

MEANING OF COST

COST represents a sacrifice of values, a foregoing or a release of something of value. It is the price of economic resources used as a result of producing or doing the thing costed. It is the amount of expenditure incurred on a given thing. Cost has been defined as "the amount measured in money or cash expended or other property transferred, capital stock issued, services performed or liability incurred in consideration of goods or services received or to be received". By cost, we mean the actual cost i.e. historical cost. ICWA (UK) defines cost as the amount of expenditure (actual or notional) incurred on, or attributable to a specified thing or activity.

Q.1. What is Cost?

[5 Marks]

CLASSIFICATION OF COST

Cost classification is the process of grouping costs according to their common features. Costs are to be classified in such a manner that they are identified with cost centre or cost unit. The following chart shows the classification of cost :

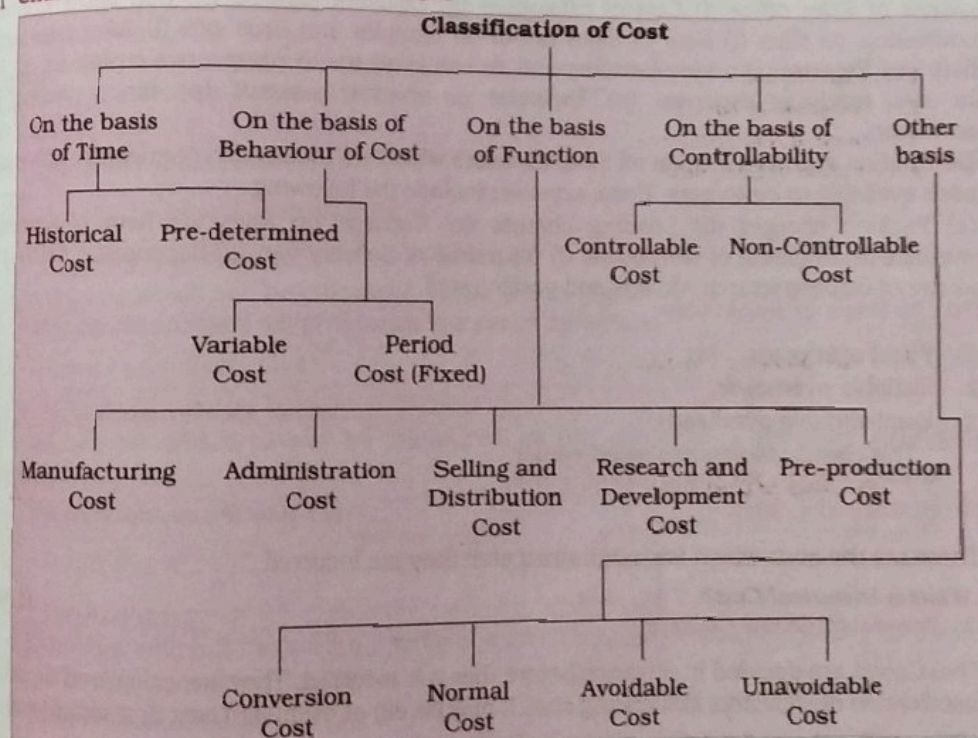
2.1 Chart Showing Classification of Cost

Fig. 11.1

2.1.1 Overheads or On Cost or Burden or Supplementary Cost

Aggregate of indirect cost is referred to as overheads. It arises as a result of overall operation of a business. According to Weldon, overhead means "the cost of indirect material, indirect labour and such other expenses, including services as cannot conveniently be charged direct to specific cost units. It includes all manufacturing and non-manufacturing supplies and services.

[5 Marks]

Q.2. What is Overheads Cost?

Classification of Overheads**A. On the Basis of Functions**

- 1. Factory Overheads :** It is the aggregate of all the factory expenses incurred in connection with manufacture of a product. These are incurred in connection with running of factory. It includes the items of expenses viz., factory salary, work manager's salary, factory repairs, rent of factory premises, factory lighting, lubricants, factory power, drawing office salary, haulage (cost of internal transport) depreciation of plant and machinery unproductive wages, estimation expenses, royalties, loose tools w/off, material handling charges, time office salaries, counting house salaries etc.

[5 Marks]

Q.3. What is Factory Overheads?

