Indication of a Value – The Concept of Cost

'You are required to put a cost on it!' This is a common phrase that is used as a general dialect now and then. So, what does it mean? It means putting value on something. Thus, the cost is nothing but a payment of value that is given in order to utilize the service or goods. The concept of cost gives an indication of the overall resource required to avail the same.

Cost is thus another vital concept in the study of business, so, without further ado let us start digging into its concept.

Concept of Cost in Cost Accounting

The concept of cost is a key concept in Economics. It refers to the amount of payment made to acquire any goods and services. In a simpler way, the concept of cost is a financial valuation of resources, materials, risks, time and utilities consumed to purchase goods and services. From an economist's point of view, the cost of manufacturing any goods and services is often said to be the concept of opportunity cost.

With heightened competition in today's world, companies are urged to make maximum profits. The company's decision to maximize earnings relies on the behavior of its costs and revenues. Besides the concept of opportunity cost, there are several other concepts of cost namely fixed costs, explicit costs, social costs, implicit costs, social costs, and replacement costs.

Hence there are several different types of concepts of cost, which have been discussed in the following.

Types of Cost Concept

The idea behind the concept of opportunity cost is that the cost of one item is the lost opportunity to do something else. For example, by being married to a person, one could lose the opportunity to marry some other person or by investing more capital in video games, one might lose the opportunity in watching movies.

The concept of cost can be effortlessly comprehended by classifying the costs. The process of grouping costs is based on similarities or common characteristics. A well-defined classification of costs is certainly essential to mention the costs of cost centers. The different types of cost concepts are:

1. Outlay costs and Opportunity costs
2. Accounting costs and Economic costs
3. Direct/Traceable costs and Indirect/Untraceable costs
4. Incremental costs and Sunk costs
5. Private costs and social costs
6. Fixed costs and Variable costs

Based on the Nature of Expenses

On the basis of nature, the following are the two types of cost:

- **Outlay Costs**

  The authentic payments undergone by an entrepreneur in employing input are known as outlay costs. It includes costs on payments of fuel, rent, electricity, etc.

- **Concept of Opportunity Cost**

  It is the value of the next best thing you give up whenever a decision is made by you.

Classification in Terms of Traceability

On the basis of traceability, the types of costs are:

1. **Direct Costs**

   A direct cost is a cost that is related to the production method of a good or service. It is the opposite of an indirect cost.

   These costs are related to a certain product or a process. They are also known as traceable costs as they could be traced to a specific activity. It is the opposite of an indirect cost.

2. **Indirect Costs**

Indirect costs are expenses that could not be traced back to a single cost object or cost source. They are also known as untraceable costs. However, they are extremely important as they affect the total profitability.

Concept of Costs in Terms of Treatment

1. **Accounting Costs**

   Accounting costs are direct costs. They are also known as hard costs. The entrepreneur pays the cash directly for obtaining resources for production. It includes the cost of prices that are paid for the machines and raw materials, electricity bills, etc. These costs are treated as expenses.

2. **Economic Costs**

   The economic cost is the combination of gains and losses of the products. This cost is mainly used by economists to compare one with another.

Classification based on the Purpose

1. **Incremental Cost**

   Incremental costs are the changes in future costs and that will occur as a result after a decision is made.

2. **Sunk Costs**

   Sunk costs are the costs that cannot be recovered after sustaining. It includes the amount spent on conducting research and advertising.

Types of Cost Concept based on Players and Variability

1. **Based on Payers**

   Private cost implies the cost that is sustained when an individual produces or consumes something. The business person spends his/ her own private or business interests. The social cost is the cost to an entire society that results from a news event or a change in the policies.

2. **In Terms of Variability**

As the term predicts, fixed costs don't change in the volume of output. These costs are constant even with an increase or decrease in the volume of services/ goods produced or sold. Variable costs, in simple words, are a cost that varies according to the outcome of the output. Higher production costs higher expenses and lower production costs lower expenses. If the production is more, the business will pay more and vice versa.

Did You know?

The Institute of Cost Accountants has constituted the Cost Accounting Standards Board (CASB) to procure suggestions and uniformity in Costing. The board has issued 24 standards to create a better knowledge of distinct components of cost and better procedures to be used. The idea of opportunity cost in the concept of the cost was first begun by John Stuart Mill, a major in Economics.