 (?), and Prod-4 (?).
4. How much profit do you make under your proposed optimal production plan?