2. Administrative Overheads or Office Overheads : It is the aggregate of all the expenses as regards administration. It is the cost of office service or decision making. It consists of the following expenses : Staff salaries, printing and stationery, postage and telegram, telephone charges, rent of office premises, office conveyance, printing and stationery and repairs and depreciation of office premises and furniture etc.

Q. 4. What is Administrative Overheads?

[5 Marks]

3. Selling and Distribution Overheads : It is the aggregate of all the expenses incurred in connection with sales and distribution of finished product and services. It is the cost of sales and distribution services.

Q. 5. What is Selling and Distribution Overheads?

[5 Marks]

Selling expenses are such expenses which are incurred in acquiring and retaining customers. It includes the following expenses :

(a) Advertisement (b) Show room expenses (c) Travelling expenses (d) Commission to agents, (e) Salaries of Sales office (f) Cost of catalogues (g) Discount allowed (h) Bad debts written off (i) Commission on sales (j) Rent of Sales Room (k) Samples and Free gifts (l) After sales service expenses (m) Expenses on demonstration and technical advice to prospective customers (n) Free repairs and servicing expenses (o) Expenses on market research (p) fancy packing and demonstration.

Distribution expenses include all those expenses which are incurred in connection with making the goods available to customers. These expenses include the following :

(a) Packing charges (b) Loading charges (c) Carriage on sales (d) Rent of warehouse (e) Insurance and lighting of warehouse (f) Insurance of delivery van (g) Expenses on delivery van (h) Salaries of Godownkeeper, drivers and packing staff.

B. On the Basis of Behaviour

1. Fixed overheads
2. Variable overheads
3. Semi-variable overheads

N.B. This classification is explained earlier.

2.1.2 Classification on the Basis of Time.

2.1.2.1 Historical Costs

These are the costs which are ascertained after they are incurred.

Q. 6. What is Historical Cost?

[1 Mark]

2.1.2.2 Pre-determined Costs

These costs are decided in advance before they are incurred. They are calculated on the basis of a specification of all factors influencing cost. It may be either estimated cost or standard cost.

Q. 7. What is Pre-determined Costs?

[1 Mark]

2.1.3 Classification on the Basis of Association with the Product

2.1.3.1 Product Costs or Variable or Direct Cost

These costs are those which are traceable to the product and included in inventory values. It is a full factory cost.

Q. 8. What is Product Cost?

[1 Mark]

2.1.3.2 Period Costs or Fixed Costs

These costs are incurred on the basis of time such as rent, salaries etc. They cannot be assigned to the product. Period costs are charged to the period in which they are incurred.

Q. 9. What is Period Costs?

[1 Mark]

2.1.4 On the Basis of Functions

An organisation performs many functions. Costs can be classified on the basis of function as follows :

2.1.4.1 Manufacturing Cost

It is the cost of operating the manufacturing department of an organisation. It includes cost of direct materials, direct labour, direct expenses, packing (primary) cost and overheads expenses relating to production.

Q. 10. What is Manufacturing Costs?

[1 Mark]

2.1.4.2 Administration Cost

It is the cost which is incurred for formulating the policy, directing the organisation and controlling the operations.

Q. 11. What is Administrative Cost?

[1 Mark]

2.1.4.3 Selling & Distribution Cost

It is the cost of stimulating demand. It includes advertisements, market research etc.

Distribution cost is incurred for distribution of products. It includes warehousing, cartage etc.

Q. 12. What is Selling & Distribution Cost?

[1 Mark]

2.1.4.4 Research and Development Costs

These costs are incurred to discover new ideas, processes, products by experiment. It includes the cost of the process which begins with the implementation of the decision to produce a new or improved product.

Q. 13. What is Research and Development Cost?

[1 Mark]

2.1.4.5 Pre-Production Costs

These costs are incurred when a new product is introduced. These costs are incurred for trial run. They are treated as deferred revenue expenditure. They are charged to the cost of future production.

Q. 14. What is Pre-production Cost?

[1 Mark]

2.1.5 On the Basis of Controllability**2.1.5.1 Controllable Cost**

It is the cost which can be influenced by the action of a specified member of an organisation. This can further be analysed with reference to a particular person.

Q. 15. What is Controllable Cost?

[1 Mark]

2.1.5.2 Non-Controllable Cost

It is the cost which cannot be influenced by the action of a specified member of an organisation.

Q. 16. What is Non-controllable Cost?

[1 Mark]

2.1.6 Other Basis**2.1.6.1 Normal Cost**

It is the cost which is incurred normally at a given level of output, in the conditions in which that level of output is normally attained.

