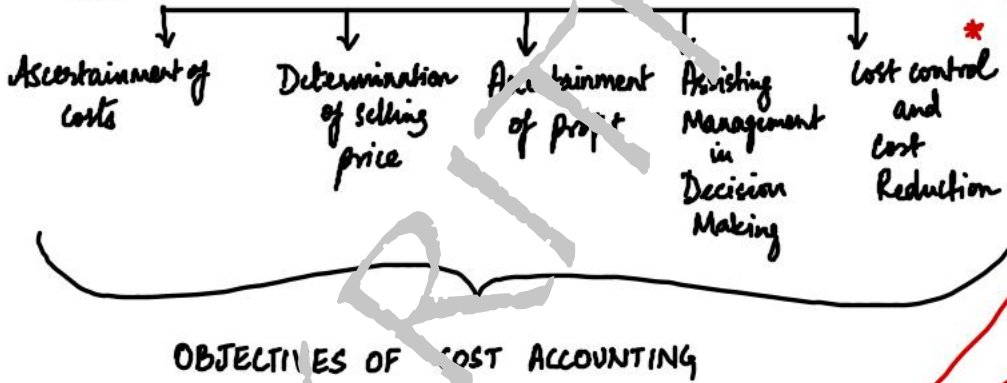
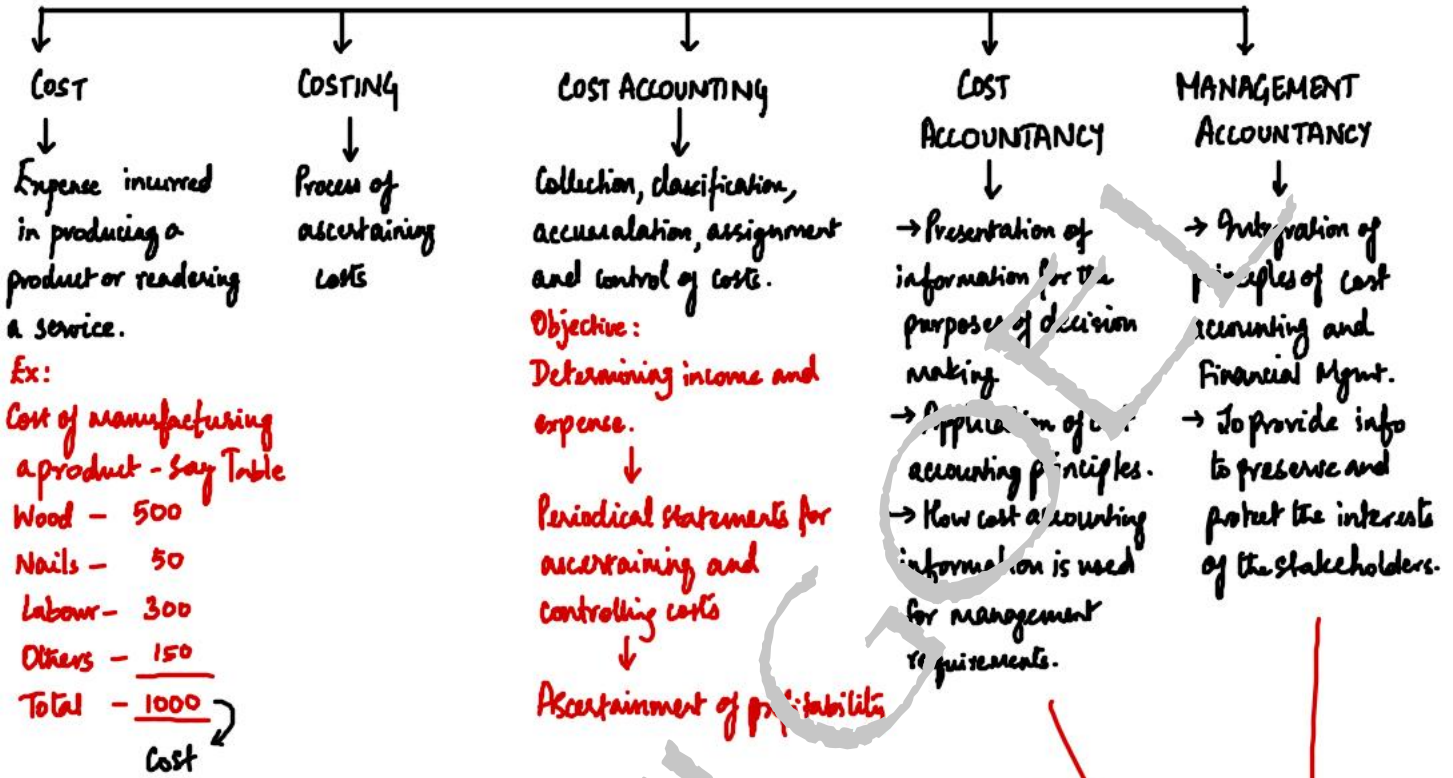
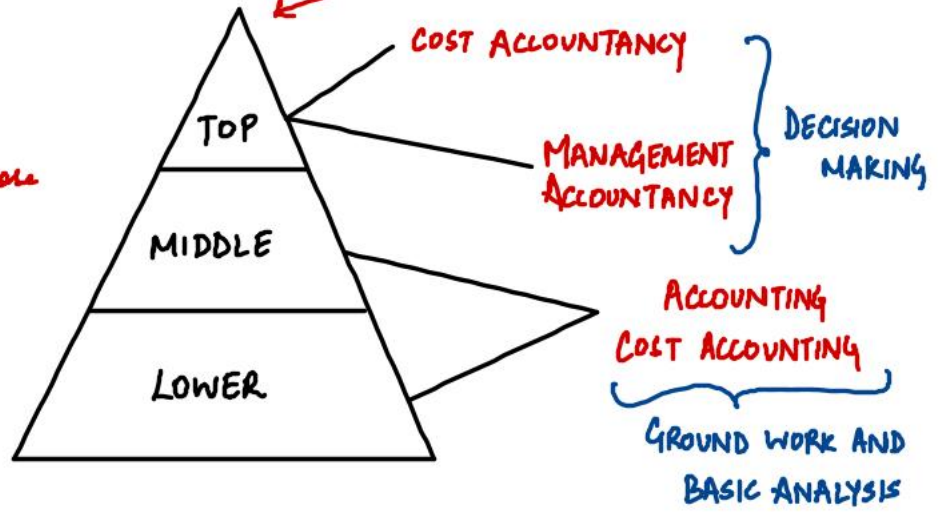


# INTRODUCTION TO COSTING CHAPTER - 1



- Key decisions such as
- Make or buy
  - Continue or shut down
  - Which suppliers to choose
  - Which payment scheme to choose for employees.
  - Plant A v/s Plant B
  - Product A v/s Product B
  - Location A v/s Location B



# \* COST CONTROL AND COST REDUCTION

• A technique which tells the management if the costs are aligned with the Target costs or not and achieved through Managerial Action.

• Temporary savings most of the times.

• Savings in total cost or per unit cost.

• Quality maintenance is not guaranteed.

• Step 1: Set a Target

Step 2: Investigate variances

Step 3: Take remedial action

• Emphasis on present and past behaviour of costs.

• Achievement of real and permanent reduction in the unit cost of goods manufactured and services rendered without impairing the quality of the product.

• Permanent and genuine reduction in costs.

• Savings in cost per unit only.

• Product Quality, utility and characteristics are retained.

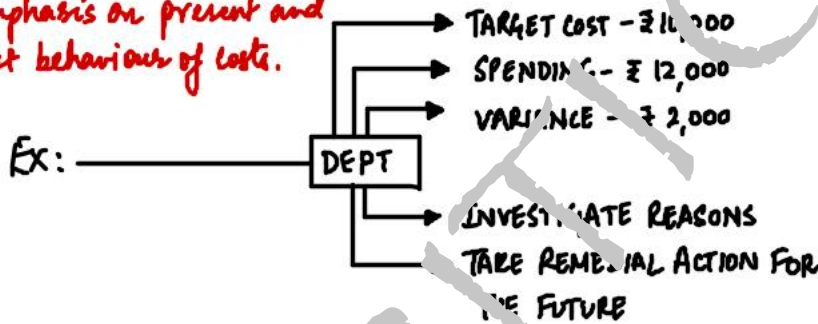
• Not concerned with maintenance of performance standards.

• Emphasis on present and future costs.

