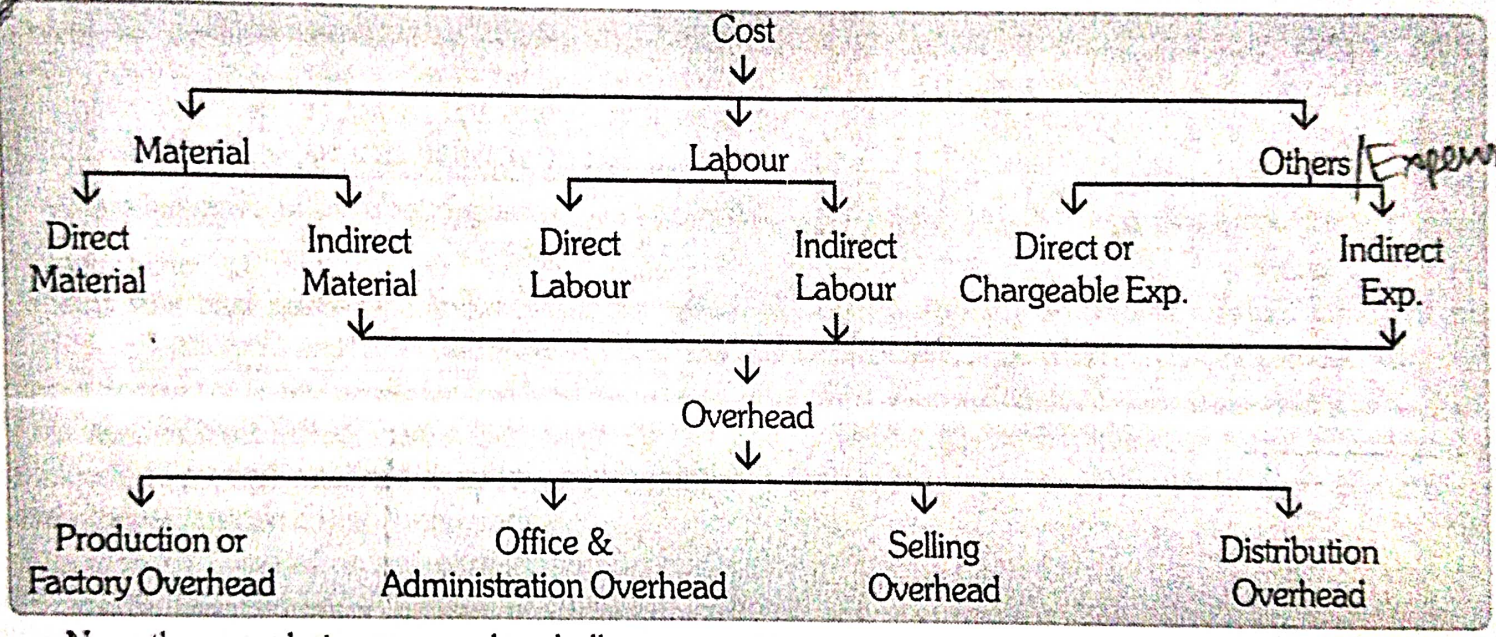
A more useful classification of Cost can be shown in the following table :–



Now, these are being summed up bellow :

1. Nature-wise Classification of Cost :

According to nature the cost of an output or product or services may be classified into two categories:

A. Direct Cost/Expenditure : Direct cost means the cost which can be conveniently indentified with or allocated to a particular cost centre or cost unit, i.e., job, product, contract, process or department. It is also known as Direct Expenditure.

Example : cost of raw-meterials (forming part of the product), wages of machine operators or converters (directly engaged in production) etc.

B. Indirect Cost/Expenditure : Indirect cost means the cost which can not be conveniently identified with a particular cost centre or cost unit, rather it is apportioned to different cost centres or cost units in total, on some equitable or scientific basis. It is also known as "Indirect Expenditure".

Examples : Cost of consumable stores, wages of foremen, factory rent, office expenses, salesman commision etc.

N.B. (a) A cost may be allocated or identified with a particular cost centre or cost unit before being apportioned to other cost centres or cost units. In such case it is a direct cost to one cost centre and indirect cost to other cost centre or cost unit. There is no clear -cut procedure for identification of direct and indirect cost in every factory. Moreover, sometimes the process of identification of direct and indirect cost become so costly, time consuming and labourious, so that some cost may be considered as indirect cost instead of taking as direct cost, e.g., thread used in a particular shirt in tailoring company, nails/ screws used in shoes in shoe company, glue & colour used in carpentory shop are athough direct in nature but normally treated as indirect cost. Apart from this, if an item of cost is of negligible amount then it is usually considered as indirect cost instead of charging it as direct cost.

