

- 2) Define 'Cost Accounting'. State its main objects.
- 3) State the importance of costing in a modern economy.
- 4) **Differentiate** between Cost Accounting and Financial Accounting.
- 5) What are the major advantages of Cost Accounting to a manufacturing concern?
- 6) How can you instal a system of costing in a biscuit producing factory? What are the possible difficulties in installing such system?
- 7) "Financial Accounting procedures are generally designed to ascertain the periodic profit or loss, but there are important limitations and deficiencies in the **system.**" Discuss.
- 8) How do Cost Accounting records help in the planning and control of business operations of an enterprise?

Note : These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

UNIT 2 CONCEPT OF COST AND ITS ASCERTAINMENT

Structure

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- 2.3 Classification of Costs
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2.0 OBJECTIVES

After studying this unit, you should be able to :

- define the **term** cost
- explain the concepts of cost unit and cost centre
- classify costs
- describe the elements of cost
- give a **proforma** of cost sheet and identify the components of total cost
- describe different methods of costing and identify the industries to which each method is applicable.

2.1 INTRODUCTION

In Unit 1 you have learnt about the nature and scope of costing, the difference between Cost Accounting and Financial Accounting, and the advantages of installing a costing system in an organisation. You **learnt** that costing is the technique and process of **ascertaining costs**. In order to understand this process, one must gain **familiarity** with certain concepts like cost, cost unit, cost centre, classification of **costs**, elements of cost and components of total cost. This unit mainly covers these aspects and gives a **proforma** of cost sheet prepared for ascertaining cost and profit of each product manufactured by an organisation during a particular period. This unit also discusses various methods of costing and identifies the industries for which each method is considered suitable.

2.2 MEANING OF COST

Cost means the amount of expenditure (actual or notional) incurred on, or attributable to, a given thing. In other words, cost indicate: : (i) an actual or estimated expenditure, (ii) a direct or indirect expenditure, and **(iii)** it is related to a job, process, product or service. Examples of expenses which constitute cost are :

(a) materials, (b) labour, (c) factory overheads, (d) administrative overheads, and (e) selling and distribution overheads.

Cost is a wide concept. It does not give an exact meaning unless it is properly qualified. It is necessary, therefore, that both who ascertain cost and who use it as a base for certain decisions, interpret the meaning and contents of cost in a similar manner. The main characteristics of cost are :

- 1) The term 'cost' is not complete unless it is fully identified with its nature and category.
- 2) Costs do not represent the same contents under every situation.
- 3) No cost is true, exact or accurate. It is a flexible concept; it does not mean the same thing under all circumstances.
- 4) Cost may be ascertained in different ways by different persons.
- 5) Costs vary with time, volume, firm, method or purpose.

Thus cost has no fixed, certain or definite meaning. This may change according to its interpretation and the manner in which, or the purpose for which, it is ascertained. Cost must indicate its purpose and the conditions under which it is computed. If not, it may be vague, giving different meaning to different people. Hence, it must be related to a particular activity or commodity and expressed for a given quantity or unit of goods produced or services performed.

Cost and Loss : You should be able to distinguish between the terms 'cost' and 'loss'. Cost actually signifies an expenditure incurred for securing some benefit to the business. If no benefit is derived from a particular expenditure, it is regarded as a loss. Cost of materials destroyed by fire or salary paid to a foreman during the period of strike are **not regarded** as cost. These are examples of loss to the business.

2.3 CLASSIFICATION OF COSTS

We often come across a wide variety of costs. Unless we are fully familiar with their meaning and utility, we may not be effective in their computation, analysis comparison and control.

There are various bases according to which costs have been classified. These are (1) according to functions to which they relate, (2) according to their **identifiability** with jobs, products, or services, (3) according to their variability with changes in output, (4) according to their association with product, or period, (5) according to their **controllability**, and (6) according to their relevance to decision making. The first three bases are considered important at the introductory stage and, therefore, have been discussed here in detail.