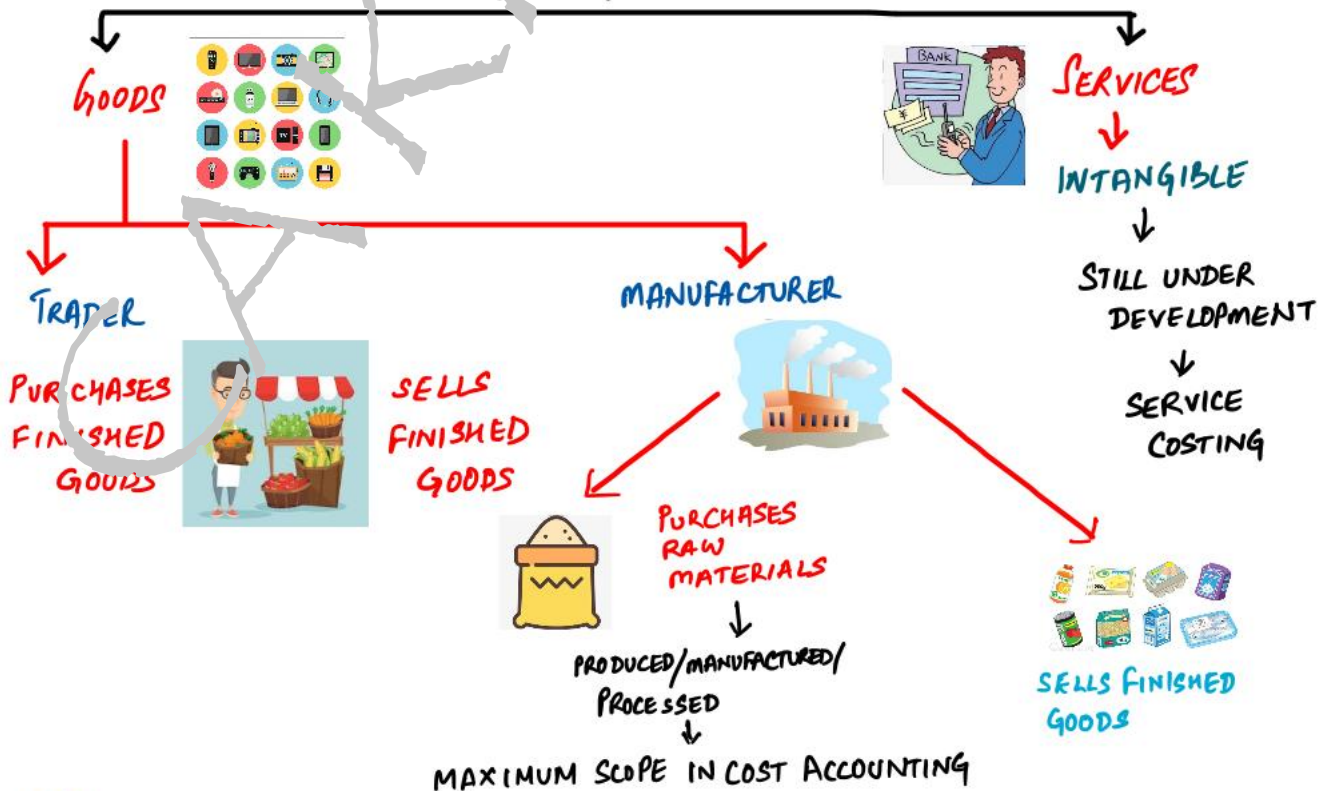
Ex: 1 - WAGES → 10 workers → ₹1000 → 10 units →  $\frac{1000\text{₹}}{10\text{units}}$  → ₹10 pu

2 - WORKERS REPLACED BY MACHINERY → ₹500 → 10 units →  $\frac{500\text{₹}}{10\text{units}}$  → ₹5 pu

REAL & PERMANENT REDUCTION IN COST PER UNIT OF THE PRODUCT



## SELLING



# DIFFERENCE BETWEEN FINANCIAL AND COST ACCOUNTING

EX:- 1

## Financial Accounting

Material - ₹ 150,000  
 Wages - ₹ 70,000  
 Other Exp - ₹ 50,000

$$\text{Profit \% on sales} = \frac{30,000}{3,00,000} \times 100$$

Total Costs - ₹ 2,70,000

Total Sales - ₹ 3,00,000

$$\text{Profit} = 3,00,000 - 2,70,000 = 30,000 \text{ ₹}$$

10% Profit looks satisfactory!

## Cost Accounting

PARTICULARS	PRODUCT A	PRODUCT B	PRODUCT C	TOTAL
1. Material	48,000	37,000	65,000	150,000
2. Labour	15,000	25,000	30,000	70,000
3. Other Expenses	15,000	18,000	17,000	50,000
<b>TOTAL COSTS (A)</b>	<b>78,000</b>	<b>80,000</b>	<b>112,000</b>	<b>270,000</b>
<b>SALES (B)</b>	<b>1,02,400</b>	<b>1,03,000</b>	<b>89,600</b>	<b>3,00,000</b>
<b>PROFIT (B) - (A)</b>	<b>24,400</b>	<b>28,000</b>	<b>(22,400)</b>	<b>30,000</b>
<b>PROFIT %</b>	<b>23.8%</b>	<b>25.9%</b>	<b>-</b>	<b>10%</b>

### CONCLUSIONS

Product C is pulling down the total profitability of the organisation from products A and B.

The Mgmt needs to make a labour decision.

### DECISION OPTIONS

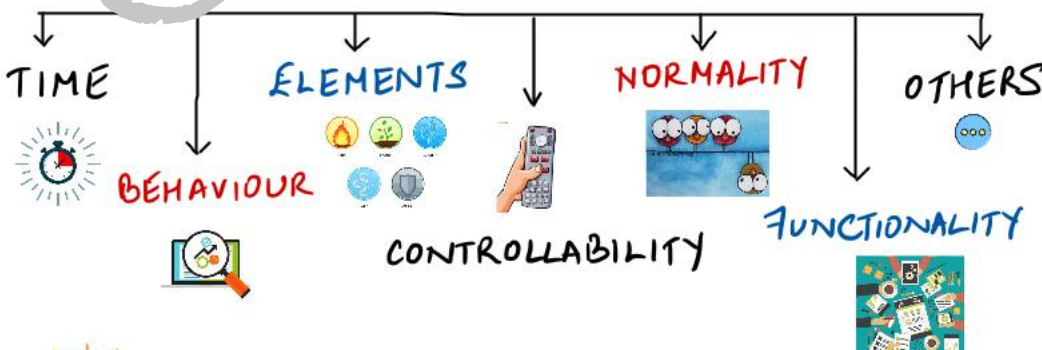
Investigate thoroughly product C to find economies  
 ↓ costs of C