(b) The summation of all direct costs of a product, goods or service is known as prime cost. Whereas, the summation of all indirect costs is known as overhead.

Difference between Direct Cost / Expenditure and Indirect Cost/Expenditure :

The main differences between direct and indirect costs are stated below :

Points	*Direct Cost*	*Indirect Cost*
(i) **Identification**	Direct cost can be conveniently identified with and directly charged to cost centres or cost units.	Indirect cost can not be conveniently identified with and can not be directly charged to cost centres or cost units.

Points	Direct Cost	Indirect Cost
(ii) Nature of Cost	These are specific cost for the cost units and not the common/joint cost to be apportioned among cost centres/ cost units.	These are the common/joint cost to be apportioned among cost centres /cost units and cannot be specifically allocated to a particular cost centre or cost unit.
(iii) Treatment	These are included in prime cost.	These are included in overhead charges.
(iv) Function	These are related to the production function only.	These are related to production, administration, selling and distribution function.

2. Element-wise Classification of Cost :

The elements that constitute the cost of manufacture of product, goods or service is known as elements of cost. The elements of cost are of three types—(a) Material, (b) Labour and (c) Expenses, Again each of these elements are sub-divided into two categories direct and indirect.

(a) Material Cost : Material means the substance from which goods are manufactured. These are bought by a firm from outside suppliers which include all goods and merchandise except immovable properties. Materials may be classified as direct and indirect. According to *Terminology of CIMA*, London, material cost is the cost of commodities supplied to an undertaking.

(i) Direct Materials : Direct Materials are those substance which can be directly indentified with, conveniently measured and directly allocated to a cost centre or cost unit, i.e., product, job, process, contract etc. Direct materials refer to those raw materials that form an integral part of the finished product. This can be separately indentified in product cost. Moreover, it varies directly and proportionately with the volume of production. According to the ***Terminology of CIMA*, London,** direct material cost is "the cost of materials entering into and becoming constituent elements of a product or saleable service and which can be identified separately in product cost."

Examples : Cotton in the production of cloth, cloth in garment, clay in bricks, leather in shoes, steel in machines, timber in furniture etc are the direct materials.

(ii) Indirect Material : Indirect Materials are those substances which cannot be directly allocated but apportioned to or absorbed by cost centres or cost units. According to the ***Terminology of CIMA*, London,** indirect materials cost is that "materials costs which are not charged directly to a product, e.g., coolant, cleaning materials." Therefore, The cost of materials, supplies, stores etc which cannot be identified with, conveniently measured and directly charged to a cost unit, i.e., product, job, contract, process etc, rather incurred in the course of production generally for a number of units. Again, it does not vary with the volume of production. All materials other than direct materials are considered as indirect material. Generally, these are the component of factory overhead.

Examples : lubrication oil, pins, nuts & bolts, screws, coal, soap, gum, cotton waste etc. are indirect materials.

(b) Labour Cost or Wages : Labour may be defined as human effort by the application of which utility is created. Labour cost means the cost of remuneration (i.e. wages, salaries bonus, commission etc.) of the employees of an undertaking. Again labour cost means the amount paid or payable for the workers or employees (other than those engaged in capital products or construction of assets) employed directly or indirectly in the production process for conversion of materials into finished products. Like materials, labour cost may also be classified as direct and indirect. According to ***Terminology of CIMA*,** London, labour cost is "the cost of remuneration, i.e., wages, salaries, commissions, bonus, etc. of employees of an undertaking."

(i) Direct Labour : Direct Labour refers to direct wages paid to the workers (both skilled and

unskilled) who are directly engaged in converting raw materials into finished product. According to **CIMA, London**, direct labour cost means, "the cost of remuneration for employees , efforts and skilled applied directly to a product or saleable service and which can be identified separately in product cost." Again direct labour means the amount of wages which can be directly identified with and allocated to cost centres or cost units.Direct labour is also termed as Productive Labour, Process Labour, Prime Labour, Production Labour, Operating Labour and so on.

Examples : Wages of bakers in bakery, shoe-makers in shoe-making, carpenters in carpentary shop, tailors in tailoring etc. are direct labour.

(ii) Indirect Labour : Indirect Labour refers to indirect wages pold to the workers who are not directly connected with the production Thus, it may be defined as wages which cannot be allocated rather apportioned to or absorbed by the cost centres or cost units. According to the ***Terminology of CIMA*, London,** indirect labour cost is the aggregate of those "labour costs, which are not charged directly to a product, e.g., supervision." They are not directly engaged in the conversion/ transformation of materials into finished product but in the auxiliary activities in different production process. All labour other than direct labour is called as indirect labour.

Examples : wages/salaries of foremen, supervisors, inspectors, cleaners, store-keepers, time-keepers,watchman, peon etc. are indirect labour.