2.3.1 Functional Classification

The most common classification of costs in a manufacturing establishment is on the basis of **functions** to which they relate because costs have to be ascertained for each of these functions. On this basis, costs are **classified into** four categories : (i) manufacturing costs (production costs), (ii) administrative costs, (iii) selling costs, and (iv) distribution costs.

Manufacturing Costs : Manufacturing costs refer to all expenditure incurred in the **course** of production from acquisition of materials to primary packing (packaging) of the finished product. It includes cost of materials, cost of labour, other direct expenses and factory overheads. These are also termed as 'production costs'.

Administration Costs : Administrative costs include all costs that are incurred for general administration of the organisation and for the operational control. Some examples of such costs are : salaries of the office staff, rent of the office building, depreciation and repairs of the office furniture, etc. In fact, any expenditure which is not related directly to production, selling, distribution, research or development forms part of the administrative costs.

Selling Costs : Selling costs are those costs which are incurred in connection with the sale of goods. Some examples of such costs are: cost of warehousing, advertising, salesmen salaries, etc. .

Distribution Costs : Distribution costs are those costs which are incurred on despatch of the finished products to customer including transportation. Some examples of such costs are : packing, carriage, insurance, freight outwards, etc.

2.3.2 On the Basis of Identifiability with Products

On this basis costs are divided into (i) direct costs, and (ii) indirect costs.

Direct Costs : Direct costs refer to expenses which can be directly identified with a product, job or process. For example, in case of materials used and labour employed, we can easily ascertain as to which product or job or process they relate. The same thing is not true of expenditure like rent of the building which is a common cost for various products manufactured in the factory and will have to be allocated to all products on some rational basis.

Indirect Costs : Indirect costs refer to those expenses which cannot be easily identified with a particular product, job or process. These are of a general, common or collective nature which are to be allocated to various products manufactured in the factory. Some examples of such costs are : rent of the factory building, salary of the production manager, wages paid to chowkidar, etc. These costs have to be apportioned among different products on some rational basis. These are known as 'overheads' or 'oncosts' and can be subdivided into factory overheads, administrative overheads, selling and distribution overheads.

2.3.3 On the Basis of Variability

On this basis costs are classified into (i) fixed costs, (ii) variable costs, and (iii) semi-variable (or semi-fixed) costs.

Fixed Costs : Costs which remain unaffected by changes in volume of output are termed as 'fixed costs'. For example, whether we produce 10,000 units or 15,000 units of a particular product during a particular period, the rent of the factory building or salary of the production manager will remain the same. Hence, the rent or salary is regarded as fixed cost. It should, however, be noted that fixed costs do not remain fixed for all times to come. They remain fixed only upto a certain level of production capacity. If there is a change in the production capacity which require additional building and equipment, such costs will also increase.

Variable Costs : Costs, which increase or decrease in direct proportion to changes in the volume of output are termed as 'variable costs'. For example, for 10,000 units of output, cost of materials consumed comes to Rs. 1,50,000. If the production is increased to 12,000 units (increase of 20%) the cost of materials will increase to Rs. 1,80,000 (increase of 20%). It should be noted that the cost of material per unit of output has not changed. It remains the same i.e., Rs. 15 per unit. But, it is the total cost of materials which changes because of the change in the volume of output.

Semi-variable Costs : Costs which increase or decrease with a change in volume of output but not in the same proportion as the change in the volume of output are termed as 'semi-variable costs'. In other words, these costs are partly variable and partly fixed and, as such, are also known as 'semi-fixed costs'. Depreciation and repairs of machinery are the best examples of such costs. Depreciation on machinery is caused partly by passage of time and partly by its usage. Hence, when production is increased the amount of depreciation also increases, but not in the same proportion as the increase in the volume of output. Take another example. If the quantity of goods sold increases, the remuneration of salesman may also increase. But, such increase will not be in direct proportion to the increase in sales because his commission on sales will increase while his salary remains the same.