↑ S.P. of C

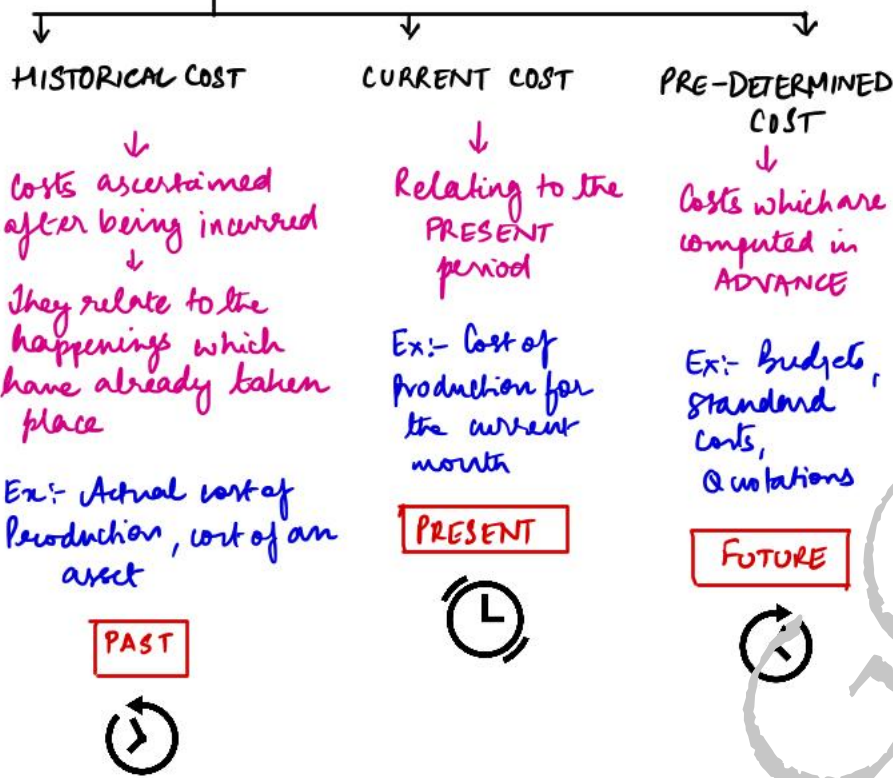
stop prodn of C

FINANCIAL ACCOUNTING IS A MERE POST MORTEM! COST ACCOUNTING GOES DEEPER INTO EACH ELEMENT OF COST

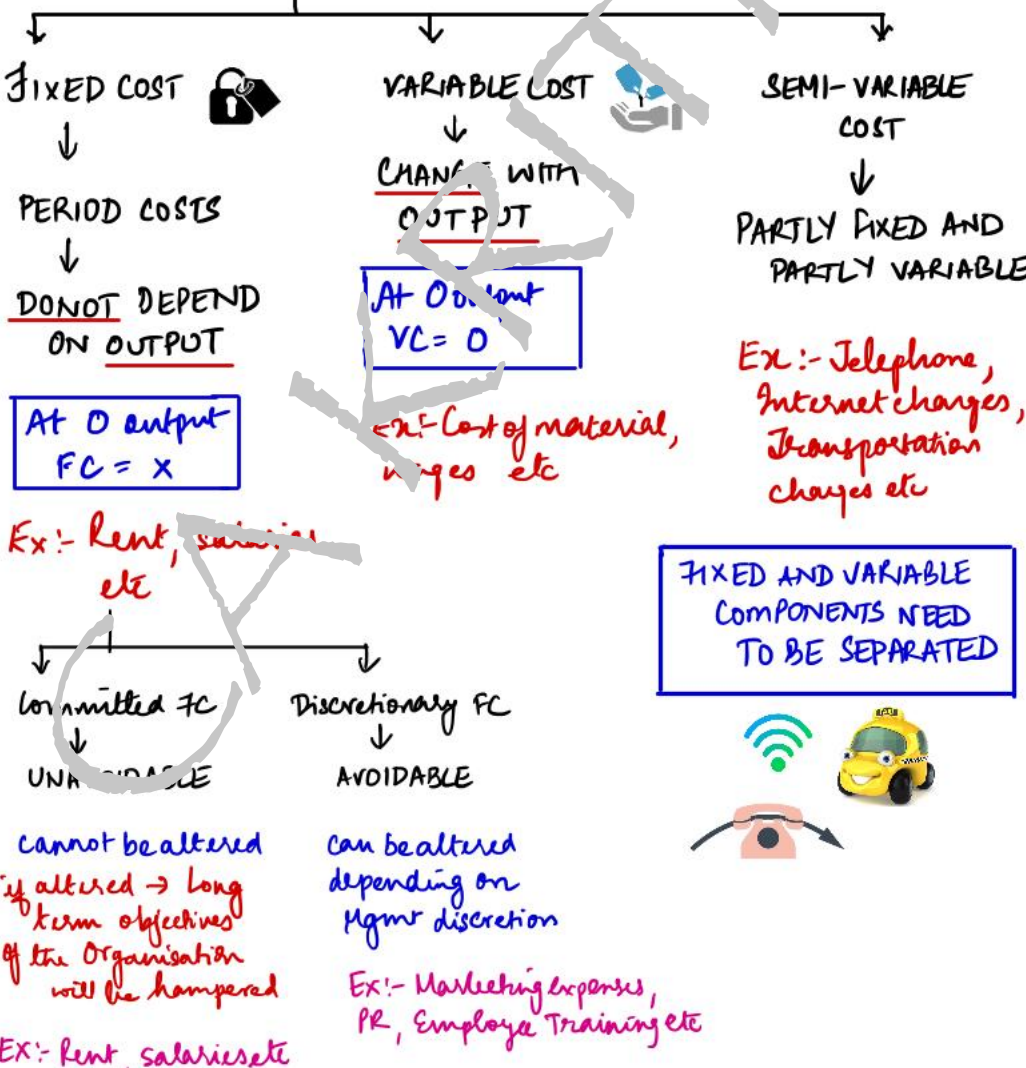
### COST CLASSIFICATION



**ON THE BASIS OF TIME**



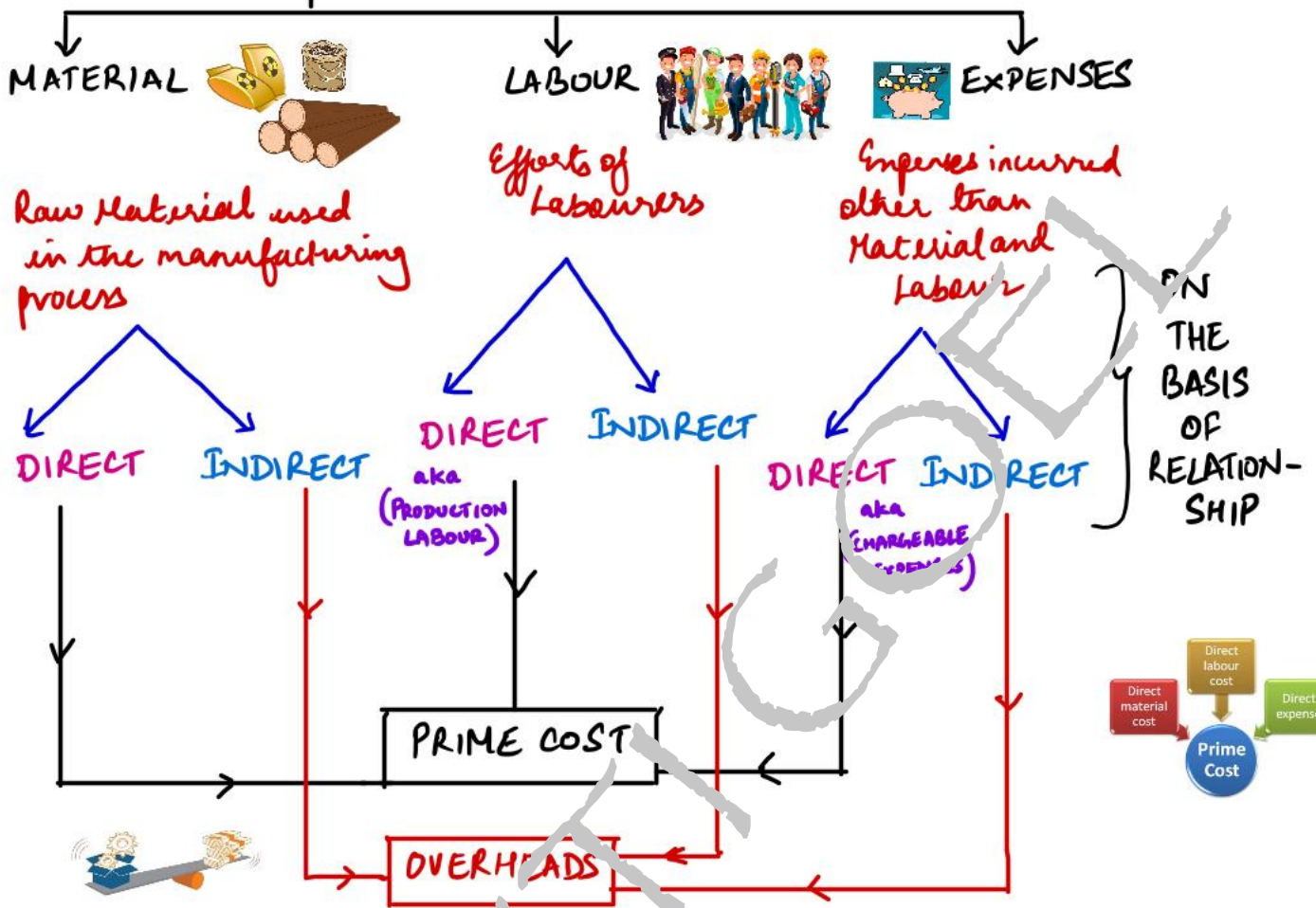
**ON THE BASIS OF BEHAVIOUR**



FC remains the same in TOTAL  
FC changes p.u. of output

VC remains the same p.u. of output  
VC changes in TOTAL

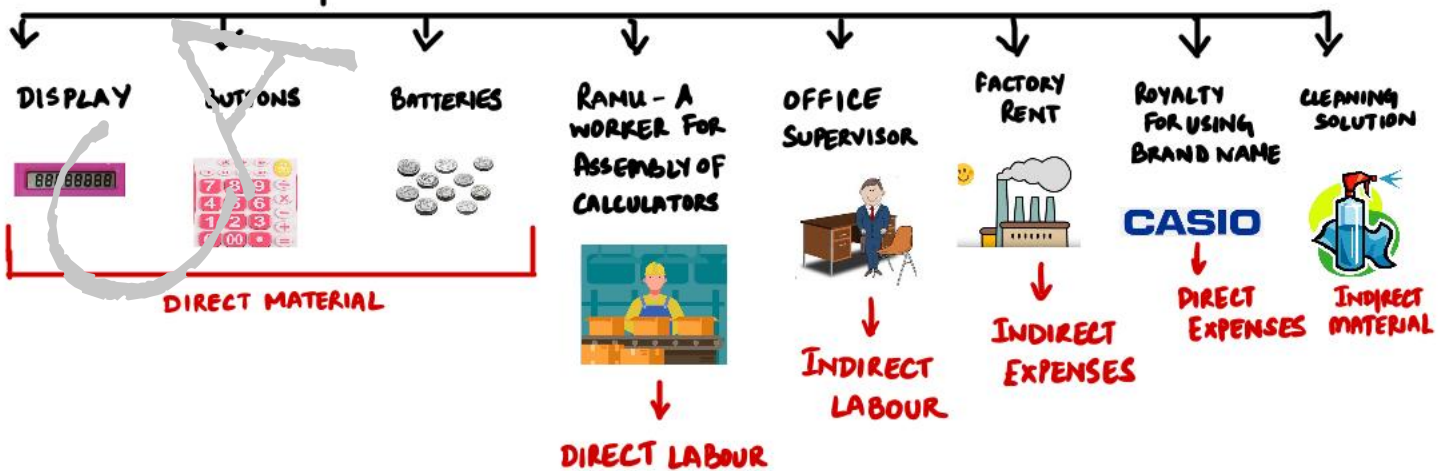
**ON THE BASIS OF ELEMENTS**



**DIRECT COSTS** can be identified on a per unit basis. **ALWAYS ALLOCATED**  
**INDIRECT COSTS** cannot be identified on a per unit basis

**ALWAYS APPORTIONED**

**Ex: A CALCULATOR**



## ON THE BASIS OF CONTROLLABILITY

### CONTROLLABLE COSTS

Influenced and controlled by Managerial Action.

Ex:- Rental agreements are controllable in the hands of the CEO but not in the hands of the Factory Manager.