(c) Service Cost or Expenses : Expenses refer to that portion of total cost other than material and labour cost which are involved in an activity for production of goods or rendering of services. It is the amount usually, paid or payable against certain services within the factory or not. According to the ***Terminology of CIMA*, London** other expenses are "the cost of services provided to an undertaking and the notional cost of the use of owned assets." These expenses may be of two types–direct and indirect.

(i) Direct Expenses : Direct expenses refer to those direct expenses other than direct materials and direct labour which are incurred on a specific cost unit. These are the expenses which can be easily identified or linked with the cost centres or cost units.Again the expenses which are directly allocated to a specific cost centre or cost unit can be easily traceable to a product or to some specific service is known as direct expenses.

Examples : Royalty on production, Hire charges of plant, job processing charges etc. are direct expenses.

(ii) Indirect Expenses : Indirect expenses refer to those expenses other than the nature of materials and labour which cannot be allocated to a particular cost centre or cost unit, rather can be apportioned to and absorbed by cost centres or cost units. According to the ***Terminology of CIMA*, London**, indirect expenses are those "expenses which are not charged directly to a product, e.g., building insurance, water rates." Thus, Indirect expenses are those expenses which cannot be conveniently identified with and directly charged to a specific cost unit, rather are incurred for getting different services. These type of expenses are apportioned among related cost units on some equitable bases. In most cases the indirect expenses are numerous.

Examples : rent, rates, taxes, insurance, depreciation, power; electricity; repairs and mainenance, canteen expenses; advertisement etc. are indirect expenses.

3. Behaviour-wise Classification of Cost :

According to behaviour, cost can be classified as : (a) Fixed cost; (b) Variable cost and (c) Semi-fixed/ semi-variable cost.

(a) Fixed Cost : A cost which remain fixed up to a certain level of output by fluctuation in volume of output or turnover is known as fixed cost. ***C.I.M.A London*** defines fixed cost as, "a cost which tends to be unaffected by variations in volume of output". The characteristic feature of fixed cost is that it remain fixed in total over a wide range of output but variable per unit with the change in volume of output. This cost is also known as period cost, stand-by cost,policy cost, capacity cost etc.

Example : rent, rate & taxes of factory & building ; salary or wages of staff; depreciation of plant and building; insurance; printing & stationery; advertisement; directors' fees etc are fixed cost.

(b) Variable Cost : A cost which tends to vary directly and proportionately with the change in the volume of output or turnover is known as variable cost. ***C.I.M.A, London*** defines variable cost as, "a cost which tends to vary with the level of activity." Thus variable cost is the aggregate of those items of cost which vary directly and proportionately with the level of activity or volume of output. The characteristic feature of variable cost is that it remain constant per unit but variable in total in direct proportion to changes in activity level. This cost is also known as non-fixed cost, changing cost, product cost, direct cost etc.

Examples : Direct materials; direct labour/ wages; chargeable expenses; power; fuel; consumable stores etc are variable cost. Thus, there exist a linear relationship between total variable cost and level of output.

(c) Semi-fixed/Semi-variable Cost : A cost that is partly fixed and partly variable, i.e., contains both fixed and variable elements is known as semi -fixed/ semi-variable cost. This type of cost is partly affected by fluctuations in the level of output and partly remain fixed up to a certain level of output. According to the ***Terminology of CIMA,*** **London,** semi-variable or semi-fixed cost is the "cost containing both fixed and variable elements and which is thus partly affected by fluctuations in the level of activity." This cost varies directly with the volume of output or level of activity but not proportionately. Because of the variable element it tends to vary with the volume of output and because of the fixed element it does not vary in direct porportion with the volume of output. Therefore, semi-fixed/semi-variable cost move in the same direction as that of output but not in same proportion.

Examples : Cost of supervision and inspection, maintenance & repair of plant & machinery; telephone expenses; power & light; depreciation; service department expenses etc./are semi-fixed/semi-variable expenses.

The Fixed Cost and Variable Cost Lines/Curves are shown as follows :