The classification of costs into fixed, variable and semi-variable is very helpful in estimating the total cost at various levels of activity and also in various managerial decisions,

Check Your Progress A

1) What do you mean by the term 'cost'.

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- 2) Distinguish between 'cost' and 'loss'
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- 3) Give three examples of semi-variable costs.
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- 4) Distinguish between direct costs and indirect costs.
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- 5) State whether the following statements are True or False.
 - i) Costs may be ascertained in different ways by different persons.
 - ii) The term 'cost' has a fixed, certain and definite meaning.
 - iii) Rent of a factory building is a variable cost.
 - iv) Salesmen salary is a fixed cost.
 - v) All factory expenses can be identified directly with the products manufactured by a factory.
 - vi) Bad debts are selling costs.

2.4 COST UNIT

You know one of the main functions of costing is to ascertain cost per unit of output. This means that each economic activity has to be measured in identifiable units which may serve as the basis of costing. Such units for the purpose of costing may be as follows :

- 1) unit of product (e.g., cost per book)
- 2) unit of time (e.g., cost of generating electricity per hour),
- 3) unit of weight (e.g., cost per kilogram of biscuits)
- 4) unit of measurement (e.g., cost per metre of cloth or per square foot of construction),
- 5) operating unit of service (e.g., cost of running a bus per kilometer).

Thus, a **cost unit is a unit of product, service or time in terms of which costs are ascertained or expressed.** Cost unit will normally be the quantity of a product for which price is quoted to the customers.

Selection of a cost unit, however, must be appropriate. Firstly, it should offer convenience in cost ascertainment. Secondly, it should be easier to associate expenses with cost units. Thirdly, it should be according to the nature and practice of the business.

Some examples of cost unit for different products and services are given below

Product/Activity	Cost Unit
Wire	per metre
Power	per kilowatt hour
Telephone	per call
Iron	per tonne/quintal
Transport	per passenger per kilometer/ per kilogram per kilometer
Bricks	per thousand
Cement	per bag/per tonne
Paper	per ream/per kilogram
Computer	per hour
Printing	per thousand impressions
Cars	per car

Petrol	per litre
Television	per set
Pencils	per dozen
Gold	per gramme
Ship-building	per ship
Nursing Home	per bed per day

2.5 COST CENTRE

A Cost Centre is a location, person or item of equipment (or group of these) for which costs may be ascertained and used for the purposes of cost control. In other words, a cost centre may consist of either or a combination of the following :

LOCATION : Factory, Office, Warehouse, Stores, Sales Depot, etc.

PERSON : Foreman, Salesman, Customer, etc.

EQUIPMENT : Machine, Car, Truck, Crane, etc.

In fact, the entire organisation may be divided into specified cost centres which jointly contribute to the total cost. Identification of cost centres helps us in

- 1) ascertaining the centre-wise costs,
- 2) comparing the centre-wise costs periodically,
- 3) finding out the major trends of variance, and
- 4) applying the techniques of control to check undue, undesirable or unexpected movements in costs.

A cost centre is a convenient unit of the organisation. It segregates operations, demarcates activities, and distributes expenses. This helps in fixing responsibilities for every cost centre.

Types of Cost Centres : Cost centres may be divided into the following four types :

- 1) Process Cost Centre (based on sequence of operations)
- 2) Production Cost Centre (for regular production in a factory)
- 3) Operation Cost Centre (where various operations are involved in the production process)
- 4) Service Cost Centre (for activities supporting the main production)

Thus, identification or selection of cost centres depends on the nature and type of industry,

Check Your Progress B

- 1) Match the cost unit appropriate to the activity/product.

i) Transport	a) per sq. centimeter
ii) House Construction	b) per job
iii) Furniture	c) per contract
iv) Advertising	d) per piece
v) Nursing Home	e) per ton kilometer
vi) Ice Cream	f) per bed per day
vii) Shirt	g) per kilogram

2) Define Cost Unit.

3) What do you mean by Cost Centre?

4) State the objectives of identifying cost centres.

