Operating costing

It is an extension and refined form of process costing. It is also more or less very similar to single or output costing. The operating costing gives more emphasis on providing services rather than the cost of manufacturing an article. The services provided may be for sale to the general public or they may be provided within an organization.

The operating costing is also called as service costing, period costing or terminal costing. Service costing means rendering service to the public or to an organization for which cost is accumulated and calculated. Period costing means the costs data collected and calculated for a specific period. Terminal costing means a bus or truck of a transport undertaking chartered for a specific trip.

Definition

CIMA defines the method "operating costing applies where standardized services are provided by an undertaking'.

Unit of Cost

It is quite important to find out a proper unit of cost in case of operating cost so that the cost per unit can be ascertained. In certain cases the unit is obvious. For example in case of hospital it will be bed, in case of water works it will be 1000 liters, in case of electricity it will be a unit or kwh and in case of a retail store it will be the sale per Rs. 100 In case of transport concerns, however, the unit is likely to be composite. It may be a passenger-km. or ton-km signifying the effort which is made in carrying a passenger one kilometer or a ton of goods one km. Following are composite units based on two or more factors.

Services	*Composite units*
Transport – goods	Per ton km or per quintal – km.
Transport – passengers	Per passenger – km.
Hospital	Per patient – day or per bed – day
Hotel – lodging	Per Room – day or per service day
Canteen	Per meal or per plate
Boiler House	Per 1000 lbs. of Steam
Electricity	Per kilowatt – hours
Water supply	Per thousand litres
Educational Institution	Per student tution fees.

Features of operating cost

The main features of operating costs are as follows:

1. A commitment that depends on the cost of service does not produce any tangible goods. These pledges provide unique services to their clients.
2. Expenses are divided into fixed and variable costs. Such classification is necessary to ascertain the cost of the service and the unit cost of the service.
3. The unit of cost may be simple or complex. Examples of simple cost units are the unit cost in electricity supply, the cost of a liter of water supply, the cost of a meal in the cafeteria, etc. etc. are examples of the unit cost combined.
4. Average total cost was calculated based on the total amount of the service provided.
5. Costs are usually calculated by period. However, in the case of vehicle use, use of road vehicles etc., costs are calculated in order.
6. The cost of the service can be used for the service performed internally or externally.
7. Documents like daily record sheet, cost sheet, etc. are used to collect cost data.

Classification of Cost

Operating costs are classified and accumulated under the following three heads:

(A) Fixed or permanent fees:

These are inherently fixed expenses. For example, in the case of transportation, insurance, tax, license, and consumption service garage fees, it is a fixed cost. In the case of a hospital, the depreciation related to the cost of construction, equipment, family, family insurance, etc. is fixed fee. These expenses are fixed and are incurred regardless of the extent of service.

(B) Maintenance fees:

These are semi-variable costs and include expenditures on repair and maintenance, tires, tubes, accessories and parts.

(C) Operating or operating fees:

This is a variable cost. For example in the case of a hospital, the cost of the drug, diet, washing, etc. will represent operating fees. In the case of a gasoline or diesel transportation service, lubricating oil, driver or cleaner wages are either turned on or in operation.

Objectives of Operating Costing

The following are the objectives of operating/service costing:

(1) It is used to calculate the relevant operating cost.

(2) Summing the actual cost under different heads.

(3) Determine the price to be paid for providing the service to customers.

(4) Determine the specific policy of either using a private source or renting from abroad to provide services, especially in the case of transportation costs.

(5) To help the concern to take appropriate decision for reducing the service cost.

Application of Operating Costing

Operating costing is applied by an organization, which provides service to the public as a whole instead of manufacturing an article, and sells the same. For example, Transport undertaking electricity, theatre, hospitals, schools and the like. Similarly, the same type of an organization or cost center renders service to production departments. For example, Electricity, powerhouse, canteen etc.

The service cost in operating cost should be find out to understand whether an organization or cost center render services to others or sell the services to the general public. If the services are sold, the operating expenses and the extent of services rendered are taken into consideration to find out the service cost. On the other hand, if the services are sold, the service expenses should be apportioned to the production department on a suitable basis.

Generally, the basis may be the extent of service availed by the production departments. It may also become necessary to compare the cost of such a service with the cost of an outside service for deciding whether it is profitable to buy a service from outside rather than make the same available from within an organization.

How are services classified under Operating Costing?

The services may be classified into two categories under operating costing, namely

1. Internal service and
2. External service.

Internal service refers to rendering service to the production departments within an organization. External service refers to providing services to the general public uniformly. The object of both internal service and external service is the same.

Selection of Cost under Operating Costing

Cost is expressed in terms of the unit of service rendered. Though, operating cost is relating to units of costing the cost unit is not as tangible as a job or a contract. Any person cannot easily select a cost unit. Thus, the selection of cost unit requires more skill, technical and statistical talent on the part of the cost accountant.

The cost unit may be simple cost unit or composite cost unit. There is only one variable in the simple cost unit. For example, per bed in case of hospitals, a cup of tea or coffee in case of canteen, per room or per bed in case of lodge and the like. Two or more variables have a close relationship in the composite cost unit. Costs are collected in terms of composite cost units. For example, per tone km in case of transport (truck), per man show in case of cinema theatres, per passenger km in case of transport (passenger) and the like. Hence, the selection of suitable cost unit depends upon the nature of service.

Illustration

Union Transport Company supplies the following details in respect of a truck of 5-tonne capacity:

The truck carries goods to and from city covering a distance of 50 miles each way. While going to the city freight is available to the extent of full capacity.

Assuming that the truck runs on an average 25 days a month, work out:

(i) Operating cost per tone-mile, and

(ii) Rate per ton per trip that the company should charge if profit of 50% on freightage is to be earned.

Solution

(i) **Operating Cost Statement**

		Rs.	Per month Rs.	Per tonne-mile Rs.
1.	**Fixed Costs :**			
	Driver's wage	500		
	Cleaner's wage	250		
	Insurance	400		
	Taxes	200		
	General supervision	400	1,750	0.233
2.	**Running Costs :**			
	Diesel oil, etc.	750		
	Repairs & maintenance	500		
	Depreciation	750	2,000	0.267
			3,750	
			7,500	0.500

(ii) **Calculation of Freight Rate**

Cost per ton-mile	Re. 0.50
Profit per ton-mile	Re. 0.50
Freight rate per ton-mile.	Re. 1.00

Freight rate per trip both ways = 300 × Re. 1.00 = Rs. 300

Tonne-miles are computed as under :

(50 × 5) + (50 × 1) × 25 = 7,500 tonne-mile.