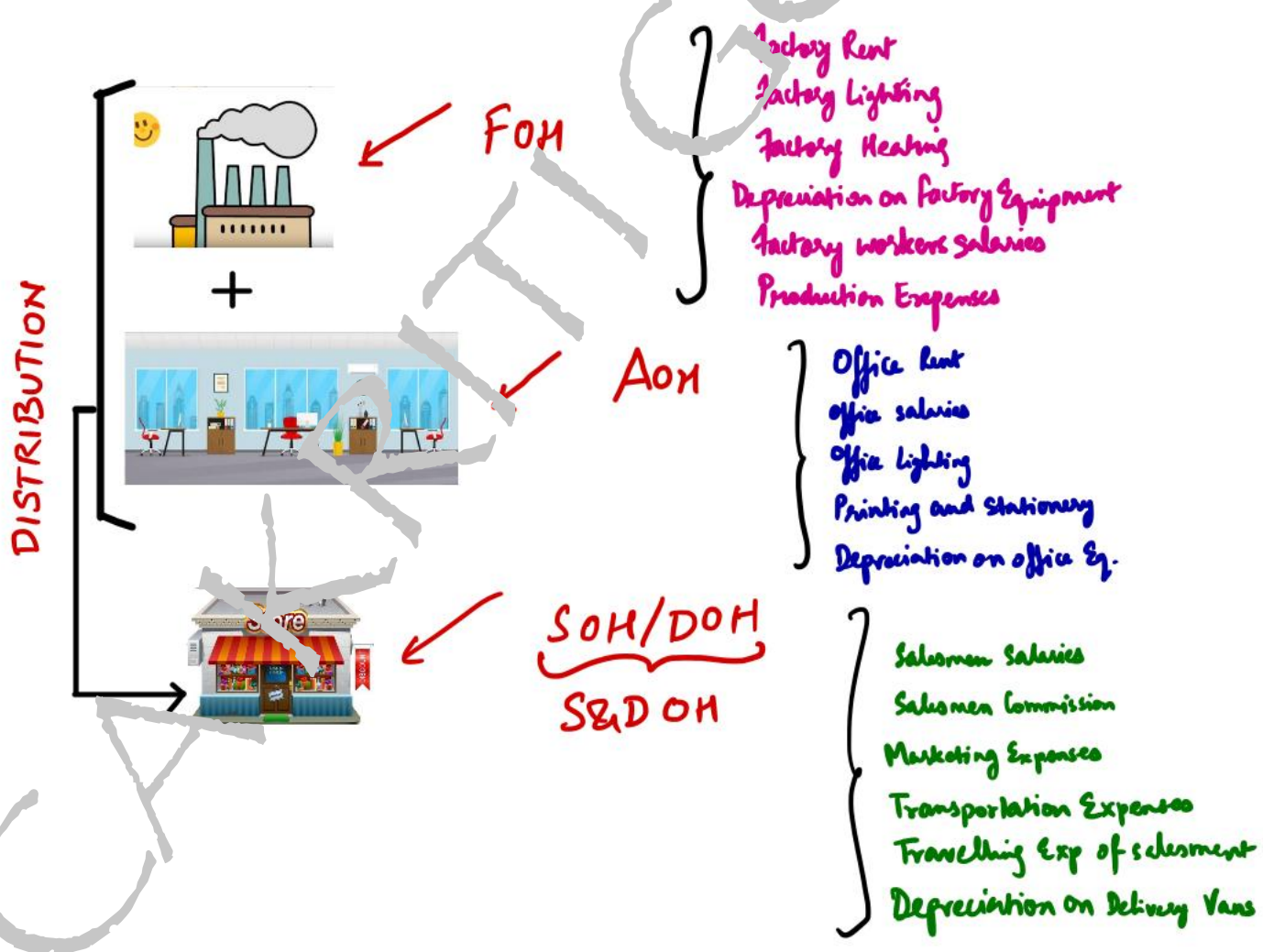
### UNCONTROLLABLE COSTS

Cannot be controlled by Managerial Action

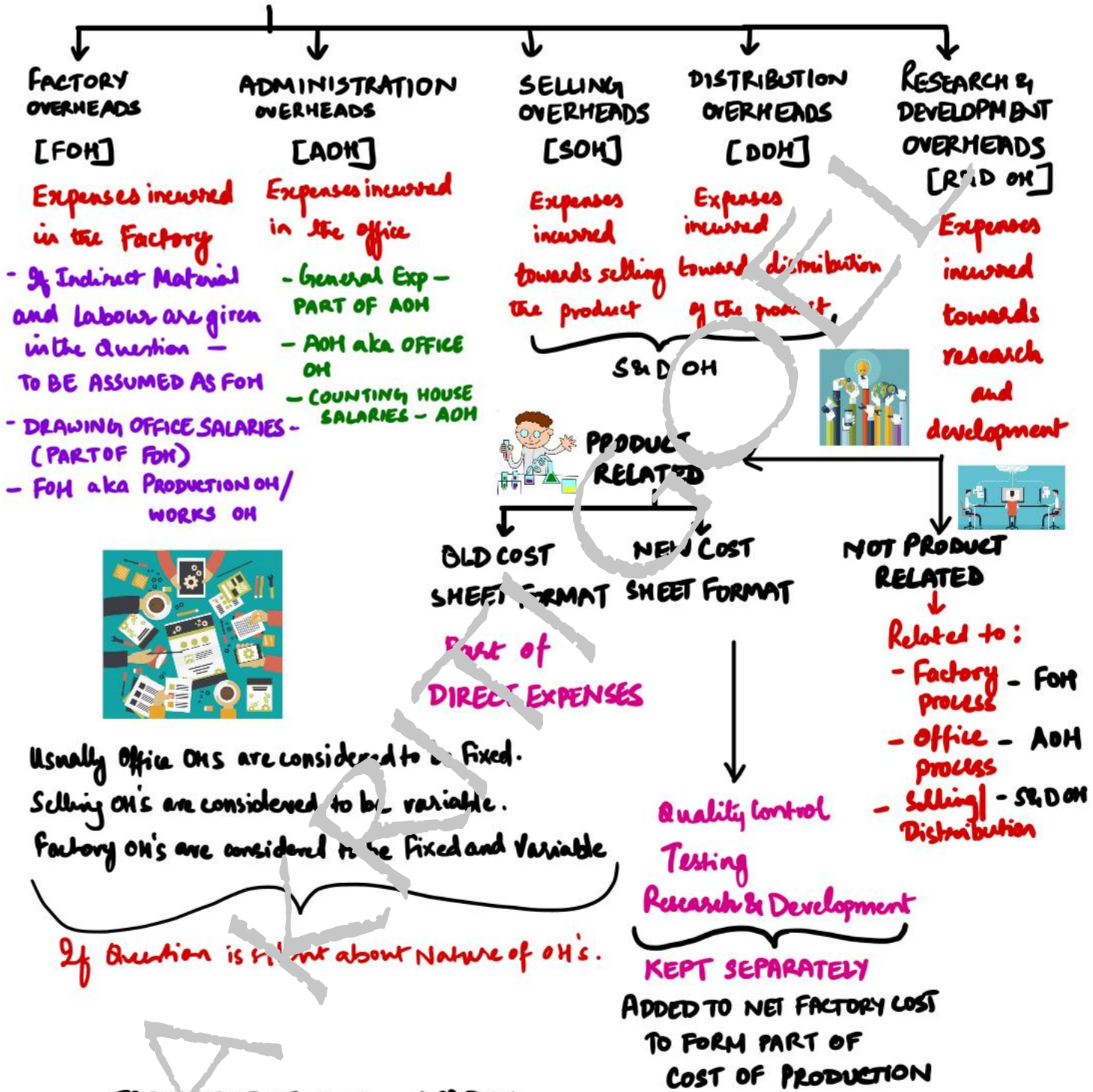
Ex:- Wastage of material during production can be controlled by the Factory workers but is not controllable in the hands of the CEO.



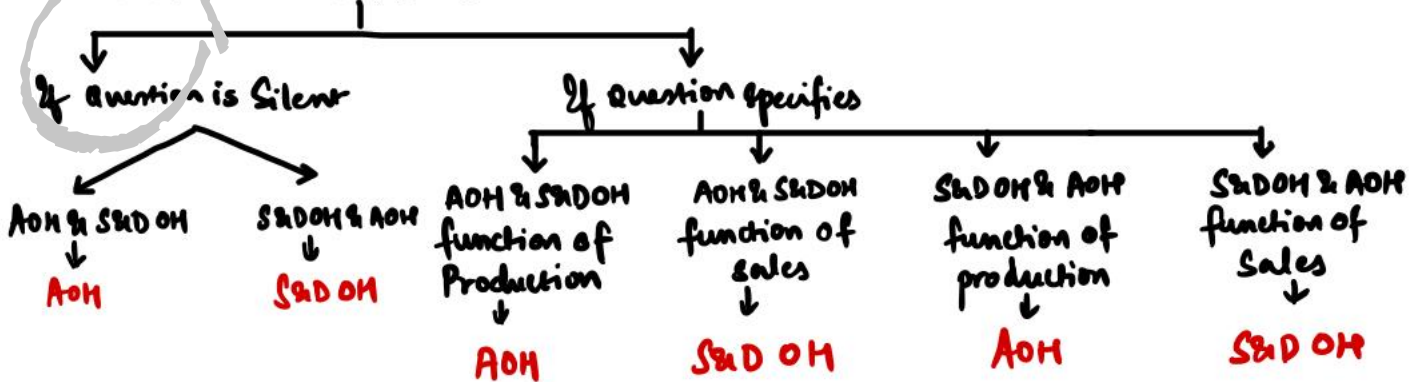
## ON THE BASIS OF FUNCTIONALITY



# ON THE BASIS OF FUNCTIONALITY



## TREATMENT OF AOH and S&DOH



# ON THE BASIS OF NORMALITY



## NORMAL COSTS

Normally incurred at a given level of output in Normal Conditions.