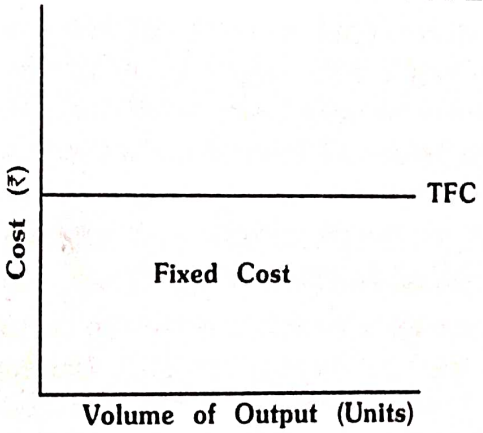


Fig.1 : Total Fixed Cost Lines

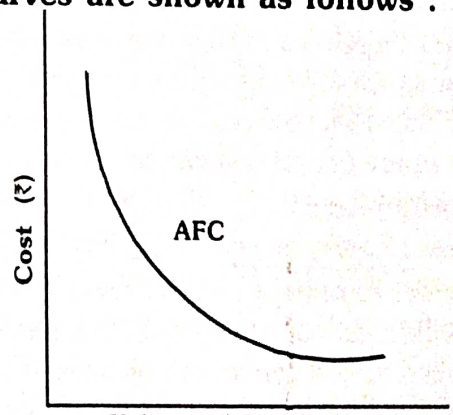


Fig 2 : Fixed Cost Per Unit

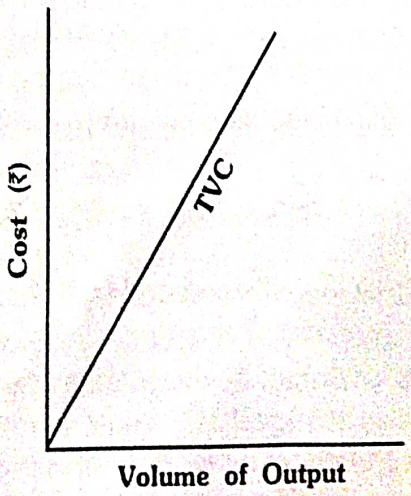


Fig 3 : Total Variable Cost Line

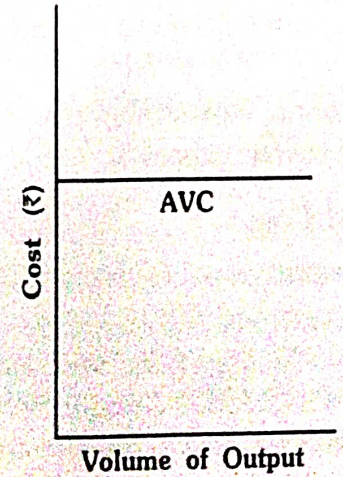


Fig 4 : Varibale Cost per Unit

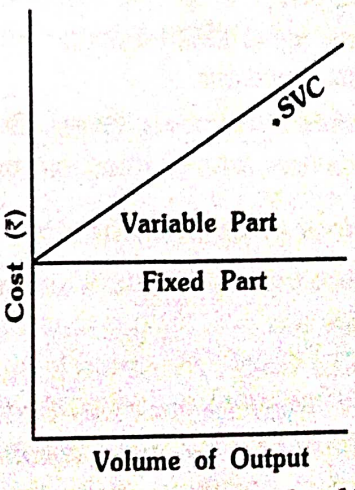


Fig 5 : Semi-Varibale Cost Line

Difference between Fixed Cost and Variable Cost :

The main differences between fixed cost and variable cost are stated below :

Points	*Fixed Cost/ Expenses*	*Variable Cost/ Expenses*
1. **Definition**	Fixed cost means the cost which tends to be unaffected by variation in volume of output.	Variable cost means the cost which varies directly and proportionatily with the change in volume of output.
2. **Features of Cost**	It is known as period cost, stand by cost, policy cost or capacity cost.	It is known as product cost, direct cost, marginal cost or changing cost.
3. **Nature of Total Cost**	Total fixed cost is always remain fixed and does not change with the change in volume of output and therefore TFC Curve is a straight line paralled to horizontal axis.	Total variable cost is always change with the change in volume of output and therefore TVC curve is upward risning straight line passing through the origin.
4. **Nature of Average Cost**	Fixed cost per unit change inversely with the volume of output and therefore AFC curve is downward slopping convex curve in the form of rectangular hyperbola.	Variable cost per unit is always fixed whatever the output produced and therefore Average variable cost (AVC) curve is a straight line paralled to horizontal axis.

4. Function-wise Classification of Cost :

According to Function cost may be classfied as production, administration, selling, distribution, research, development and financing.

(a) Production Cost : Production cost consists of all direct expenses, such as direct material, direct labour, direct expenses and factory overheads, such as indirect materials, indirect wages and indirect expenses incurred in the process of production. According to the ***Terminology of CIMA*, London,** production cost is the "prime cost plus absorbed production overhead." Therefore, it is the cost of the sequence of operation which begins with supplying materials, labour and services and ends with primary packing of the product. The production cost is the cost incurred for total operation of manufacturing i.e., throughout the process of conversion of raw meterials into finished products. It is also termed as manufacturing cost, factory cost, works cost etc.

