**Decision making:** Costs are classified to enable the management to take a specific course of action among the various alternatives available.

**Control:** Costs are classified for the purpose of exercising control on these costs. This is to effect cost reduction and management.

**Method of Cost Classification**

1. **CLASSIFICATION BY ELEMENT**
   
   **A. MATERIAL COST**
   
   i. Direct material cost
   ii. Indirect material cost
   
   **B. LABOUR COST**
   
   i. Direct labour cost
   ii. Indirect labour cost
   
   **C. EXPENSES**
   
   i. Direct expenses
   ii. Indirect expenses

2. **CLASSIFICATION BY IMPACT/RELATIONSHIP**

   a. Direct cost: The cost can be easily traced to a cost. Example includes direct material, direct labour and direct expenses.
   
   b. Indirect cost: Cost that cannot be easily traced to a particular unit of a product. Example includes indirect material, indirect labour and indirect expenses.

3. **CLASSIFICATION BY FUNCTION**

   This refers to the classification of cost according to activities;

   a. Manufacturing: as a result of manufacturing activities.
   
   b. Administrative expenses: for running the business salaries and all expenses incurred in the office.
   
   c. Financial costs: incurred when the company wants to raise capital e.g. interest