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COST AND WORKS ACCOUNTING
(Overheads and Methods of Costing-II)
T.Y.B.COM

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Topic- V: Methods of Costing
(Methods of Costing)

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Introduction to Methods of Costing:

Costing is simply a method of cost finding. It is the technique and process of ascertaining the costs. It is the classifying, recording and appropriate allocation of expenditure for the determination of costs of products or services and for the presentation of suitably arranged data for the purpose of control and guidance of the management. Costing includes ascertainment of the cost of every order, job, batch, contract, process, service or unit as may be appropriate.

Costing is the proper allocation of expenditure whereby reliable cost may be ascertained appropriately and suitably presented to afford guidance to the manufacturers, traders or service-providers in control of their respective businesses.

Cost Accounting is the process of accounting for cost, from the point at which expenditure is incurred or to be incurred to the point of charging to the cost centres and cost units. It has many uses which includes the presentation of statistical data, the application of cost control methods and the ascertainment of the profitability of activities carried out or planned,
METHODS OF COSTING:

A) Specific Order Costing:

Definition as per the terminology of ICMA:
“Specific Order Costing is the category of basic costing methods applicable where the work consists of separate contracts, jobs or batches each of which is authorised by a special order or contract”.

Specific Order Costing method is adopted in made-to-order type of products which depends entirely on the specifications of customers. As such there is no standardisation in the production process for uniform products.

Following are the different methods of Specific Order Costing:

1. Job Costing:

Definition as per the terminology of ICMA:
“Job Costing is that form of specific order costing which applies where work is undertaken to customer’s special requirements”.

Under the method of job costing, costs are collected and accumulated for job, work order or project separately. Each job can be separately identified, so it becomes essential to analyse the cost according to each job. A Cob Card is prepared for each job for cost accumulation. This method is applicable to printers, machine tool manufacturers, foundries and general engineering workshops, interior decorator, painters, repair shops etc.

2. Batch Costing:

Definition as per the terminology of ICMA:
“Batch Costing is that form of specific order costing which applies where similar articles are manufactured in batches either for sale or use within the undertaking”.

Bob Costing method is a variation of Job Costing. In this method, the cost of a batch or group of identical products is ascertained and therefore, each batch of products is a unit of cost for which costs are accumulated.
This method is applicable in biscuit factories, bakeries, ready-made garments, hardware like nuts, bolts, screws, shoes, toys, drugs and pharmaceuticals etc.
3. Contract or Terminal Costing:

Definition as per the terminology of ICMA:
“Contract Costing is that form of specific order costing which applies where work is undertaken to customers’ special requirements and each order is of long duration”.

In the method of Contract Costing the cost unit here is a contract which is of a long duration and may continue over more than one financial year. A separate account is kept for each contract. This method is used by builders, civil engineering contractors, constructional and mechanical engineering firms etc.

4. Multiple or Composite Costing:

Definition as per the terminology of ICMA:
“Multiple or Composite Costing is that form of specific order costing which applies where a number of components are separately manufactured and then assembled into a final product”.

This method is applicable where a number of components are separately manufactured and assembled into a final product, therefore, more than one method of cost ascertainment in respect of the same product is used. In such industries each component differs from the others as to price, material used and process of manufacture undergone. So it will be necessary to ascertain the cost of each component for this purpose, process costing may be applied and batch costing may be applied to ascertain the cost of the final product.
This method is used in factories of manufacturing cycles, automobiles, engines, radios, TVs, typewriters, aeroplanes etc.

5. Class Cost Method:

Definition as per the terminology of ICMA:
“Class Cost method of Costing is that form of specific order costing which applies where the costing of goods is done by classes instead of the unit or a piece”.

Instead of the cost being separately accumulated for each article or piece, the cost will cover a group of orders of the same class of product.

B) Operations Costing:

Definition as per the terminology of ICMA:
Operations Costing is the category of basic costing methods applicable where standardised goods or services result from a sequence of repetitive and more or less continuous operations or process to which costs are charged before being averaged over the units produced during the period”.
Following are the different methods of Operations Costing:

1. **Process Costing:**

Definition as per the terminology of ICMA:
“Process Costing is that form of operation costing which applies where the standardised goods are produced”.

Process Costing is a method of costing where cost is ascertained at the stage of every process and also after completing the finished product. It is used in manufacturing concerns where production follows a series or sequential process. Process type of industries do not manufacture individual items to the specific requirements of customers. As such, production is not continuous. Each process represents a distinct stage of manufacture and the output of one process becomes the input of the another (next) process.

This method is used in industries like chemicals, oil refining, paper making, flour milling, cement manufacturing, sugar, rubber, textiles, soap, glass food processing etc.
2. Operating or Service Costing:

Definition as per the terminology of ICMA:
“Operating Costing is that form of operation costing which applies where standardised services are provided
either by an undertaking or by a service cost centre within an undertaking”.

This method of costing is used by those undertakings which render service as against manufacturing and supply of tangible products. It is an essential method of costing where only the services are rendered. It ascertains the cost of one unit of service rendered. The cost unit depends upon the service provided. In service undertakings a composite cost unit is used.

This method is applicable to transport undertakings, electricity supply undertakings, hospitals, hotels, canteen, water works, gas companies, educational institutions etc.

Examples of cost units: Tonne kilo-metre, passenger kilo-metre, patient day or bed day (per patient per bed), KWH, meal served, student hours etc.
3. Unit or Single or Output Costing:

Definition as per the terminology of ICMA:
“Units or Single or Output Costing is that form of operation costing which applies where manufacturing is continuous and the units are identical”.

This method is also called as Single Costing because only one type of product alone is manufactured. In some cases the units may be differ in terms of size, shape and quality.

Examples of industries where this method is applicable- Paper mills, flour mills, textile mills, brick-making, radio, cameras, pencils, slates, diary products etc.

4. Departmental Costing:

A factory may be divided into a number of departments and sometimes good results are obtained by allocating expenditure first to different departments and then to different products manufactured in that department. Under this method, the cost incurred in maintaining a particular department is ascertained. There are two objectives for using this method- 1. To control the cost of the department 2. To charge the cost of a department or to the finished product.
5. Operation Costing:

It is a special type of Process Costing. It refers to the determination of cost of operations, the cost unit is the ‘operation’ instead of the process. The per unit cost is arrived at by dividing the cost of an operation by the number of units completed in the operation centre. For large undertakings it is frequently necessary to ascertain the cost of various operations. Cost control can be exercised more effectively with operation costing.
Thank You