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2.6 ELEMENTS OF COST

There are three main elements of cost : (1) materials, (2) labour, and (3) expenses.

2.6.1 Materials

The term 'materials' refers to those commodities which are used as raw materials, components, or consumables for manufacturing a product. Materials can be direct or indirect.

Direct Materials : All materials used as raw-materials or components for a finished product are known as 'direct materials'. Sugarcane for sugar, cloth for ready-made garments, tyres for car are some examples of direct materials. Packaging is also an item of direct materials cost.

Indirect Materials : Consumables like lubricating oil, stationery, spare parts for machinery are termed as indirect materials. Such commodities do not form part of the finished product.

2.6.2 Labour

The workers employed for converting material into finished product or for doing various odd jobs in the business are known as 'labour'. Labour can also be direct or indirect.

Direct Labour : The workers who are directly involved in the production of goods are known as 'direct labour'. They may be labourers producing manually or workers operating machinery. The wages paid to such workers are known as 'direct wages' or 'manufacturing wages'.

Indirect Labour : The workers employed for carrying out tasks incidental to production of goods or those engaged for office work and selling and distribution activities are known as 'indirect labour'. The wages paid to such workers are known as 'indirect wages'.

2.6.3 Expenses

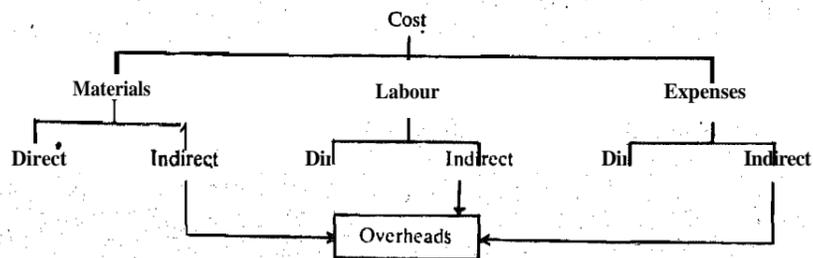
All expenditure other than material and labour are termed as 'expenses'. Expenses can also be direct and indirect.

Direct Expenses : Other expenses which are incurred specifically for a particular product, job or service are termed as 'direct expenses'. Some examples of such expenses are : carriage inwards, production royalty, hire charges of special equipment, cost of special drawings, etc. These are also known as 'chargeable expenses'.

Indirect Expenses : All expenses other than indirect materials and labour which cannot be directly attributed to a particular product, job, or service are termed as 'indirect expenses'. Rent of building, repairs of machinery, lighting and heating, insurance are some examples of indirect expenses.

The various elements of cost have been presented in the form of a chart in Figure 2.1

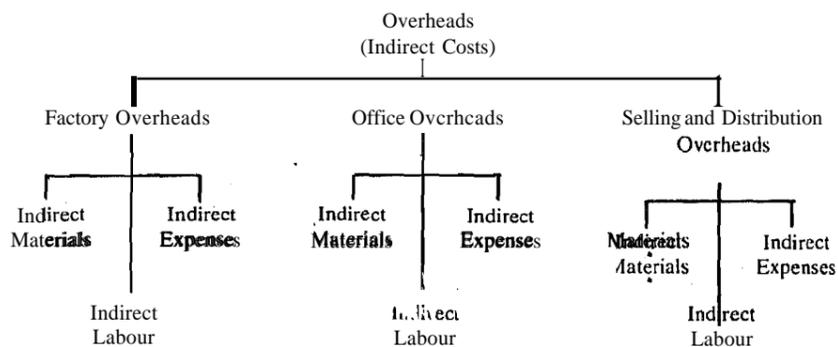
Figure 2.1 : Elements of Cost



Concept of Overheads : All material, labour and expenses which cannot be identified as direct costs are termed as 'indirect costs'. The three elements of indirect costs viz., indirect materials, indirect labour and indirect expenses are collectively known as 'Overheads' or 'Oncosts'.

