

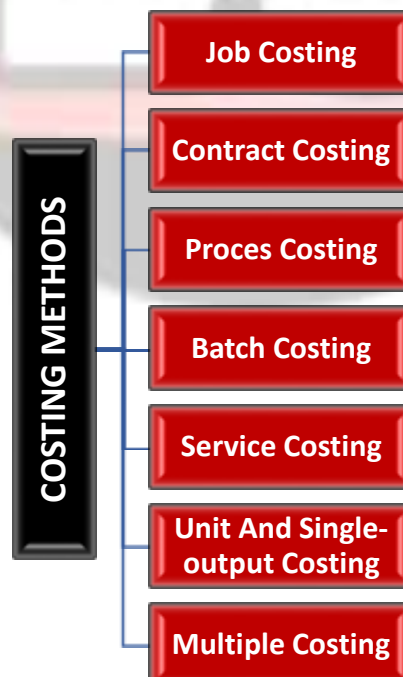
COSTING METHODS

COSTING

It refers to the process of **determining the expenses or costs** associated with a particular **project, product, service, or activity**.

COSTING METHODS

These are **techniques used by businesses to determine the cost of producing goods or services**. These methods help in determining the cost per unit of output.



JOB COSTING

- It is a costing method used to **determine the cost of producing goods or services** that are tailored to **specific customer orders or projects**.
- It involves tracking the costs associated with **each individual job or project separately**, allowing for accurate cost calculation and pricing.

JOB COST SHEETS

- These are **documents** used in job costing systems to **record and accumulate costs associated with individual jobs or projects**.
- These cards or sheets serve as a **central repository of cost information for each job**.

ADVANTAGES

Cost Tracking

Each card contains information such as **direct materials used, direct labour hours, and overhead costs incurred**. This level of tracking helps management and accountants **understand the true cost of each job and make informed decisions**.

Cost Allocation

It provides a systematic way to **allocate costs to individual jobs**. By recording direct costs and allocating overhead costs based on predetermined rates **calculate the total cost of production**.

Profit Analysis

Job cost cards facilitate **profit analysis on a per-job basis**. By **comparing the total costs incurred with the revenue generated** from a particular job, managers can evaluate its profitability.

Budgeting And Forecasting

It provides **historical data on the costs associated with similar jobs**, enabling managers to estimate costs more accurately for future projects.

Performance Evaluation

It also assists in evaluating the performance of **different departments or individuals involved in a job**. **By comparing actual costs with budgeted costs**, managers can identify areas of inefficiency, take corrective actions.

Decision-Making

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It provides **accurate cost information** that **aids decision-making in various scenarios**. They help assess the feasibility of new jobs, determine whether to **outsource tasks**, and **evaluate the profitability of product lines**.

JOB ACCOUNT

- It refers to a **specific account created to track the costs** associated with a particular job or project.
- It is a specialized account that allows for the accumulation and recording of **direct materials, direct labour, and overhead costs** incurred during the production of a specific job.
- The Job Account is **different from the job cost sheet**. Job account contains **only the monetary information**, while the job cost sheet records other information also.

CONTRACT COSTING

- It is a form of specific order costing which applies where work is undertaken to meet a customer's special requirements and each order is of a long duration.
separately for each contract.

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- It is an **extension of principles of job costing** for long-term projects like Civil Construction, Ship Building, Interior Decoration.