Always charged to Production.

Ex:- Evaporation of Petrol



ABNORMAL LOSS

NORMAL LOSS

## ABNORMAL COSTS

Costs over and above normal costs. They are Irregular and Unexpected. Abnormal costs are incurred at a given level of output under Normal Conditions.

Always charged to Costing P&L A/c. Never charged to Production as they are irregular and abnormal in nature.

Ex:- A Box CONTAINS 12 APPLES [NORMAL LOSS OF APPLES - 2]

COST OF 12 APPLES → ₹120  
COST PER APPLE  
 $= \frac{₹120}{12} = ₹10/- \text{pu}$



TOTAL ROTTEN APPLES → 5 APPLES

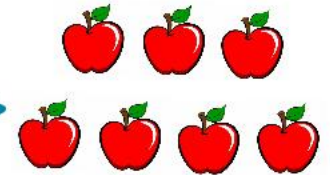
2 APPLES  
NORMAL LOSS  
(ROTTEN)



3 APPLES  
ABNORMAL LOSS  
(ROTTEN)



REMAINING APPLES  
↓  
7 APPLES  
GOOD UNITS



SINCE THIS WAS BOUND TO HAPPEN, THIS COST WILL BE BORNE BY THE REMAINING UNITS

HENCE NEW COST PER APPLE ;

$$= \frac{120 ₹}{12 - 2} = \frac{120}{10} = ₹12 \text{pu}$$

CHARGED TO PRODUCTION

INFLATED COST

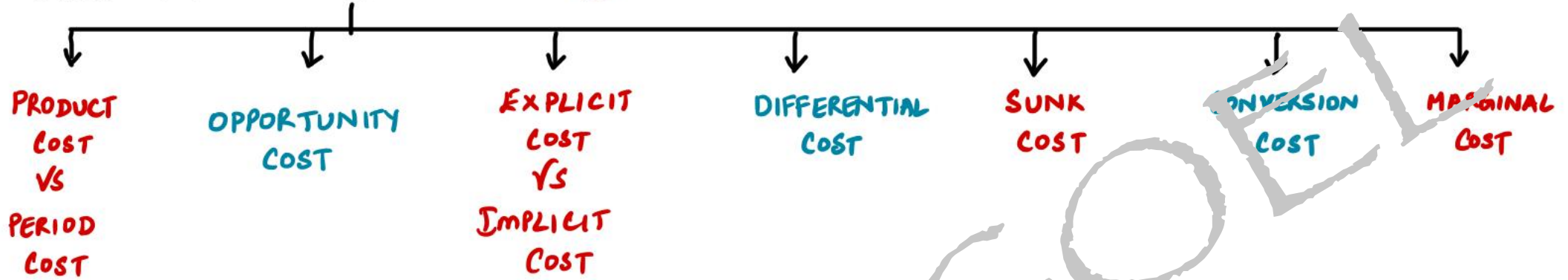
← COST OF GOOD UNITS →  $7 \times ₹12 = ₹84/-$

← COST OF ABNORMAL LOSS →  $3 \times ₹12 = ₹36/-$

CHARGED TO COSTING P&L A/c



# OTHER COST CLASSIFICATION



## PRODUCT COST V/S PERIOD COST

### PRODUCT COSTS

↓  
Assigned to Products and included in INVENTORY VALUATION



### PERIOD COSTS

↓  
Charged as expenses against revenues of the period in which they are incurred.  
NOT included in INVENTORY VALUATION

**ABSORPTION COSTING** → ALL COSTS ARE PRODUCT COSTS

**MARGINAL COSTING** → VARIABLE COSTS — PRODUCT COSTS  
→ FIXED COSTS — PERIOD COSTS

## OPPORTUNITY COST

**COST OF THE NEXT BEST ALTERNATIVE**

↓  
Used when there are Options

Ex:- Salary in A Ltd v/s starting own Business

Opportunity cost of starting ones own Business is letting go of salary in A Ltd.

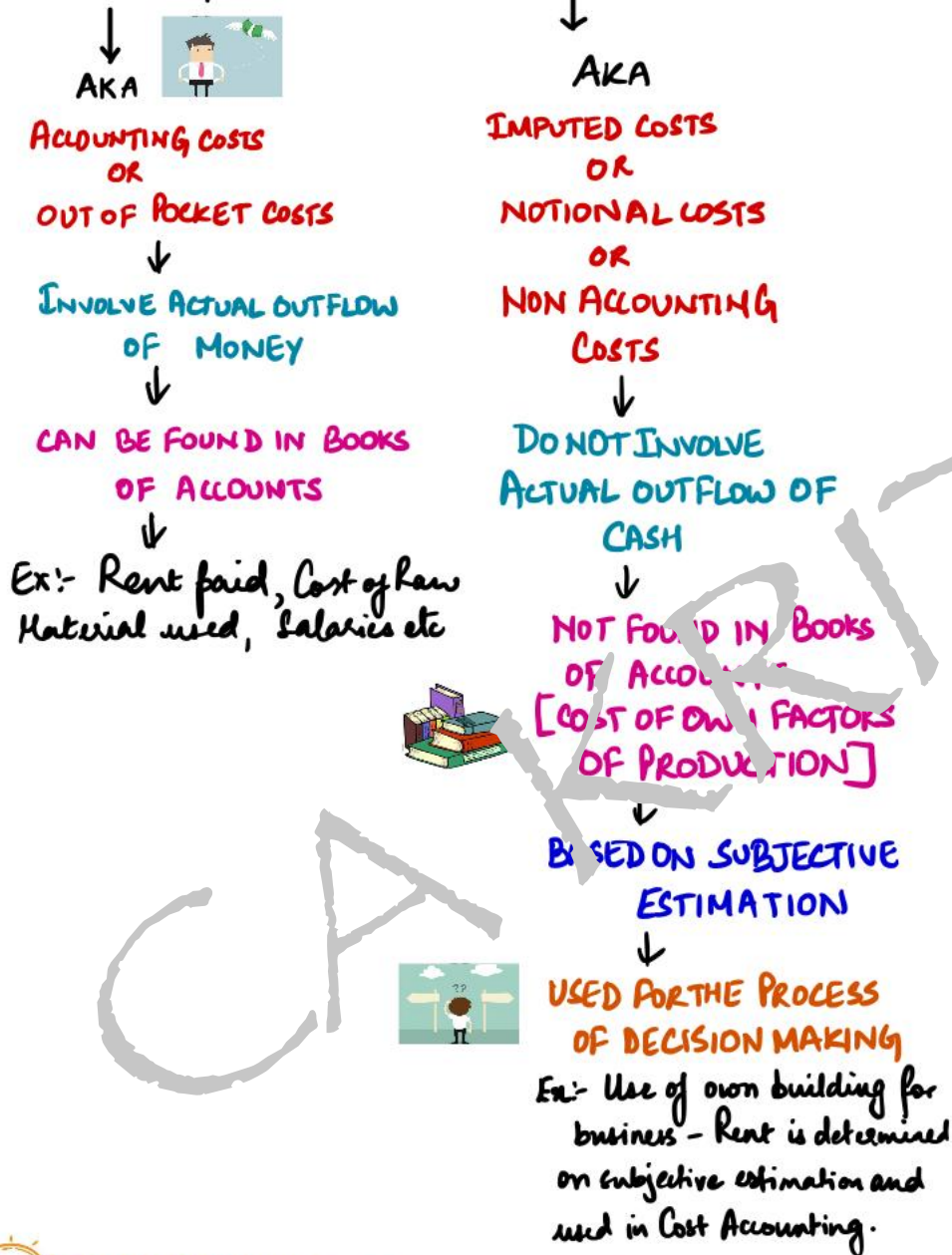


A LTD



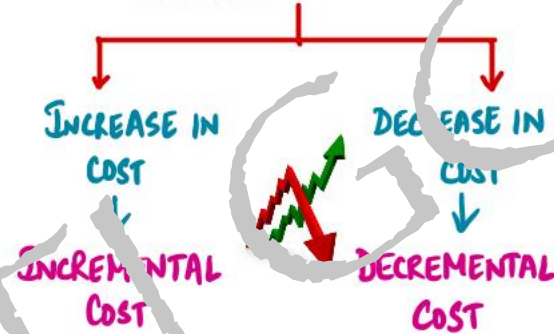
OWN BUSINESS

## EXPLICIT v/s IMPLICIT COST



## DIFFERENTIAL COST

CHANGE IN COST DUE TO CHANGE IN THE LEVEL OF ACTIVITY.



