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.

<u>Method of Cost Classification</u>

1. **CLASSIFICATION BY ELEMENT**

A. MATERIAL COST

i. Direct material cost

ii. Indirect material cot

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