

# Prime and Conversion Costs

Accounting presentation created by  
Rex A Schildhouse  
2015-01-01  
[www.schildhouse.com](http://www.schildhouse.com)



# Prime and Conversion Costs

- There are three costs associated with manufacturing a product.
- In the correct order, they are:
  - Direct materials,
  - Direct labor, and
  - Factory or manufacturing overhead.

# Prime and Conversion Costs

- Prime costs are “direct costs.” They are either of two categories:
  - Direct materials or
  - Direct labor.

# Prime and Conversion Costs

- Prime (Direct) material costs:
  - Direct costs are visible and more than immaterial.
  - Direct costs are normally items listed in the Bill of Materials (BOM).
  - The windshield of a car is a direct cost of manufacturing a car.
- Direct costs can be traced (seen) moving through production.

# Prime and Conversion Costs

- Indirect material cost examples are:
  - The cost of grease on the hinge of the car door.
  - The grease on the production machine to keep it operating properly.
- These are not values in the prime or direct costs.

# Prime and Conversion Costs

- Prime (Direct) labor costs are only the cost of those working on the assembly, the “blood, sweat, and tears” crew is direct labor.
- Supervisors, material movers, quality assurance, and the janitor, all necessary for production, are indirect labor costs and not a value within prime costs.

# Prime and Conversion Costs

- Conversion costs answer a question.
- What does it cost to convert material from one state to another state?
- This question does not involve the cost of the material itself. Therefore conversion cost is only direct labor and factory / manufacturing overhead.

# Prime and Conversion Costs

- In summary –
  - Prime costs are direct materials and labor. Prime costs do not include factory / manufacturing overhead.
  - Conversion costs are the cost of converting a material from one state into another. It is direct labor and factory / manufacturing overhead. It does not include direct materials.



# Prime and Conversion Costs

The end.