Differential costs may be due to both changes in fixed and variable costs

### EXAMPLE :

COSTS	100 UNITS	1000 UNITS
TOTAL V.C. (@ ₹2 pu)	₹ 200	₹ 2000
TOTAL F.C.	₹ 1000	₹ 1000
ADDITIONAL F.C.	-	₹ 500

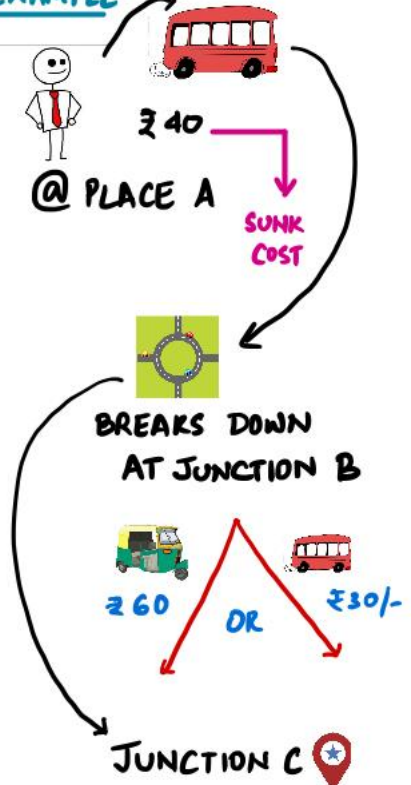
**TOTAL COSTS**      ₹ 1200      ₹ 3500

₹ 2300/-  
DIFFERENTIAL COST

## SUNK COST

COST WHICH IS ALREADY INCURRED AND IRRELEVANT FOR DECISION MAKING

### EXAMPLE



**CONVERSION COST**  
COST OF CONVERTING  
RAW MATERIAL TO  
FINISHED PRODUCT.



**MARGINAL COST**  
COST INCURRED IN  
PRODUCING ONE  
ADDITIONAL UNIT

$$MC = \frac{\Delta TC}{\Delta Q}$$

↓  
Like Variable cost

**EXAMPLE**

COST	100 UNITS	101 UNITS
VARIABLE COST (@ ₹ 2 pu)	₹ 200	₹ 202
FIXED COST	₹ 100	₹ 1000
<b>TOTAL COST</b>	<b>₹ 1200</b>	<b>₹ 1202</b>

$$\text{MARGINAL COST} = \frac{1202 - 1200}{101 - 100}$$

$$\left( \frac{\Delta TC}{\Delta Q} \right) = ₹ 2 \text{ pu} \cong \text{v.c.}$$

DOES NOT INCLUDE  
THE COST OF RAW MATERIAL.

CONVERSION COST = LABOUR  
+  
OTHER EXPENSES

**EXAMPLE**

COST OF GIFT WRAPPING



COST OF GIFT WRAPPER  
~~COST OF GIFT~~

PRIME COST    CONVERSION COST    FACTORY COST

DM	✓	✗	✓
DL	✓	✓	✓
DE	✓	✓	✓
FOH	✗	✓	✓

**ADDITIONAL POINTS TO BE NOTED**

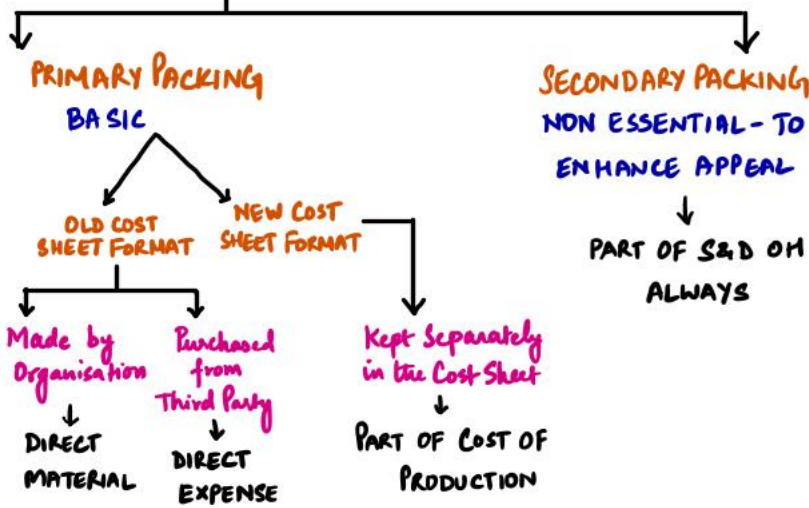
1. **ABNORMAL LOSS**

- To be removed from the Cost Sheet.
- To be transferred to Costing P&L A/c.
- Scrap from Abnormal Loss to be adjusted with loss and then transferred to Costing P&L A/c.

2. **NORMAL LOSS**

- Cost of Normal Loss to be borne by Good UNITS.
- Cost of Good UNITS gets INFLATED.
- Scrap proceeds arising due to Normal Loss shall be deducted from Total Cost so that Total Cost associated with loss comes down.

### 3. PACKING EXPENSES



If Question does not state whether packing is primary or secondary it is assumed to be **PRIMARY PACKING**.  
This is because some products may not have secondary packing.

#### EXAMPLES

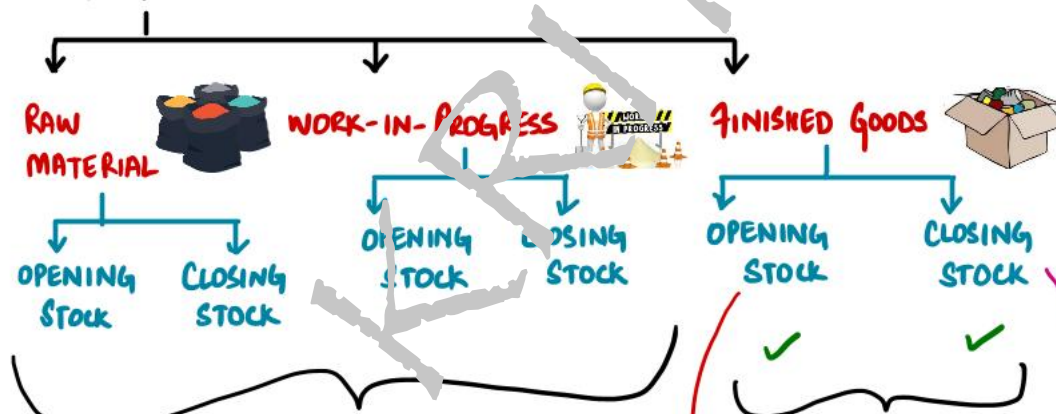
##### PRIMARY PACKING



##### SECONDARY PACKING



### 4. STOCK



NO COMPUTATION AS IT WILL BE GIVEN IN THE PROBLEM

TO BE COMPUTED

VALUED AT PREVIOUS YEAR'S COST OF PRODUCTION

VALUED AT CURRENT YEAR'S COST OF PRODUCTION

If Previous Year's Cost of Production is not given then opening stock of finished goods can be valued at current year's Cost of Production.

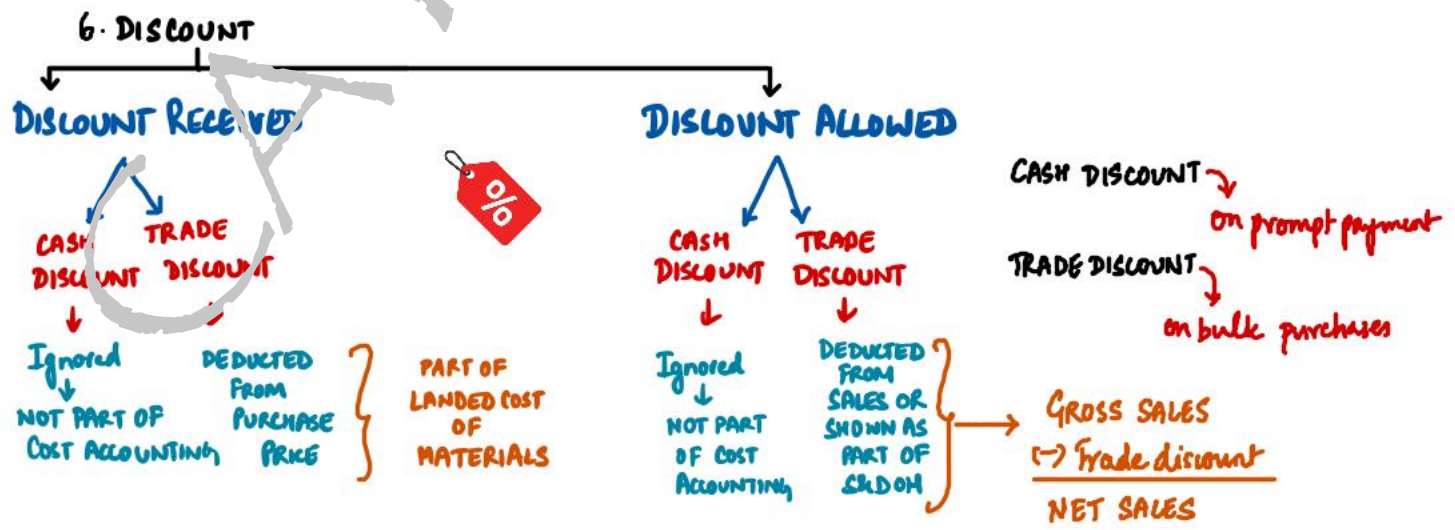




- PURELY FINANCIAL CHARGES** → Loss on sale of Fixed Assets, Loss on investments, Discounts on shares, Deb, Interest on Bank loan, \* Expenses on raising Capital
- APPROPRIATIONS OF PROFITS** → Donation, Charities, Taxes on Incomes, Dividends, Transfer to Reserves, Prov. for Bad debts\*
- WRITING OFF OF FICTITIOUS ASSETS** → Preliminary exp written off, underwriting commission etc
- PURELY FINANCIAL INCOMES** → Rent Receivable, Profits on sale of Fixed Assets, Interest on Bank Deposits, \* Dividend Received etc
- ABNORMAL GAINS & LOSSES** → Transferred to COSTING P&L A/c

\* **DISPUTED ITEMS**   
 Can be considered as purely Financial charges / Financial Incomes OR  
 Can be considered in Cost Accounting if assumed to be directly associated with the product.