(b) Administration Cost : According to the ***Terminology of CIMA*, London,** the administration cost is the "cost of management, and of secretarial, accounting and administrative services, which cannot be directly related to the production, marketing, research or development functions of the enterprise." It refers to the cost of formulating the general policies and controlling the operations of a business firm.It is the nature of indirect expenses and related with the maintenance of office as well as the performance of various functions like planning, organising, directing, co-ordinating, controlling etc. Thus, it includes the cost of materials used in office, salaries paid to office staff and incurred any other expenses related to office and management functions.

Examples : Salary of office staff, office rent, rates and taxes, printing and stationery, accounts office expenses, lighting, office insurance, running and maintenance of office; depreciation of office building & furniture, postage, directors fees etc, are the administration cost.

(c) Selling Cost : It refers to the cost of securing orders, promoting sales and retaining the existing customers by keeping them satisfied. Simply, selling cost means those items of cost which are incurred for performing selling function. It is also termed as marketing cost. It is also preferred by ***CIMA, London***. According to the ***Terminology* of CIMA,** marketing costs is "the cost incurred in researching the potential markets and promoting products in suitably attractive forms and at acceptable price."

Examples : Advertisement and publicity, show-room expenses, rent, rates, taxes, insurance, maintenance of sales counters,sales promotion expenses; printing & stationery for selling, bad debts, cost of free samples/ gifts, expenses of fair exhibition, market research expenses; cost of quotation, cost of price list & catelogues

etc. are selling costs.

(d) Distribution Cost : According to the ***Terminology of CIMA, London,*** distribution cost is, the "cost incurred in warehousing saleable products and in delivering products to customers." It refers to the cost incurred in performing the distribution function. Distribution cost is the cost of sequence of operations which begins with making the packed product available for dispatch and ends with making the reconditioned returned empty package, if any, available for reuse. It includes the cost of warehousing the goods sold and delivering them to the customers. This is also known as post-sale delivery cost.

Examples : Final packing cost; warehousing cost, carriage outward; outward cartage & shipping cost; running and maintenance; repair & depreciation of delivery van; salary of cleaners & drivers of delivery van etc. are distribution costs.

(e) Research Cost : Research cost is, "the cost of original investigation undertaken in order to gain new scientific or technical knowledge and understanding not primarily directed towards any specific practical aim or application. It is the cost of searching for new or improved products, new application of materials or new improved methods. The ***CIMA, London*** defines the research cost on two basis – such as, (i) Applied and Basic. According to the ***Terminology of CIMA,*** research cost (applied) is "the cost of original investigation undertaken in order to gain new scientific or technical knowledge and directed towards a specific practical aim or objective; and research cost (basic) is "the cost of original investigation undertaken in order to gain new scientific or technical knowledge and understanding not primarily directed towards any specific practical aim or application". Therefore, research cost is the expenses incurred in connection with all research works relating to new method, process, technique, policy, product etc.

Examples : Salaries to research staff & scientists; materials used in the laboratory, running & maintenance of laboratory: payment to outside research organisation etc. are research cost.

(f) Development Cost : Development cost is the cost of the process which begins with the implementation of decision to produce or to employ a new or improved method and ends with commencement of formal production of that product or by that method. The development cost is incurred after completion of research works on the basis of decisions made by the management for the improvement, development, replacerment, renewal etc of factory product or process. According to the ***Terminology of CIMA, London,*** development cost is "the cost of using scientific or technical knowledge in order to produce new or substantially improved materials, devices, products, process, systems or services prior to the commencement of commercial production."

(g) Financial Cost : Financial cost means the cost incurred for financing the capital and other related expenses for such financing. As financing is done at modern times from different sources by adopting different procedures, thus financial cost includes a wide variety of items starting from the application for finance and ending with the use of such capital in appropriate cases.

Examples : Brokerage and commission for raising finance, interest on capital, dividend, deposit money, legal expenses for financing etc. are financial cost.

6. Classification of Cost on the basis of Normality :

According to the situation of expenses, cost may be classified in two categories. (a) Normal cost and (b) Abnormal cost.

(a) Normal Cost : Normal cost means the cost which is normally incurred at a given level of output in the condition in which such level of output is normally attained. According to the ***Terminology of CIMA*, London,** normal cost is "a cost at a given level of output in the conditions in which that lavel of output is normally attained." It is a part of cost of production. The items of such type of cost are normally incurred for production of output, goods or services in normal circumstances or conditions.

Examples : Material, labour and other expenses in normal courses.

(b) Abnormal Cost : Abnormal cost means the cost which is not normally incurred at a given level of output in the conditions in which such level of output is normally attained.Abnormal cost is excluded from the cost of production. The items of cost which are incurred in abnormal situations, conditions, reasons or circumstances are known as abnormal cost.

Example : Expenses incurred on circumstances arising out of natural calamities such as flood, earth quake, lighting firing etc, change of management policy etc are abnormal cost.