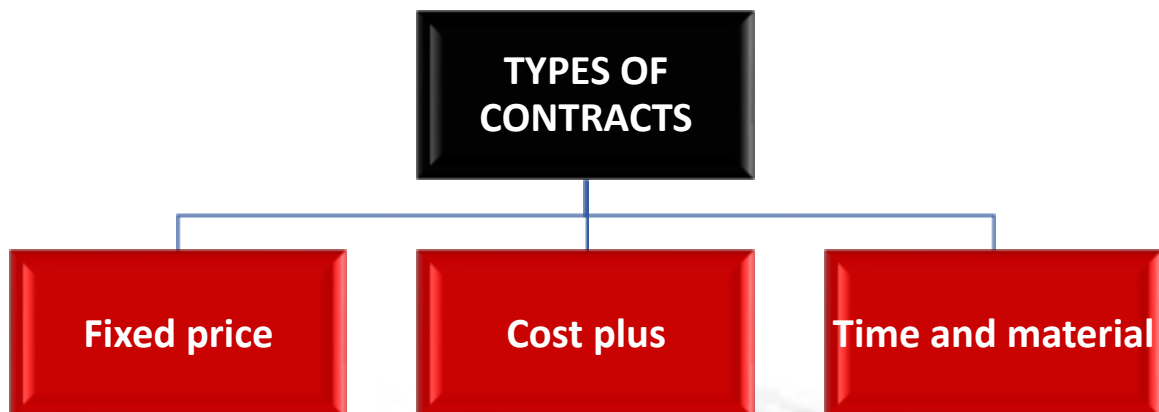
FEATURES OF CONTRACT COSTING

PARTIES There are two parties in a contract **Contractor - One who undertakes and executes work** under a contract, and **Contractee - One for whom the work is undertaken.**

SITE WORK Major part of the work in each contract is **generally carried out at the site of the contract.**

SEPARATE ACCOUNTS A **separate account is maintained** for each contract, to ascertain Profit or Loss.

TYPES OF CONTRACTS



Fixed price

- A Fixed Price Contract is one where the **Contract Price is fixed and determined in advance** at the time of entering into the agreement.
- Such type of contracts is entered into when **contract costs can be reasonably estimated with a degree of certainty.**

Cost plus

- A Cost-plus Contract is one where the **Contract Price is ascertained by adding a percentage of profit** to the total cost of the work.
- Such type of contracts is entered into when contract costs **cannot be estimated with reasonable accuracy** due to **unstable conditions, e.g., material prices, labour, etc.**

Time and material

The time and material arrangement are **comparable to a cost-plus contract**, with the **distinction that the contractor incorporates a profit margin** in their billings instead of being provided with a predefined profit.

IMPORTANT TERMS IN CONTRACT COSTING

Progress Payments

- It refers to **partial payments made by a customer** or client to a contractor or service provider during the course of a project.
- These **payments** are typically made at predefined stages of the **project's completion and are based on the percentage of work completed.**

Retention money

- It refers to a **portion of the contract value** that is **withheld by the customer or client** from the contractor until the completion of the project.
- It serves as a **form of security to protect the customer's interests and ensure the satisfactory completion of the work.**

Escalation Clause

- It is a **contractual provision** that allows for adjustments to the price or contract terms in response to changes in certain specified factors.
- This clause provides that in case prices of materials, labour etc. specified in the contract, change beyond a specified limit then contract price will be suitably adjusted.

Profit on Incomplete Contracts

- It refers to the recognition of profit or income from a construction or long-term project that is still in progress.
- It involves estimating and accounting for the **expected profit on a project that has not yet been fully completed.**
- This accounting practice is employed to provide a more accurate representation of the contractor's financial position and performance during the project's duration.

AS 7 and Ind AS 115 also recognise this principle and provide guidelines in this respect.

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Profit to date

$$= \frac{\text{Cost of work completed}}{\text{Total estimated contract cost}} \times \text{Estimated contract}$$

If the total cost of a contract is 500 lakh and the estimated profit from the contract is 100 lakhs, the profit on completion of the work, where cost already incurred is 200 lakh,

$$\text{Profit to date} = (200 / 500) \times 100 = 40 \text{ lakh}$$



DISTINCTION BETWEEN JOB AND CONTRACT COSTING

Basis of difference	Job Order Costing	Contract Costing
1. size	The work performed under job order costing is comparatively small in size.	The work performed under contract costing is larger in size than the job order.
2. Place of work	The manufacturing of product is carried out inside the factory premises.	The production or construction work is carried out at site.
3. time	Takes comparatively lesser time to complete the work.	Management takes a longer time to complete a contract, even more than an accounting period.
4. Payment of price	The price under job order is paid after the completion of job.	The price under a contract is gradually paid in different installments before the completion of the work.
5. investment	Preliminary investment in assets is low.	Preliminary investment in assets is comparatively high.
6. Nature of expenses	The expenses are both direct and indirect in nature.	Generally, the expenses are direct in nature.