Overheads are grouped into three categories : (1) factory (or manufacturing) overheads, (2) office (or administrative) overheads, and (3) selling and distribution overheads as shown in Figure 2.2.

Figure 2.2 : Categories of Overheads



Conversion Cost : The cost of converting raw materials into finished goods is termed as 'conversion cost'. This includes direct wages, direct expenses and factory overheads.

2.7 .COMPONENTS OF TOTAL COST

Total cost of a product is the combination of direct costs (also known as prime cost) and indirect costs (also known as overheads).

Thus, the two main components of total cost are : (1) Prime Cost. and (2) Overheads. The prime cost which represents all direct costs, therefore, consists of direct materials, direct labour and other direct expenses. Overheads, on the other hand, consists of factory overheads, office overheads, and selling and distribution overheads?

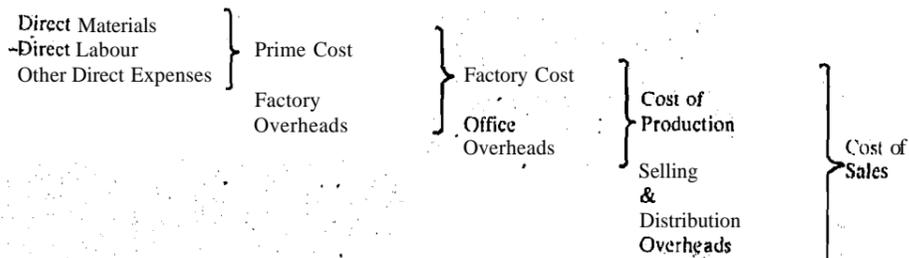
Total Cost Build Up

If we add various costs step by step, we get the following framework of total cost build-up.

- 1) Direct Material + Direct Labour + Other Direct Expenses = PRIME COST
- 2) Prime Cost + Factory Overheads = WORKS COST
- 3) Works Cost + Office and Administrative Overheads = COST OF PRODUCTION
- 4) Cost of Production + Selling and Distribution Overheads = TOTAL COST or COST OF SALES

The above framework of total cost build-up is shown in Figure 2.3.

Figure 2.3 : Total Cost Build-up



Thus, we get the following components of total cost:

- 1) Prime Cost (also known as Direct Cost or First Cost)
- 2) Works Cost (also known as Factory Cost)
- 3) Cost of Production (also known as Office Cost)
- 4) Cost of Sales

Check Your Progress C

- 1) Give four examples of other direct expenses.
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.....
- 2) Give four examples of indirect expenses.
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.....
- 3) Distinguish between direct and indirect wages.
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.....
- 4) Fill in the blanks.
 - i) Direct Materials + + Other Direct Expenses = Prime Cost
 - ii) Prime Cost + = Works Cost
 - iii) Works Cost + Office Overheads =
 - iv) Prime Cost + + + =
Cost of Sales

2.8 COST SHEET

A Cost Sheet is a statement showing various components of total cost which acts as a guide to pricing decisions and a basis for cost control.

It is a presentation of cost data incorporating its various elements in a classified manner. In view of its valuable contents, a cost sheet should be prepared properly and at frequent intervals (weekly or monthly).

Possible information which may be incorporated into a cost sheet in accordance with the requirements of the business are :

- 1) Name of the product cost centre or cost unit
- 2) Period to which the statement relates
- 3) Output for the period
- 4) Details of various components of total cost
- 5) Item-wise cost per unit
- 6) Changes in stock position
- 7) Cost of goods sold
- 8) Profit or loss position

Proforma of cost sheet is given in Figure 2.4.