Q. 17. What is Normal Cost?

[1 Mark]

2.1.6.2 Abnormal Cost

A cost which is not normally incurred at a given level of output in the conditions in which that level of output is normally attained.

Q. 18. What is Abnormal Cost?

[1 Mark]

2.1.6.3 Avoidable Cost

The cost which can be avoided under the present conditions is an avoidable cost.

Q. 19. What is Avoidable Cost?

[1 Mark]

2.1.6.4 Unavoidable Cost

The cost which can not be avoided under the present conditions is an unavoidable cost.

Q. 20. What is Unavoidable Cost?

[1 Mark]

Q. 25. How is cost classified on different basis?

[7/8 Marks]

3. DETERMINATION OF TOTAL COST

Cost of product is determined as per cost attach concept. Total cost of a product consists of various elements of cost which have the quality of coherence. All the elements of cost can be grouped and regrouped. Grouping and re-grouping of the various elements of costs leads to

significant divisions of cost. The logical process of determination of cost by grouping and re-grouping various elements is illustrated as follows :

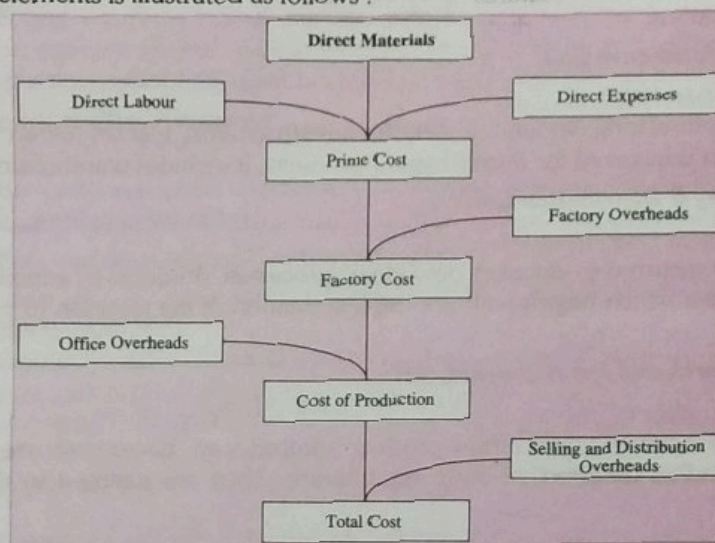


Fig. 11.2

Q. 22. What is the process of determination of total cost?

[5 Marks]

4. NON-COST ITEMS

Non-cost items are those items which do not form part of cost of a product. Such items should not be considered while ascertaining cost of a product. These are items included in Profit and Loss Account as per principles of Financial Accountancy but not related to product.

Incomes / Gains :

- i) Transfer fees
- ii) Interest received
- iii) Dividend received
- iv) Rental Income
- v) Profit on sale of fixed assets
- vi) Profit on sale of investments
- vii) Profit from speculation.

Expenses / Losses :

- i) Preliminary expenses written off
- ii) Goodwill W/off
- iii) Brokerage on issue of Shares / Debentures
- iv) Underwriting commission
- v) Discount on issue of Shares / Debentures
- vi) Interest on loans
- vii) Fines & Penalties
- viii) Loss on sale of fixed assets
- ix) Loss on sale of investments
- x) Expenses on criminal law suits
- xi) Interest on capital

Appropriations :

- i) Provision for taxation
- ii) Provision for dividend
- iii) Provision for dividend distribution tax
- iv) Transfer to various reserves.

Q. 23. What are Non-cost items ?

[7/8 Marks]

5. COST SHEET

For determination of total cost of production a statement showing the various elements of cost is prepared. This statement is called as a 'statement of cost' or 'cost sheet'. Cost sheet is a statement which provides for the assembly of the detailed cost of a cost centre or cost unit. It is a statement showing the details of the total cost of job, operation or order.

Q. 24. What is Cost Sheet?

[1 Mark]

Features of Cost Sheet

Cost sheet has the following features :

1. It relates to a particular product.
2. It relates to cost incurred during a particular period.
3. It may show total cost as well as per unit cost.
4. It may be based on actual data or estimated data.