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COSTING METHODS

PROCESS COSTING

- This costing technique is employed when a **product** undergoes multiple sequential stages or processes, where

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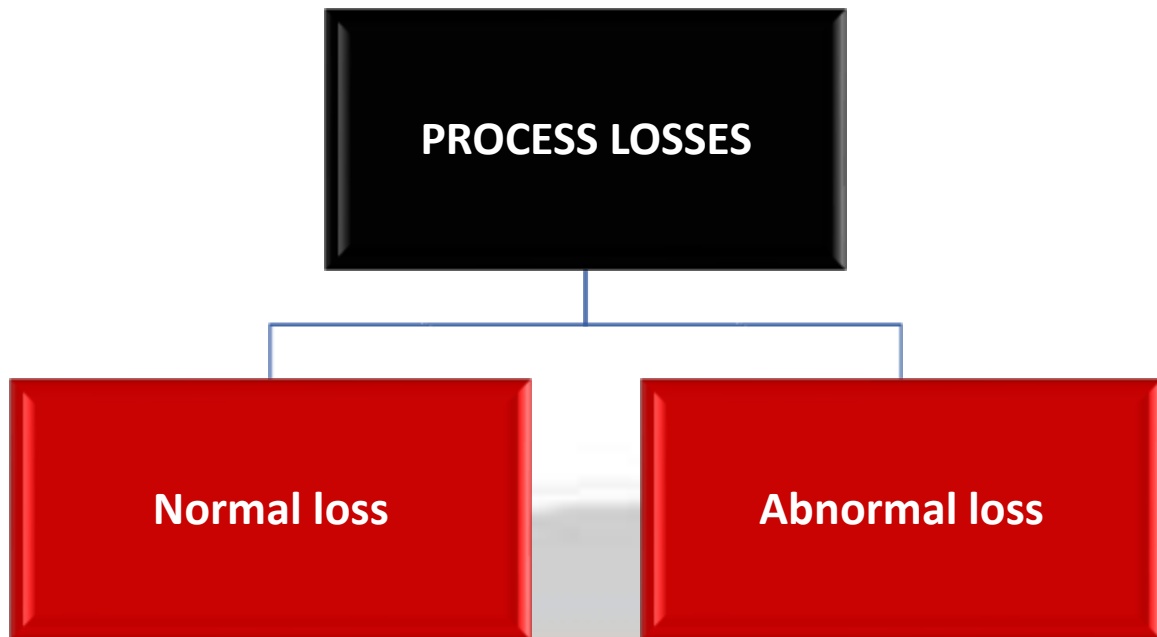
the output of one process becomes the input of the subsequent process.

- In Process costing we determine the cost **associated with each individual stage or process of production.**
- Process costing allows for the **allocation of costs to each specific stage or process**, enabling businesses to track and evaluate the expenses incurred at each step of the production process.

IMPORTANT TERMS PROCESS COSTING

Process Losses

- It refers to the materials or units of production **that are lost or wasted during the manufacturing process.**
- These losses can occur due to various reasons such as **spoilage, evaporation, leakage, or any other form of waste.**



Normal loss

- It refers to the **expected and unavoidable loss** that occurs during the production process.
- This loss occurs due to the **inherent nature of the production process and materials** under normal conditions.
- It can be due to evaporation, shrinkage, or other reasons inherent to the production process.

Abnormal loss

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- It is an unexpected and unusual loss that **occurs due to accidents, machine breakdowns, or other abnormal events.**
- It is not a part of the regular production process and is **treated as a separate cost.**

Abnormal gain

- If the actual process loss is **less than the estimated normal loss**, it is called Abnormal Gain.
- This may be due to the increased efficiency of workers, favourable process conditions or expected loss not materializing.

Work-In-Progress

It refers to partially completed units of production that are **still in the production process** but have not yet reached the stage of being considered finished goods.

Equivalent Units

- It is a concept used to measure the amount of **work done on partially completed units** in terms of fully completed units.

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- It helps in evaluating the progress and **cost of production for WIP inventory.**

"Equivalent units" of work in progress = Actual no. of units in progress x Percentage of work completed

Inter-Process Profit

- Inter-process profit refers to the **profit earned or generated** during different **stages or processes of production within a company.**
- It represents the profit attributable **to each individual process or stage of production** before the final product is completed.

Joint- Products

- It refers to **multiple distinct products** that are produced simultaneously from a **common input or production process.**
- These products are typically derived from a single raw material or production process that undergoes various stages of processing.