Figure 2.4 : Proforma of Cost Sheet

COST SHEET OF		Output :units	
for the month ending		Total Rs.	Per Unit Rs.
Raw Materials Consumed			
Opening stock of raw materials	_____		
Add : Purchases of raw materials	_____		
Less : Closing stock of raw materials	_____		

Direct Labour			
Other Direct Expenses			
	PRIME COST		
Factory Overheads			
	WORKS COST		
Office & Administrative Overheads			
	COST OF PRODUCTION (..... units)		
Add : Opening Stock of Finished Goods (..... units)			
Less : Closing Stock of Finished Goods (..... units)			
	COST OF GOODS SOLD (..... units)		
Selling & Distribution Overheads			
	COST OF SALES (..... units)		
	PROFIT (LOSS)		
	SALES/SELLING PRICE		

Look at Illustration 1 and see how cost sheet is prepared from given costing data.

Illustration 1

From the following particulars of a manufacturing firm, prepare the Cost Sheet showing (i) Prime Cost, (ii) Works Cost, (iii) Cost of Production, and (iv) Cost of Sales.

	Rs.
Stock of materials on 1.1.1989	40,000
Purchase of Materials	11,00,000
Stock of finished goods on 1.1.1989 (5,000 units)	50,000
Productive wages	5,00,000
Finished goods sold (1,74,000 units)	24,36,000
Works overheads	1,50,000
Office expenses	1,00,000
Selling and Distribution expenses	1,74,000
Stock of materials on 31.12.1989	1,40,000
Stock of finished goods on 31.12.1989 (6,000 units)	60,000

Solution

Before preparing the Cost Sheet, we should work out the number of units produced during the year,

Closing Stock	6,000
Number of units sold	<u>1,74,000</u>
	1,80,000
Less : Opening Stock	<u>5,000</u>
Number of units produced	<u>1,75,000</u>

COST SHEET
for the year ending 31.12.1989

Output : 1,75,000 units

		Total Rs.	Per Unit Rs.
Raw Materials Consumed :			
Opening Stock	40,000		
Add : Purchases	<u>11,00,000</u>		
	11,40,000		
Less : Closing Stock	<u>14,00,000</u>	10,00,000	
Direct Wages		5,00,000	
Other Direct Expenses			
	PRIME COST	15,00,000	
Works Overheads		1,50,000	
	WORKS COST	16,50,000	
Office Overheads		1,00,000	
	COST OF PRODUCTION (1,75,000 units)	17,50,000	10.00
	Add : Opening Stock of Finished Goods (5,000 units)	50,000	
	Less : Closing Stock of Finished Goods (6,000 units)	18,00,000	
		60,000	
	Cost of Goods Sold (1,74,000 units)	17,40,000	10.00
Selling and Distribution Overheads		1,74,000	1.00
	COST OF SALES	19,14,000	11.00
	PROFIT	5,22,000	3.00
	SALES	24,36,000	14.00

2.9 METHODS OF COSTING

Though, in all cases, the basic principles and procedure of costing remain the same, but on account of the nature and peculiarities of their business, different industries follow different methods of ascertaining cost of their products and services. These methods can be summarised as follows :

Job Costing : Under this method, costs are ascertained for each job or work-order separately. It is suitable for industries like printing, car repairs, foundries, painting and decoration, where each job has its own specifications.

Contract Costing : This method is used in case of big jobs described as 'contracts'. The contract work usually involves heavy expenditure, stretches over a long period, and is undertaken at different sites. Hence, each contract is treated as a separate unit for purposes of cost ascertainment and control. Contract costing (also termed as Terminal Costing) is most suited to industries like ship-building, construction of buildings, roads and bridges.

Batch Costing : Where work-orders are arranged in batches and the units produced in a batch are uniform in nature and design, each batch is regarded as a job and treated as a separate unit for purposes of costing. In such a situation, the method of costing adopted is known as 'batch costing.' It is generally used in industries like pharmaceuticals, bakery, toy manufacturing, etc.

Unit Costing : Under this method costs are ascertained for convenient units of output. It applies to products which are turned out by continuous manufacturing activity and can be expressed in identical quantitative units. It is suitable for industries like brick

making, mining, cement manufacturing, dairy, flour mills; etc. This method is also called 'Single Output Costing'.