2.2. Distinctions between Direct Material and Indirect Material

The differences between direct and indirect material are discussed below:

Direct Material	Indirect Material
(i) The cost of raw materials that can be specifically attributed to or charged for any particular cost centre or cost unit is direct material cost.	(i) The cost of raw materials that cannot be directly charged for or attributed to any specific cost centre or cost unit is indirect material cost.
(ii) It is generally the cost of basic materials used in production that can be identified for a specific department or product.	(ii) It is generally the cost of incidental or auxiliary materials having alternative use which cannot be identified as being incurred for any specific department or product.
(iii) It is included in prime cost.	(iii) It is included in overhead and more specifically in factory or production overhead.
(iv) The cost of direct materials usually changes proportionately as a result of increase or decrease in volume of production.	(iv) The cost of indirect materials may or may not be increased or decreased with change in the volume of production. Even if it varies such changes are not proportional to the change in output.
(v) It is possible to directly ascertain the cost of direct materials for each unit of goods produced by dividing the total cost for this purpose by the total units used.	(v) Per unit cost of indirect materials is calculated in an indirect manner by apportioning the total cost of indirect materials to all the departments and finding out unit cost.

2.3. Distinctions between Direct Wages and Indirect Wages

The differences between direct wages and indirect wages are discussed below:

Direct Wages	Indirect Wages
(i) Labour cost or wages that can be specifically attributed to or charged for any particular cost centre or cost unit is direct labour cost or wages.	(i) Labour cost or wages that cannot be directly charged for or attributed to any specific cost centre or cost unit is indirect labour cost or wages.
(ii) It is generally the basic wages paid that can be identified for a specific department or product.	(ii) It is generally the incidental wages paid that cannot be identified as being incurred for any specific department or product.
(iii) Direct wages are included in prime cost.	(iii) Indirect wages are included in overhead and more specifically in factory or production overhead.
(iv) Direct wages generally change proportionately with changes in the volume of production.	(iv) Indirect wages may increase or decrease or remain unchanged with a change in the volume of production. If it changes such changes are not proportional to the change in output.
(v) Per unit direct wages can be directly ascertained by dividing the total direct wages by the number of units produced.	(v) Per unit cost of indirect materials indirectly calculated by apportioning the total cost of indirect materials to all the departments and finding out unit cost.

2.4. Distinctions between Fixed Cost and Variable Cost

The differences between fixed cost and variable cost are discussed below:

Fixed Cost	Variable Cost
(i) Costs which remain constant up to a certain activity level or level of output are fixed costs.	(i) Costs which change in most of the cases proportionately with any change in the volume of production are variable costs.
(ii) The amount of fixed cost is same at any level of production so long the activity level does not exceed the installed capacity or the maximum limit fixed. Even if output is nil fixed costs are to be incurred.	(ii) Total variable costs are different for different activity levels. There will be no variable cost if output is nil.
(iii) Per unit fixed cost gradually decreases with increase in volume of output and increases with fall in volume of output.	(iii) Per unit variable cost always remains the same irrespective of the volume of output.
(iv) Fixed cost is never included in prime cost. All elements of prime cost are variable in nature.	(iv) Variable costs are included in prime cost. Some variable costs which are indirect in nature are included in overhead.

2.5. Cost Sheet

A. Definition of Cost Sheet: A statement or sheet prepared in a systematic, logical and analytical manner to ascertain the total and per unit actual or notional cost of goods produced or to be produced or of service rendered or to be rendered is known as Cost Sheet. In this statement costs are shown in an analytical manner by dividing them basically into direct and indirect costs. Direct costs are segregated element-wise into direct materials cost, direct wages and direct other expenses. The summation of all direct costs is shown as prime cost.

On the other hand indirect costs are segregated function-wise into factory or works overhead, administration overhead and selling and distribution overhead and shown in the Cost Sheet as an addition to the Prime Cost.

B. Basic Components of Cost Sheet: The basic components of Cost Sheet are discussed as follows:

(i) Prime Cost: This term has already been discussed in Para 2.1.A$_1$. In Cost Sheet all direct costs i.e. cost of direct materials, direct wages and direct expenses are added to arrive at the prime cost. So Prime Cost = Direct Materials Cost + Direct Wages + Direct or Chargeable Expenses.

(ii) Works or Factory Cost: In Cost Sheet after showing the Prime Cost Works or Factory Cost is calculated. Works or Factory Cost is arrived at after adding factory or works overhead and opening stock of work-in-progress or semi-finished goods with the Prime Cost and deducting from that the closing stock of work-in-progress or semi-finished goods. Semi-finished goods lie in the factory. For this reason for arriving at the true factory cost of goods produced opening stock of semi-finished goods is added to the Prime Cost and closing stock of semi-finished goods is deducted from the same. So Factory or Works Cost = Prime Cost + Production or Factory Overhead + Opening Work-in-progress – Closing Work-in-progress.

