Specific Areas of Costing

Methods of Costing

M B G Wimalarathna
(FCA, FCMA, MCIM, FMAAT, MCPM)(MBA–PIM/USJ)
Introduction

This chapter deals with determining appropriate costing mechanism of the particular entity. An entity should select most appropriate costing method best suit to its business model/key operations in order to determine the cost of the particular product/service in unit and in total and as such determining a suitable price.

Any method/technique/set procedure apply(use) to determine a cost of the particular cost unit does usually refer costing method.

Key/most commonly used/popular costing methods;
- Job Costing
- Batch Costing
- Service Costing
- Contract Costing
- Process Costing
Costing Methods

Job Costing

Job costing is mostly used when special job/order received from the customer. This costing mechanism is more suitable when an entity fulfil well identified special order of the customer through existing production process.

Key features;
- Reasonably short period of time takes for the completion
- Based on the special job/order of the customer – for a unit
- Total costs will be determined soon after complete the job
- Indirect overheads will be apportioned into manufacturing & non-manufacturing based on specific/standard rates

Note : Generally, a separate “job card” will be maintained for each and every job by the entity and total cost of the job could trace from such job card accordingly.
Batch Costing

Batch costing is mostly used when special order received from the customer for a multiple units. This costing mechanism is more suitable when an entity fulfil **well identified special order** of the customer for **more than one unit** (**batch**) through existing production process.

Key features;
- Reasonably little long period of time takes for the completion
- Based on the special job/order of the customer – for **batch**
- Total costs will be identified after complete the whole batch
- Indirect overheads will be apportioned into manufacturing & non-manufacturing based on specific/standard rates

Cost per unit = total cost of the batch/number of units produced

*(if normal loss experienced, denominator should be expected completed units only)*
Costing Methods

Service Costing

Service costing is dedicated to determine the cost of the particular service being provided/rendered. This costing mechanism is more suitable when an entity fulfil well identified service of the customer.

Key features;

- Total cost of the service shall be determined after completion
- Based on the current practice of serving customers
- Indirect overheads will be apportioned into manufacturing & non-manufacturing based on specific/standard rates

Cost per service unit = total cost of the services offered during the period/number of service units identified/rendered

Note: it is important to determine both total cost for the period and total number of service units accurately. (a student/a course)
Costing Methods

Contract Costing

Contract costing is to determine the cost of the particular construction work/undertaking. This costing mechanism is more suitable when an entity fulfil well identified construction work/undertaking of the customer.

Key features;
- Total cost of the contract shall be determined upon completion
- Based on the request received from the customer
- Price of the contract will have direct relationship to the TC
- Indirect overheads will be apportioned into manufacturing & non-manufacturing based on specific/standard rates

Cost of the unit = total cost of the work including any contingencies (in multiple scenarios also can be considered)

Note: it is either fixed price/fee or cost plus price will be used in this types of arrangements.
Costing Methods

Process Costing

Process costing is the most common costing mechanism used in manufacturing industry/sector. When final product produced through series of well established processes/activities, the total cost of such product will be determined based on process costing mechanism.

Key features;
- Output of one activity will be an input of immediate next activity
- There will be an closing inventory at each activity levels
- Normal/abnormal losses will be experienced (waste/evaporation)
- Total cost of the process equally distributed among total units
Costing Methods

Process Costing

**Loss** – simply, the difference between output (completed units) from the production process and input (units) to the process.

**Normal loss** – any losses identified from the production process with certain assurance. This will measure/recognize at initial stage. Purely based on past experience and estimation. It can measure as a percentage of input/output/effective units.

Effective units = Op. WIP + Input – Closing WIP

Cost per unit = total cost of the production process/expected completed units (input units – normal loss)

Note: *it is a norm that cost of normal losses should bear by the completed units. Hence cost of normal loss will bear by the customer but not the entity.*
Costing Methods

Process Costing

Abnormal Loss – when actual loss of the production is greater than normal loss, the difference of those losses will be ABNL. Generally, this will recognize at the end of the production process.

Abnormal gain – when actual loss of the production is less than normal loss, the difference of those losses will be ABNG. Generally, this will recognize at the end of the production process.

Cost per unit = total cost of the production process/expected completed units (input units – normal loss)

Note: it is a norm that abnormal losses/gain should bear by the producer. Hence those will be identified in P&L as and when arise as an expenditure or other income.
Exercises

1. Details pertaining to the job – “X” received by ABC & Co. will be as follows;
   - DM - 2,000,000
   - DL - 1,000,000
   - MNF/OH - 150% on DL
   - Other OH - 20% production cost

Calculate the total cost of the job using job card.