Process Costing : In case of some industries, a product passes through different stages of production called 'processes' and each process is distinct and well-defined. The output of each process is used as a raw material for the next process and may also be a marketable commodity. Take the case of cotton textile mill where the finished product (cloth) passes through three distinct processes viz., spinning, weaving and finishing. The output of spinning process is yarn which is used as a raw material for the weaving process and the output of weaving process (coarse cloth) is transferred to finishing process. Yarn and coarse cloth can also be sold to other textile mills which may not have adequate spinning or weaving facilities. In such a situation, it becomes necessary to ascertain the cost at each stage. This helps in comparing cost with the market price as well as in cost control. The method employed for ascertaining the cost at each stage of production is termed as 'Process Costing'. It is used in case of chemicals, paints, textile and food products.

Operating Costing : This method is used for ascertaining the cost of operating a service such as bus, railways, water supply, nursing home, etc. In such organisations, the unit of cost is a service unit e.g., in case of buses the unit of cost is passenger kilometer, in case of nursing home it is per bed per day. According to the latest Terminology, this is called 'Service Costing'.

Multiple Costing : Where a produce comprises many assembled parts (or components) as in cases of motor car, typewriter, television, refrigerators, etc., costs have to be ascertained for each component as well as for the finished product. This may involve use of different methods of costing for different components and so it is known as 'multiple' or 'composite' costing.

Uniform Costing : The practice of using a common method of costing by a number of firms in the same industry is known as 'Uniform Costing'. Thus, it is not a separate method of costing. It simply refers to a common system using agreed concepts, principles and standard accounting practices. This helps in making inter-firm comparisons and fixation of prices.

It should be noted that the **two basic methods** of costing are : (1) Job Costing, and (2) Process Costing. The other methods discussed above are simply variants of these two methods.

Check Your Progress D

4) Name the two basic methods of costing.

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2) Which method of Costing would you recommend for the following industries?

- i) ship-building
- ii) Toy Making
- iii) Oil Refinery.
- iv) Sugar
- v) Brick Making
- vi) Construction of Bridge
- vii) Road Transport
- viii) Furniture

2.10 TYPES OF COSTING

While method of costing refers to the process and practice of ascertaining costs of products and services, the type of costing refers to the technique of analysing and presenting costs for purposes of control and managerial decisions. The types of costing (also known as techniques of costing) generally used are as follows :

Marginal Costing : It refers to the technique of costing which emphasises the distinction between fixed and variable costs and calculates the cost of a job or a product without taking fixed costs into account. It allocates only variable costs (direct materials, direct labour, other direct expenses and variable overheads) to production and is also known as 'Variable Costing'.

Absorption Costing : It refers to the technique of costing under which full costs are charged to production i.e., both fixed and variable costs are included in the cost of products.

Historical Costing : It refers to a system of cost accounting under which costs are ascertained only after they have been incurred. In other words, the accounting is done in terms of actual costs and not in terms of predetermined or standard costs. Most organisations follow this system of accounting for costs.

Standard Costing : It refers to the system of cost accounting under which costs are determined in advance on certain predetermined standards. These are known as standard costs which indicate the level of costs that should be attained under a given set of operating conditions. The standard costs are compared periodically with the actual costs and underlying causes for variances are analysed so that corrective action may be taken where necessary.

Thus, having adopted a method of costing suited to the nature of activity in which the undertaking is engaged, there is then a choice open with regard to the way in which the costing information is to be presented for control purposes. Either 'marginal costing' or 'absorption costing' may be employed and either 'actual costs' or 'standard costs' may be adopted to ascertain and account for costs.

2.11 LET US SUM UP

Cost ascertainment is an important process of accounting. Cost means an amount of expenditure (actual or notional) incurred or attributable to a product, job, process, or service. Cost is a flexible concept. It may vary with time, volume, firm, method or purpose. It should also be distinguished from the term 'loss' which refers to an expenditure incurred without deriving any benefit therefrom.