By-Products

These are secondary products that **are produced in addition to the main or primary product** during a manufacturing or production process.

BATCH COSTING

- This method is used to determine the **cost of producing a batch or group of identical or similar products.**
- It is commonly applied in **manufacturing or production environments** where items are produced in batches rather than individually.

SERVICE COSTING

- It refers to the process of **determining the costs** associated with providing **services rather than manufacturing goods.**
- It enables these organizations to understand the **cost structure of their services**, determine the profitability of various services, make pricing decisions, and evaluate performance.

UNIT AND SINGLE-OUTPUT COSTING

This costing method involves calculating the **total cost of production** and then **determining the cost per unit** by dividing the total cost by the number of units produced.

MULTIPLE COSTING

- It is a costing method applied when goods or **products being sold are composed of several distinct parts** or components that are individually **costed differently**.
- In such cases, it becomes necessary to determine the **total cost** of the finished product **by considering the costs of each component separately**.

STANDARD COSTING

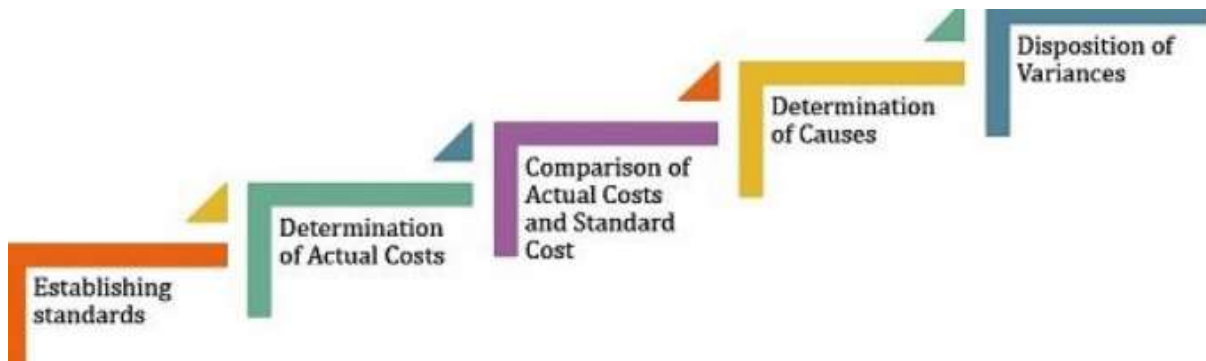
STANDARD COST

It refers to the **costs expected to be incurred to produce a goods or provide a service** under anticipated conditions, keeping in view the prevailing market conditions.

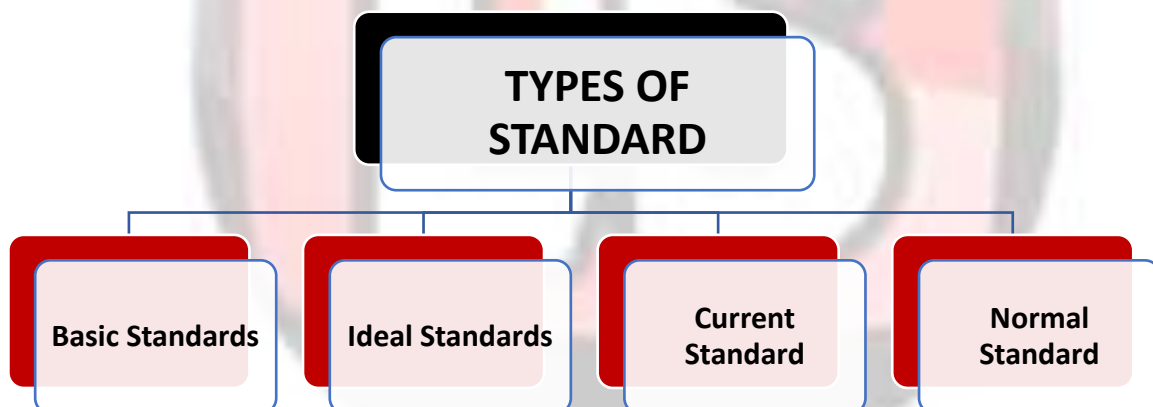
STANDARD COSTING

- It involves setting **predetermined costs for materials, labour, and overheads** to establish a benchmark or standard against which **actual costs can be compared** for calculating the variance.
- This comparison enables management to **identify and eliminate sources of inefficiencies** and waste within the organization.
- By analysing the variances, management can **take appropriate actions to improve cost control** and operational efficiency.