A SEPARATE NOTE TO BE GIVEN IN RELATION TO THESE ITEMS MENTIONING METHOD OF TREATMENT



## COST SHEET FORMAT (OLD)

- Opening Stock of Raw Material (DM)  
 (+) Purchases (DM)  
 (+) Expenses incidental in bringing material to stores  
 (-) closing stock of Raw Material (DM)

### COST OF DIRECT MATERIAL CONSUMED

- (+) Direct Wages  
 (+) Direct Expenses (Chargeable Expenses)

### PRIME COST

- (+) Factory Overheads  
 (+) Opening stock of WIP  
 (-) closing stock of WIP

### FACTORY COST / WORKS COST

- (+) Administration Overheads

### COST OF PRODUCTION (CP)

- (+) Opening stock of finished goods

### COST OF GOODS AVAILABLE FOR SALE

- (-) closing stock of finished goods

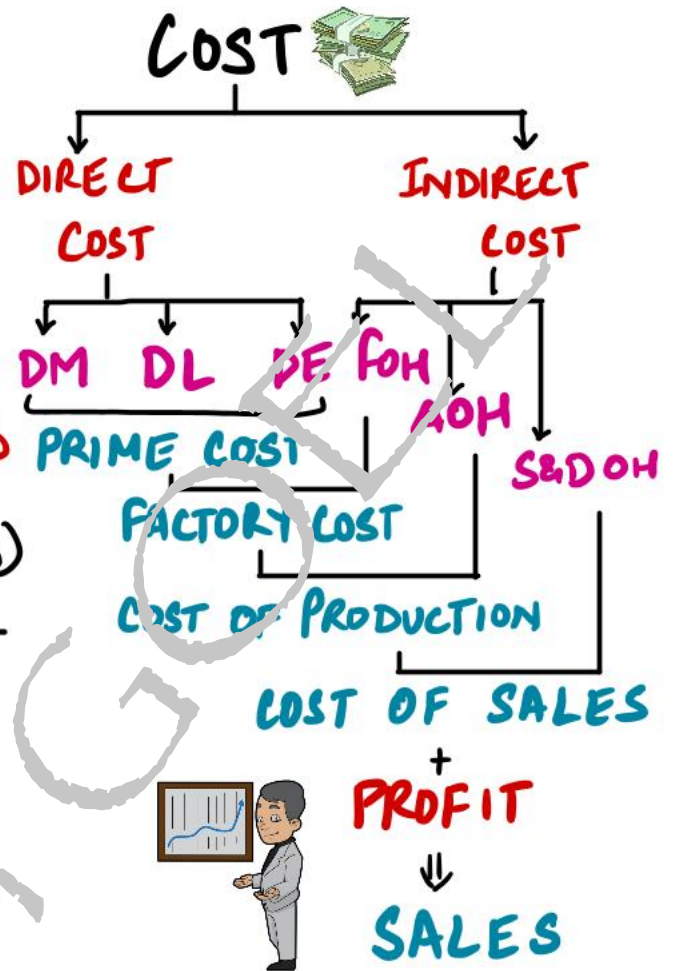
### COST OF GOODS SOLD (COGS)

- (+) Selling and Distribution Overheads

### COST OF SALES (COS)

- (+) Profit

### SALES



## COST SHEET FORMAT (NEW)

- Opening Stock of Raw Material (DM)
- (+) Purchases (DM)
- (+) Expenses incidental in bringing material to stores
- (-) closing stock of Raw Material (DM)

## COST OF DIRECT MATERIAL CONSUMED

- (+) Direct Wages
- (+) Direct Expenses (Chargeable Expenses)

## PRIME COST

- (+) Factory Overheads
- (+) Opening stock of WIP
- (-) closing stock of WIP

## FACTORY COST / WORKS COST

- (+) Quality Control Cost
- (+) Research and Development Cost
- (+) Administration OH (relating to Production)
- (-) Recovery of Scrap
- (+) Packing Cost (Primary)

## COST OF PRODUCTION (COP)

- (+) Opening Stock of finished goods

## COST OF GOODS AVAILABLE FOR SALE

- (-) closing stock of finished goods

## COST OF GOODS SOLD (COGS)

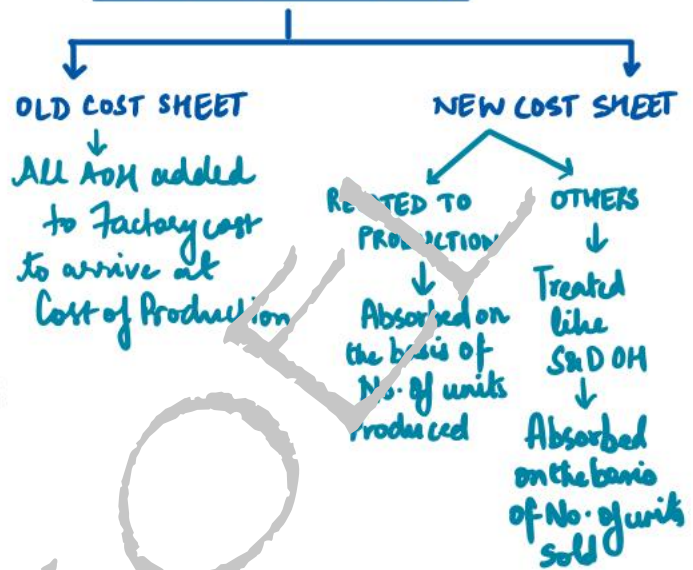
- (+) AOH - General Expenses
- (+) Selling and Distribution Overheads

## COST OF SALES (COS)

- (+) Profit

## SALES

## TREATMENT OF AOH



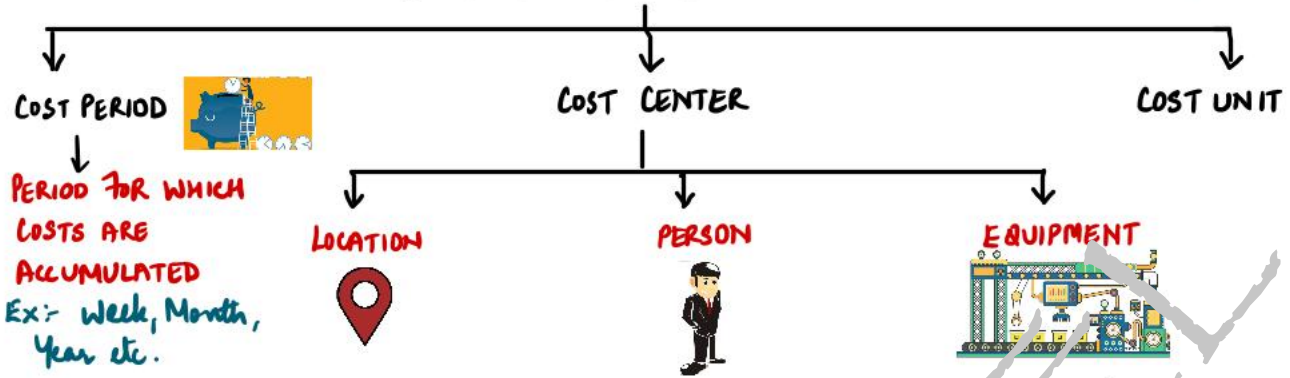
→ No clarity on whether this cost is related to Factory or Admin OHs. Hence it is kept separately.

→ Only related to Production - part of COP.

→ Kept separately. This was part of DM/DE under old format.

→ This includes dep/maintenance of machines, buildings, furniture etc of Corporate and General Management, Salaries of General admin employees, accountants, directors etc, rent, insurance, lighting, office expenses etc.

