Costing in Service and Manufacturing Entities

Definitions

Absorption costing - costing system that is used in valuing inventory. It includes the cost of materials and labour, variable and fixed manufacturing overhead costs.

> Components of Absorption Costing:
> Direct material (DM)
> Direct labour (DL)
> Variable manufacturing overhead (VMOH)
> Fixed manufacturing overhead (FMOH)
>
> Under absorption costing, variable selling and administrative;
> Fixed selling and administrative are considered period costs and do not go into the cost of a product. They are, instead, expensed in the period occurred

Differential Cost is also known as ‘incremental cost’. It is the difference in total cost that will arise from the selection of one alternative to the other. It is an added cost of a change in the level of activity.

Direct Costs are those which can be identified easily and indisputably with a unit of operation or costing unit or cost centre. Costs of direct material, direct labour and direct expenses can be directly allocated or identified with a particular cost centres or a cost unit and can be directly charged to such cost centre or cost unit. These costs are also called ‘traceable costs’.

Historical cost is the actual cost, determined after the event. Historical cost valuation states costs of plant and materials, for example, at the price originally paid for them.

Indirect Costs cannot be allocated but which can be apportioned to cost centres or cost units. These costs are also called as ‘common costs’. The indirect costs are not traceable to any plant, department, operation or to any individual final product. All overhead costs are indirect costs.

Job order costing is a cost accounting system in which direct costs are traced, and indirect costs are allocated to unique and distinct jobs instead of departments. It is appropriate for businesses that provide non-uniform customized products and services. Examples of Job Order Costing: a company that designs and produces custom-made machines or machine tooling; a company that constructs custom-designed buildings; a company that modifies trucks to meet customer unique needs.

Labour cost includes salaries and wages paid to permanent employees, temporary employees and also to employees of the contractor.

Material Cost is the cost of material of any nature used for the purpose of production of a product or a service. Material cost includes cost of procurement, freight inwards, taxes and duties, insurance etc. directly attributable to the acquisition. Trade discounts, duty drawbacks, refunds and other similar items are deducted in determining the costs of material.

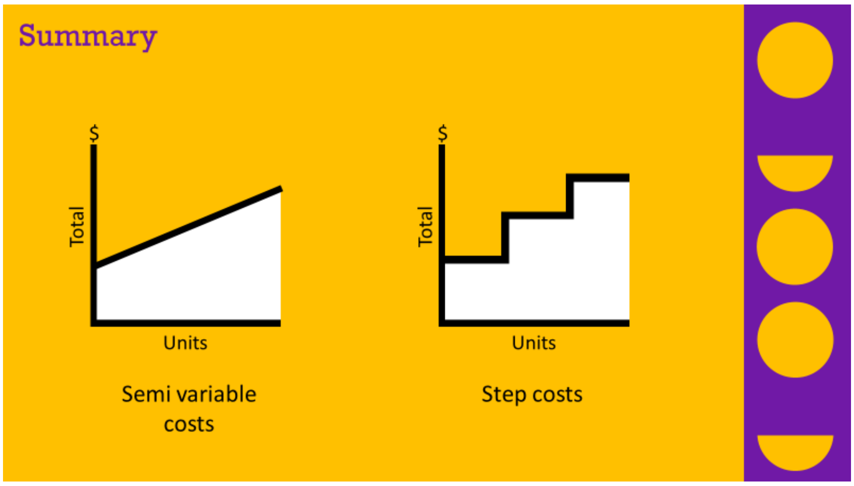
Marginal Costing - Is a costing technique wherein the marginal cost, i.e. variable cost is charged to units of cost, while the fixed cost for the period is completely written off against the contribution.

> Q: Can you provide the examples of the companies which use this method? If not, why?
> Answer: IFRS prohibits to apply this method and to include it in income statement and in balance sheet. So, there is no such examples. Companies can only use this method theoretically what in fact is illegal.
> Q: How marginal costing method can be used in business decision making?
> Answer: It is useful in decision making about fixation of selling price, replacement of machines, discounting a product or service, export decision and make or buy decision.

Predetermined Cost is the cost relating to the product are computed in advance of production, on the basis of a specification of all the factors affecting cost and cost data. Predetermined costs may be either standard or estimated.

Semi-fixed cost is a cost that contains both fixed and variable elements. As a result, the minimum cost level that will be experienced will be greater than zero. Once a certain activity level is surpassed, the cost will begin to increase beyond the base level, since the variable component of the cost has been triggered

Step fixed cost - is a cost that does not change within certain high and low thresholds of activity, but which will change when these thresholds are breached.



Variable costing - a concept used in managerial and cost accounting in which the fixed manufacturing overhead is excluded from the product-cost of production. In accounting frameworks such as GAAP and IFRS, variable costing is not allowed in financial reporting (in accordance with the accounting standards for external financial reporting, the cost of inventory must include all costs used to prepare the inventory for its intended use.