PROCESS OF STANDARD COSTING



TYPES OF STANDARDS



BASIC STANDARDS

- This is a standard which is established for us **over a long period of time**. This type of standard **remains constant** over a long period of time.

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- In this type of standard, a base year is **chosen for comparison purpose.**

IDEAL STANDARDS

- Ideal Standard is a standard which may be **attained under most favourable conditions.** This standard is based on the best possible operation conditions.
- These standards **consider the perfect performance.** Hence, these standards **more idealistic rather than realistic.**

CURRENT STANDARD

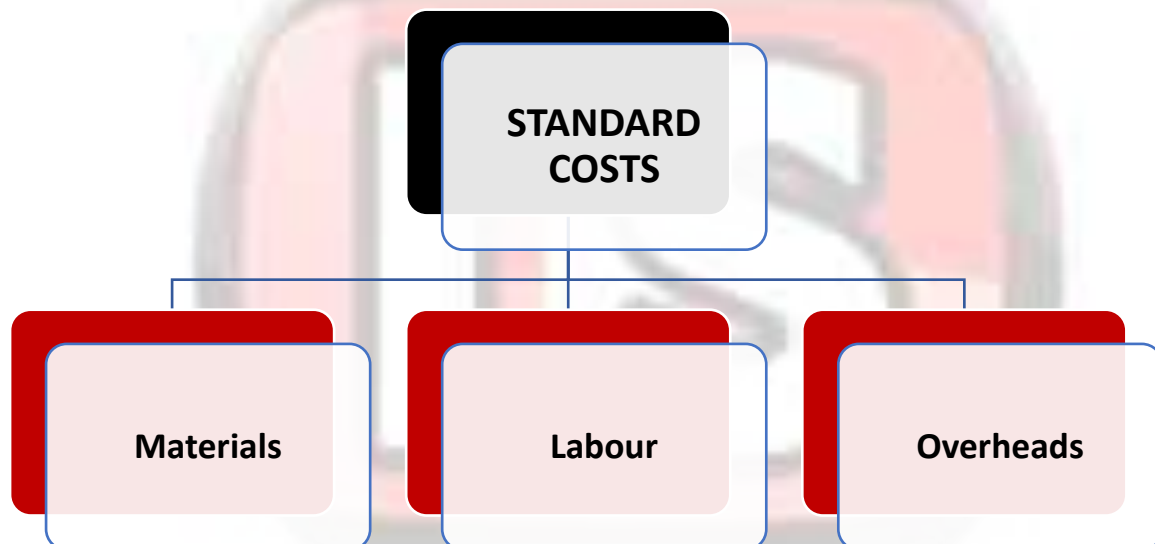
- It refers to the establishment of **standards or predetermined costs for a short period,** considering the current conditions or circumstances.
- It is a more **immediate and temporary standard** that reflects the current state of the organization, considering factors such as **market conditions, resource availability, and operational constraints.**

NORMAL STANDARD

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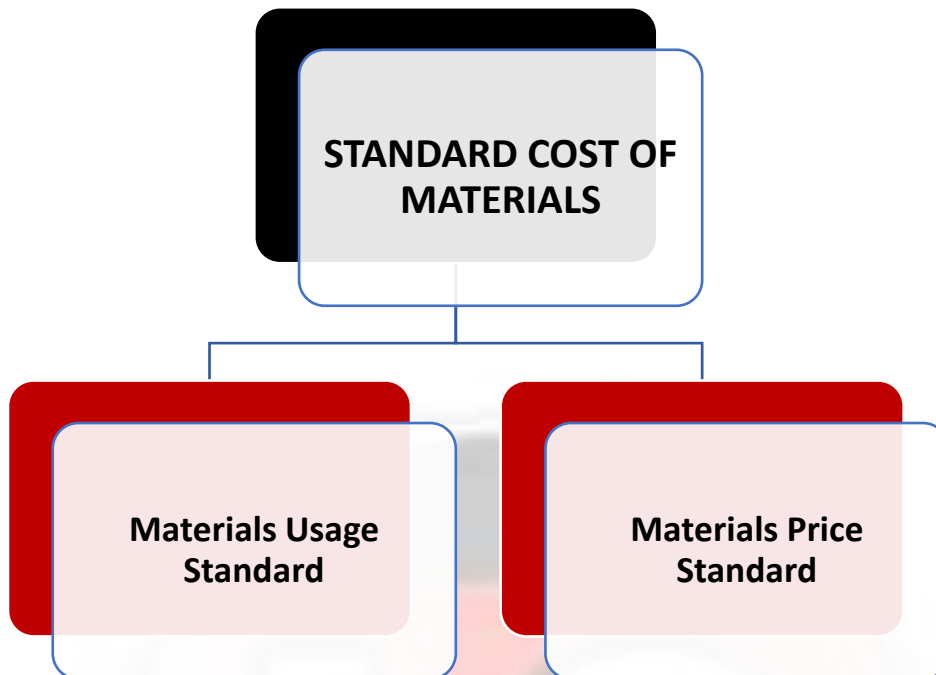
It is a standard which can be **achieved under normal operating conditions** this standard is difficult to set as it requires significant degree of forecasting.