Q. 25. What are the features of Cost Sheet?

[5 Marks]

6.1 Purposes of Cost Sheet

Cost sheet serves the following purposes :

1. It gives the break up of total cost under different elements.
2. It shows total cost as well as cost per unit.
3. It helps comparison with previous years.
4. It facilitates preparation of tenders or quotations.
5. It enables the management to fix up selling price.
6. It controls cost.

Q. 26. What are the purposes of cost sheet?

[5 Marks]

6. DIVISIONS OF COST

Prime Cost

It comprises of all direct materials, direct labour and direct expenses. It is also known as flat cost.

$$\text{Prime Cost} = \text{Direct Materials} + \text{Direct Labour} + \text{Direct Expenses.}$$

Works Cost

It is also known as factory cost or cost of manufacture. It is the cost of manufacturing an article. It includes prime cost and factory expenses.

$$\text{Works Cost} = \text{Prime Cost} + \text{Factory Overheads}$$

Cost of Production

It represents factory cost plus administrative expenses.

$$\text{Cost of Production} = \text{Factory Cost} + \text{Administrative expenses.}$$

Total Cost

It represents cost of production plus selling & distribution expenses.

$$\text{Total Cost} = \text{Cost of production} + \text{Selling \& Distribution Expenses}$$

Selling Price

It is the price which includes total cost plus margin of profit or minus loss, if any.

$$\text{Selling Price} = \text{Total Cost} + \text{Profit (- Loss)}$$

Q. 27. What are the different divisions of cost?

[5 Marks]

7. COMPOSITION OF SELLING PRICE

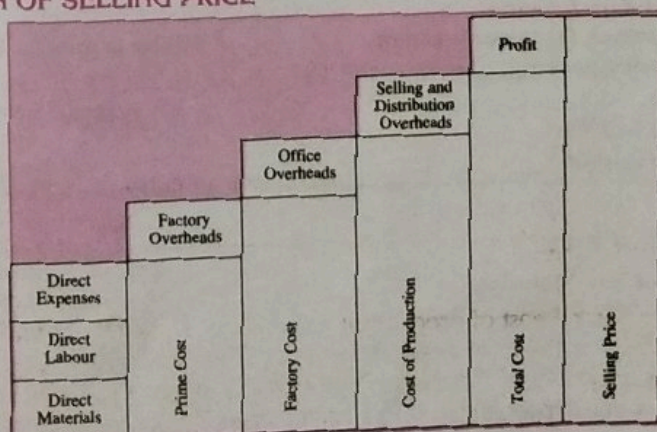


Fig. 11.3

Valuation of Stock

In costing stock may be valued at factory cost or at cost of production depending upon the policy of the organization.

$$\frac{\text{Valuation at Factory Cost}}{\text{Value of Closing Stock}} = \frac{\text{Factory Cost}}{\text{Production (Units)}} \times \text{Closing Stock (Units)}$$

Valuation at Cost Production

$$\text{Value of Closing Stock} = \frac{\text{Cost of Production}}{\text{Production}} \times \text{Closing Stock (Units)}$$

Q. 28. How is Closing Stock Valued?

[5 Marks]

8. TREATMENT OF CERTAIN ITEMS

Expenses	Examples	Treatment
1. Relating to purchase of Materials	1. Dock Charges 2. Import duty 3. Carriage 4. Cartage 5. Loading & unloading charges 6. Octroi, custom duty 7. Material returned to suppliers.	Should be added to Direct Material consumed. It should be deducted from Material cost.
2. Relating to preservation of Materials	1. Stores expenses 2. Normal Loss 3. Abnormal Loss 4. Sale of scrap or residue of defective goods or sale of salvaged goods.	Factory Overheads It is borne by good units. Excluded from cost statement. Deducted from factory overheads.
3. Relating to installation set up of machines	1. Set up cost 2. Inspection Cost	Treated as factory overheads Treated as factory overheads.
4. Relating to workers	1. Welfare expenses 2. Canteen expenses 3. Training expenses 4. Wages of Apprentices 5. Workmen's compensation insurance 6. Travel concession 7. Profit sharing bonus 8. Holiday pay	Treated as factory overheads. Treated as factory overheads Treated as factory overheads Treated as factory overheads Direct wages if wages are calculated after including the cost of benefits. Factory overheads if considered as additional cost.
Expenses relating to designs patterns, blocks	Expenses of block making, designs, drawings	Direct expenses if treated for a particular job. Otherwise considered as factory overheads.
Packing	Primary packing packing for transportation Fancy packing	Direct materials selling & distribution overheads.