(iii) Cost of Production: In Cost Sheet Cost of Production is shown by adding office and administration overhead with the Works or Factory Cost. So Cost of Production = Works or Factory Cost + Office and Administration Overhead.

(iv) Cost of Goods Sold: The next step in Cost Sheet is to calculate Cost of Goods Sold, which is arrived at after adding the value of opening stock of finished goods to the Cost of Production and deducting from that the value of closing stock of finished goods. This is done because generally all goods produced are not sold, a part of the finished goods produced remains in stock. In case there is no opening and closing stock of finished goods cost of production will be the cost of goods sold. So Cost of Goods Sold = Cost of Production + Value of Opening Stock of Finished Goods – Value of Closing Stock of Finished Goods.

(v) Cost of Sales: In Cost Sheet Cost of Sales is shown after Cost of Goods Sold. Cost of Sales is calculated by adding all overhead or indirect costs related to selling and distribution to the Cost of Goods Sold. In this context the difference between Cost of Goods Sold and Cost of Sales must be noted. The former is the cost before adjusting selling and distribution overhead while the latter is the cost after adjusting the same. So Cost of Sales = Cost of Goods Sold + Selling and Distribution Overhead.

(vi) Profit or Loss: Profit is the positive difference between total Sales Proceeds and Cost of Sales, whereas loss is the negative difference between these two. Profit or loss is shown at the concluding part of the Cost Sheet. So Profit = Total Sales Revenue – Cost of Sales and Loss = Cost of Sales – Total Sales Revenue.

C. Items not Included in the Cost Sheet: The following items of cost and revenue are not shown in a Cost Sheet.

I. Items of Cost: (i) Cash discount allowed, (ii) Interest paid on loan, (iii) Abnormal loss of machinery, etc., (iv) Preliminary expenses and goodwill or other intangibles written off, (v) Income tax and Sales tax, etc. These items are financial in nature and these are not taken into count in arriving at costing profit or loss.

II. Items of Income: (i) Interest received on investment, (ii) Cash discount received, (iii) Profit earned on sale of asset, (iv) Dividend received. These items are also financial in nature and so these are not considered in arriving at costing profit or loss.

D. Proforma or Format of Preparing Cost Sheet:

Cost Sheet or Statement of Cost for the period ended on .....

Particulars		Total Cost Rs.	Per Unit Cost Rs.
Direct Materials Consumed	Rs.		
Opening Stock of Raw Materials	.....		
Add: Purchase of Raw Materials (including import)	.....		
Add: Carriage / Freight Inward	.....		

	Rs.		
Less: Closing Stock of Raw Materials	.....		
Less: Raw Materials Returned	.....		
Less: Raw Materials Lost by Fire, etc.	.....		
Less: Raw Materials Sold as Scrap	.....		
	.....	.....	.....
Add: Direct Labour Cost or Wages		.....	.....
Add: Direct (Chargeable) Other Expenses		.....	.....
Add: Opening Work-in-progress at Prime Cost (if any)		.....	.....
		.....	.....
Less: Closing Work-in-progress at Prime Cost (if any)		.....	.....
Prime Cost		.....	.....
Add: Factory or Production or Works Overhead		.....	.....
Add: Opening Work-in-progress at Works Cost *		.....	.....
		.....	.....
Less: Closing Work-in-progress at Works Cost		.....	.....
Works or Factory Cost		.....	.....
Add: Office and Administration Overhead		.....	.....
Cost of Production		.....	.....
Add: Opening Stock of Finished Goods		.....	.....
		.....	.....
Less: Closing Stock of Finished Goods		.....	.....
Cost of Goods Sold		.....	.....
Add: Selling Overhead		.....	.....
Add: Distribution Overhead		.....	.....
Cost of Sales		.....	.....
Add: Profit or Less: Loss (Balancing Figure)		.....	.....
Sales or Selling Price		.....	.....

* If it is not mentioned whether the Work-in-progress is related to Prime Cost it must always be adjusted to the Works Cost because Work-in-progress or semi-finished goods usually lie in factory.

Note: [Where it is not needed to ascertain per unit cost, Cost Sheet can also be prepared with only one column of Total Cost.]

