

Cost center and Cost units

Cost centers

The cost center is a business unit that is responsible only for the costs it incurs. The cost center manager is not responsible for generating revenue or using the assets. Cost center performance is usually evaluated by comparing budgeted costs with actual costs. The costs incurred by the cost center can be grouped into a pool of costs and allocated to other business units, if the cost center performs services to other business units.

The cost center includes the location of production, service, job, activity, or plant component for which costs are determined one expensive device, and a set of these machines that can be extended to individual divisions or even the entire factory may be treated as a cost center in some cases.

The cost center can be set at a smaller level than the department. It could include a specific job, machine or assembly line. However, this more detailed view of cost centers requires a more detailed tracking of information, and therefore is not commonly used.

Usually, the focus of management at the cost center is on keeping expenses at a lower level, possibly using outsourcing, automation, or wage levels. The main exception is when the cost center indirectly contributes to profitability (such as R&D), in which case a certain minimum spend will be required to support sales.

Types of cost centers

(1) Production cost centers:

Production cost centers are the cost centers directly involved in the manufacturing process. Examples include forming, cutting, assembling, forming, welding, binding, cutting, etc.

(2) Service cost centers:

Service cost centers are incidental to the production process as products or cost units do not produce them. But this is necessary even though it is necessary. Examples are canteen, employees, warehouse, boiler, maintenance, etc. Any cost incurred or charged to cost of service centers later must be redistributed to production cost centers to absorb overheads in total product costs.

Uses of Cost and Profit centers

- It allows business to compare performance between departments / across products / brands etc.
- This allows businesses to make decisions about areas with poor performance
- If the cost center is determined to do a good job, companies may want to focus on the reasons behind this
- It allows a more focused study of corporate finance
- Performance can be measured
- Responsibility for the cost center will motivate the responsible individual
- By placing responsibility with the person involved in the activity, financial resources can be managed more efficiently than would be the case if there was a more distant manager who controlled it.

Advantages of Cost and Profit centers

- Financial reasons - allow you to manage and control money. It allows businesses to identify the most profitable areas
- Organizational reasons - help organize departments and resources
- Motivational reasons - motivate managers and workers

Disadvantages of Cost and Profit centers

- In practice, it may be difficult to allocate costs to a specific department / center
- Cost centers may increase pressure and pressure on employees
- Senior managers may not be able to tell if the cost center is working effectively / ineffective

Cost units

After confirming, accumulating, classifying, and recording costs, they must be linked to an appropriate measure of the quantity of the product or service. This measure of the quantity of a product or service is known as a "unit of cost".

A unit of cost is defined as the unit of the quantity of a product, service, or time (or a combination of these) in relation to the cost that can be verified or expressed. In other words, a unit of cost is a standard or unit of measure for manufactured goods or the service provided. The unit cost may be in number, length, area, weight, size, time, and value.

Characteristics of a Cost Unit

The unit of cost must possess the following characteristics:

- It must be one that spending can easily be linked to.
- It must be appropriate or natural to business operations and the product.
- It must be specific or definite and not change from time to time.
- The quotation should be easy to understand.
- It must have universal acceptance.

Types of Cost Units

Cost units can be divided into two parts:

(A) A simple unit: it involves the use of one standard or one unit of measure for manufactured goods, for example, per piece, per kilogram, per cent, per ton, per gallon, per meter, etc.

(B) Complex unit: It is a mixture of two simple units, for example, for each passenger-km, per ton-kilometer, per kilowatt-hour, etc.

The term of measurement used in cost units are number, area, volume, length, weight, time, value. Cost unit is always selected very carefully which depends on the nature of business operations the cost unit of steel is nationally ascertained in terms of per ton.

Difference between cost centers and cost units

BASIS FOR COMPARISON	COST CENTRE	COST UNIT
Meaning	Cost centre refers to a subdivision or any part of the organization, to which costs are incurred, but does not contribute to the company's revenues directly.	Cost unit implies any measurable unit of product or service, with respect to which costs are assessed.

BASIS FOR COMPARISON	COST CENTRE	COST UNIT
Use	It is used as a basis for classifying costs.	It is used as a standard for making a comparison.
Cost	Costs are collected and absorbed by cost units.	Measured and Expressed in terms of cost units.
Ascertainment	Ascertained as per the nature and technique of production process, organization size and structure.	Ascertained as per the nature of the final output and the existing trade practices.
Sequence	First	Second
How many?	Several cost centers are there, even if there is just one product or service offered.	Different cost units for different products or services.

The cost center means any location, division, person, or equipment within the organization that is responsible for incurring costs. Conversely, a unit of cost can be described as a measurable component of a product or service, for which cost is calculated.

The cost center acts as the basis for classifying costs, while the cost unit acts as a measure of comparison between standard cost and actual cost.

Cost centers are determined on the basis of the nature and techniques of the production process, and the size and structure of the organization. In contrast, cost units depend on the nature of the final product and existing business practices in the industry.

The cost center collects the costs that are absorbed by the cost unit. Conversely, they measure cost units and express the cost of the product in terms of cost units.

First, the entire organization is divided into different cost centers to check costs, after which they are absorbed by cost units.

Even if an organization produces only one product or provides only one service, it may have many cost centers. Against this, there are different cost units for different products or services.

Conclusion

Basically, cost centers are created to assist management activities such as budgeting, strategic planning, decision-making and monitoring. On the other hand, unit cost does not play such a role, as it is only a measure of cost expression.