# PARAMETERS OF COST EXPRESSION

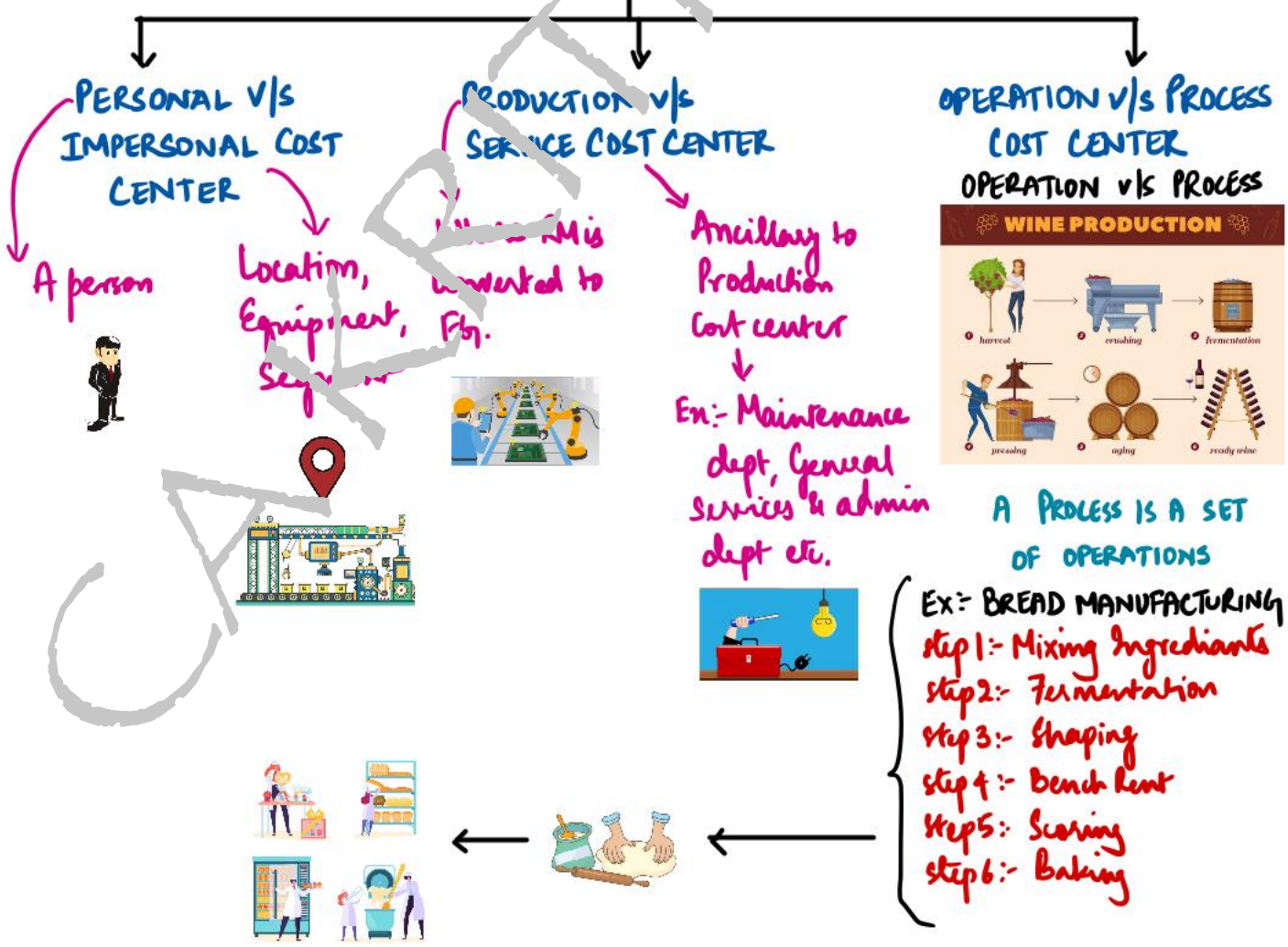


OR  
SMALLEST SEGMENT FOR WHICH COST MAY BE ACCUMULATED

EXAMPLE: Delivery Van

Very Important for Cost ascertainment and Control

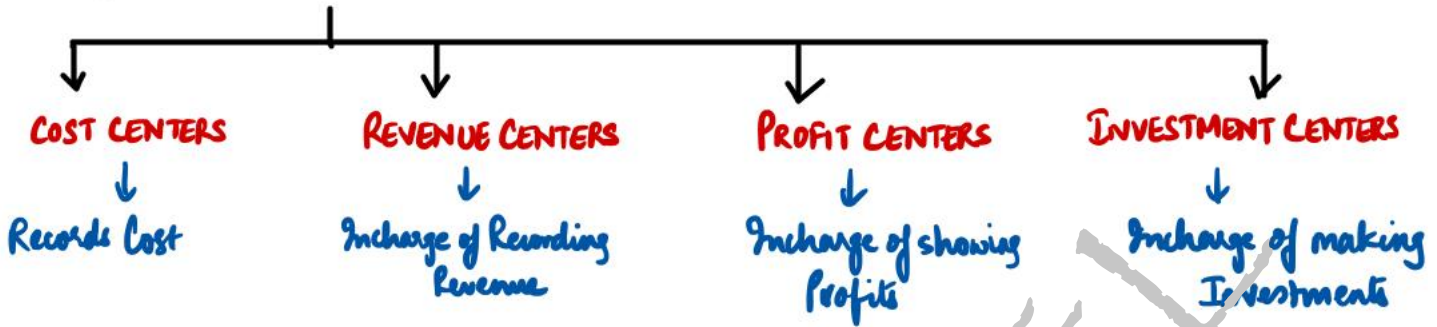
## TYPES



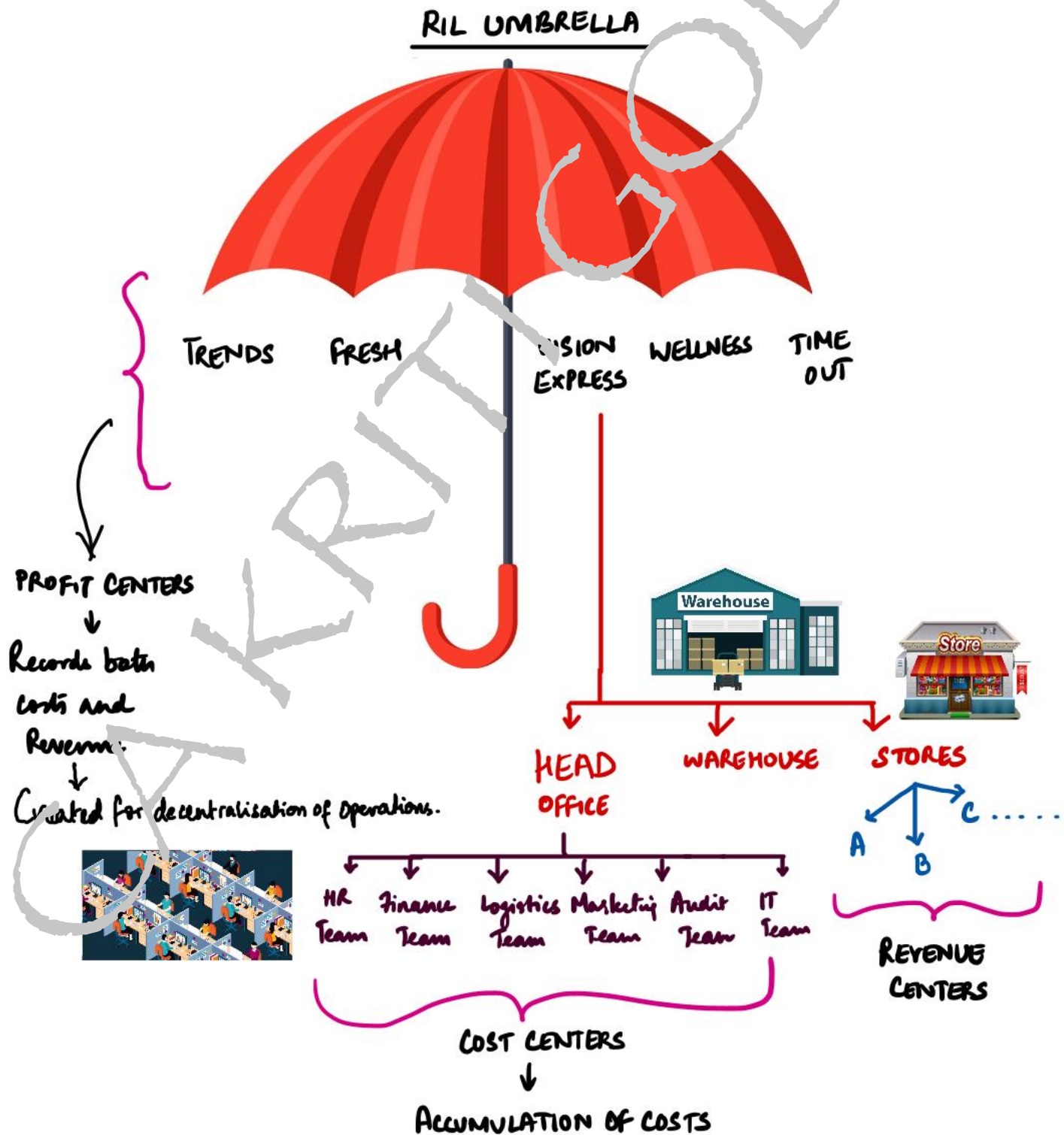
A PROCESS IS A SET OF OPERATIONS

- Ex:- BREAD MANUFACTURING
- step 1:- Mixing Ingredients
  - step 2:- Fermentation
  - step 3:- Shaping
  - step 4:- Bench rest
  - step 5:- Scoring
  - step 6:- Baking

# TYPES OF RESPONSIBILITY CENTERS



## EXAMPLE



# METHODS AND TECHNIQUES OF COSTING

↓ Application of same principle differently

↓ Application of different principles

## SINGLE / OUTPUT COSTING



## JOB COSTING



## BATCH COSTING



## CONTRACT COSTING



## PROCESS COSTING



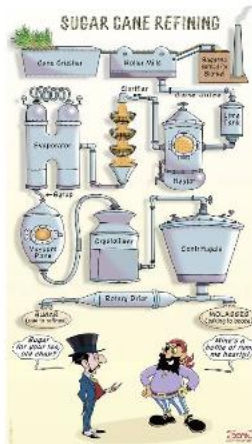
## JOINT PRODUCT AND BY PRODUCT COSTING



## OPERATING COSTING



## MULTIPLE COSTING

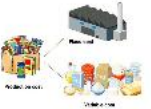


## UNIFORM COSTING

When every firm in the given industry decides to follow a particular technique.

## ABSORPTION COSTING

All costs are charged to production whether fixed or variable.



## STANDARD COSTING

Costs are predetermined and are called as standard costs. They are then compared with actuals to determine variances.



## MARGINAL COSTING

All variable costs are charged to production. Fixed costs are period costs and charged to Costing P/L a/c.

## DIRECT COSTING

Only Direct costs are charged to the product. Indirect costs are period costs.

## POST COSTING

Cost is only ascertained after production is completed.