Illustration 2. Calculate Prime Cost, Factory Cost, Cost of Production, Cost of Sales and Profit from the following particulars :

	Rs.		Rs.
Direct materials	1,00,000	Depreciation :	
Direct wages	30,000	Factory Plant	500
Wages of foreman	2,500	Office Premises	1,250
Electric power	500	Consumable stores	2,500
Lighting : Factory	1,500	Manager's salary	5,000
Office	500	Directors' fees	1,250
Storekeeper's wages	1,000	Office stationery	500
Oil and water	500	Telephone charges	125
Rent : Factory	5,000	Postage and Telegrams	250
Office	2,500	Salesmen's salaries	1,250
Repairs and Renewals :		Travelling expenses	500
Factory Plant	3,500	Advertising	1,250
Office Premises	500	Warehouse charges	500
Transfer to Reserves	1,000	Sales	1,89,500
Discount on shares		Carriage outward	375
written off	500	Income-tax	10,000
		Dividend	2,000

Solution

STATEMENT OF COST AND PROFIT

		Rs.	Rs.
	Direct materials		1,00,000
	Direct wages		30,000
	Prime Cost		1,30,000
Add :	Factory Overheads :		
	Wages of foreman	2,500	

	Electric power	500	
	Storekeeper's wages	1,000	
	Oil and water	500	
	Factory rent	5,000	
	Repairs and Renewals—Factory Plant	3,500	
	Factory lighting	1,500	
	Depreciation—Factory Plant	500	
	Consumable stores	2,500	
			17,500
	Factory Cost		1,47,500
Add :	Administration Overheads :		
	Office rent	2,500	
	Repairs and Renewals—Office Premises	500	
	Office lighting	500	
	Depreciation : Office premises	1,250	
	Manager's salary	5,000	
	Directors' fees	1,250	
	Office stationery	500	
	Telephone charges	125	
	Postage and Telegrams	250	
			11,875
	Cost of Production		1,59,375
Add :	Selling and Distribution Overheads :		
	Carriage outward	375	
	Salesmen's salaries	1,250	
	Travelling expenses	500	
	Advertising	1,250	
	Warehouse charges	500	
			3,875
	Cost of Sales		1,63,250
	Profit		26,250
	Sales		1,89,500

Notes : (1) Transfer to reserves, income-tax and dividend are excluded from cost accounts being items of appropriation of profit, so these items have not been included in cost.

(2) Discount on shares written off being an item of non-operating nature is excluded from cost.

Ex : 6. From the books of accounts of M/s. Aryan Enterprises, the following details have been extracted for the year ending March 31, 2007 :

	Rs.		Rs.
Stock of Materials–Opening	1,88,000	Rent, Rates and Taxes :	
–Closing	2,00,000	–Factory	12,000
Materials Purchased during the year	8,32,000	–Office	6,400
Direct Wages paid	2,38,400	Travelling Expenses	12,400
Indirect Wages	16,000	Salesman's Salaries and Commission	33,600
Salaries to Administration Staff	40,000	Depreciation written off	
Freights –Inward	32,000	–Plant and Machinery	28,400
–Outward	20,000	–Furniture	2,400
Cash Discounts allowed	14,000	Directors' Fees	24,000
Bad Debts written off	18,800	Electricity Charges (Factory)	48,000
Repairs to Plant and Machinery	42,400	Fuel (for boiler)	64,000
		General Charges	24,800
		Manager's Salary	48,000

The manager's time is shared between the factory and the office in the ratio of 20 : 80. From the above details you are required to prepare a statement showing (a) Prime Cost ; (b) Factory Overhead ; (c) Factory Cost ; (d) General Overhead ; and (e) Total Cost. **[I.C.W.A. Inter, June–1994–Adapted]**

Solution :

M/s. Aryan Enterprises

Statement Showing Cost of Production for the year ended 31 March, 2007

Particulars	Rs.	Rs.
I. Materials Consumed :		
Opening Stock of Materials	1,88,000	
Add : Purchases during the year	8,32,000	
Add : Freights Inward	32,000	
	10,52,000	
Less : Closing Stock of Materials	(–) 2,00,000	
		8,52,000
Direct Wages		2,38,400
A. Prime Cost		10,90,400
II. Factory Overheads :		
Indirect Wages	16,000	
Repairs to Plant and Machinery	42,400	
Rent, Rates and Taxes–Factory	12,000	
Depreciation on Plant and Machinery	28,400	
Electricity Charges (Factory)48,000		
Fuel (for boiler)	64,000	
Manager's Salary ($48,000 \times \frac{20}{100}$)	9,600	
		2,20,400
C. Factory Cost		13,10,800
III. General Overheads (including Office, Selling and Distribution Overhead)		
Salaries to Administration Staff	40,000	
Freight Outward	20,000	

Rent, Rates and Taxes—Office	6,400	
Travelling Expenses	12,400	
Salesman's Salaries and Commision	33,600	
Depreciation–Furniture	2,400	
Directors' Fees	24,000	
General Charges	24,800	
Manager's Salary ($4,800 \times \frac{80}{100}$)	38,400	
		2,02,000
D. Total Cost		15,12,800