Costs can be classified in various ways. On the basis of functions to which they relate, costs are classified into manufacturing costs, administrative costs, and selling and distribution costs. On the basis of their identifiability with products, costs can be classified into direct costs and indirect costs. On the basis of their variability in relation to nature of output, costs can be classified into fixed costs, variable costs and semi-variable (or semi-fixed) costs.

The two concepts which serve as the basis for cost computation are : (i) cost unit, and (ii) cost centre. Cost unit refers to that quantity of a product in terms of which costs are ascertained e.g., per kilogram, per dozen, per piece, etc. Cost centre refers to the division of organisation into convenient segments with defined responsibilities to which initial allocation and apportionment of various costs can be made and which can be used for the purpose of cost control. It can be a department, a person or an item of equipment.

There are three basic elements of cost : (i) materials, (ii) labour, and (iii) expenses. They may be direct or indirect. Indirect costs including indirect materials, indirect labour and indirect expenses are known as 'overheads'. Overheads are usually classified into factory overheads, office overheads, and selling and distribution overheads.

The main components of total cost are prime cost, works cost, cost of production and cost of sales. These are actually the stages to determine the total cost and facilitate control.

There are various methods of costing. These are (i) job costing, (ii) contract costing, (iii) batch costing, (iv) unit costing, (v) process costing, (vi) operating costing, (vii) multiple costing, and (viii) uniform costing. Every organisation adopts the method which suits the nature of its products and the technique of production used.

2.12 KEY WORDS

Conversion Cost : Cost of converting materials into finished products. It includes direct labour, direct expenses and factory overheads.

Cost Centre : A convenient costing segment to which initial allocation and apportionment of various expenses can be made.

Cost of Sales : Total cost of a product including selling and distribution expenses.

Cost Unit : The quantity in terms of which the cost of a product is ascertained.

Prime Cost : Cost of direct expenses including those of materials and wages.

Semi-variable Cost : Expenses which change with changes in output, but not in the same proportion.

Standard Cost : A predetermined cost based on a technical estimate for material, labour and overheads for a selected period of time and for prescribed set of working conditions.

Works Cost : Prime cost plus factory overheads.

2.13 ANSWERS TO CHECK YOUR PROGRESS

- A 5 (i) True (ii) False, (iii) False (iv) True
(v) False (vi) True
- B 1 (i) e (ii) c (iii) b (iv) a
(v) f (vi) g (vii) d
- C 4 (i) Direct Wages (ii) Factory Overheads (iii) Cost of Production
(iv) Factory Overheads, Office overheads, Selling and Distribution Overheads
- D 2 (i) Contract Costing (ii) Batch Costing
(iii) Process Costing (iv) Process Costing
(v) Unit Costing (vi) Contract Costing
(vii) Operating Costing (viii) Job Costing

2.14 TERMINAL QUESTIONS

- 1) Define the term 'Cost Centre'. Analyse the importance of selecting suitable cost centres.
- 2) Why do we need to qualify 'cost'? Discuss.
- 3) "Costs may be classified according to their nature and characteristics." Elaborate on this statement and clarify the meaning of fixed, variable and semi-variable costs with examples.
- 4) What are the different methods of costing? State the industries to which they can be applied.
- 5) State the main characteristics of the following methods of costing and indicate in which industry each would be suitable :
 - a) Process Costing
 - b) Job Costing
 - c) Output Costing

ECO-10 ELEMENTS OF COSTING
Course Components

BLOCK	UNIT NO.	PRINT MATERIAL
1		Basic Concepts
	1	Nature and Scope
	2	Concept of Cost and its Ascertainment
2		Materials and Labour
	3	Procurement, Storage and Issue of Materials
	4	Inventory Control
	5	Pricing Issue of Materials
	6	Labour
3		Overheads
	7	Classification and Distribution of Overheads
	8	Absorption of Factory Overheads
	9	Treatment of other Overheads
4		Methods of Costing
	10	Unit Costing
	11	Reconciliation of Cost and Financial Accounts
	12	Job and Contract Costing
	13	Process Costing