STANDARD COSTS OF MATERIALS, LABOUR, AND OVERHEADS



STANDARD COST OF MATERIALS

- It refers to the **predetermined cost set for the materials** required to produce a product or provide a service.
- It represents the **expected or planned cost of acquiring and using materials** based on various factors such as **historical data, market prices, supplier contracts**.



Materials Usage Standard

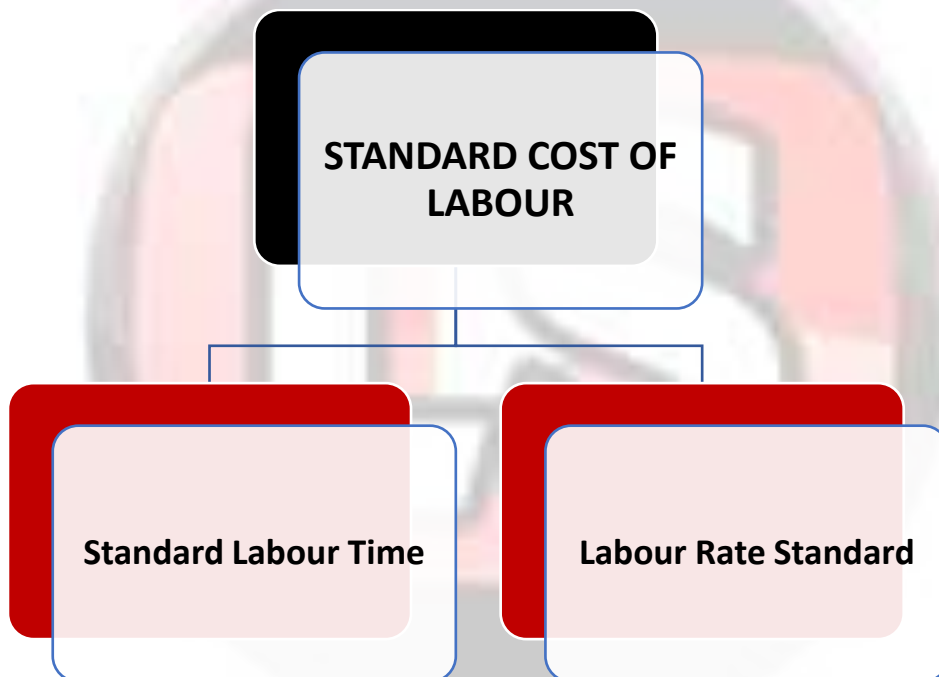
- It refers to the **predetermined number of materials** that should be used to produce a unit of product or service.
- it is also necessary to define the **specifications related to attributes such as size, grade, or other relevant characteristics** of the materials.

Materials Price Standard

It refers to the **predetermined cost per unit or quantity of materials** used in the production process. It represents the **expected or planned price at which materials should be acquired.**

STANDARD COST OF LABOUR

- It refers to the **predetermined cost associated with the direct labour** required to produce a unit of product or service.
- It represents the expected or planned cost of **utilizing labour resources in the production process.**



Standard Labour Time

It involves setting predetermined **amount of time required to complete a specific task** or operation by a worker with the expected level of skill and efficiency.

Labour Rate Standard

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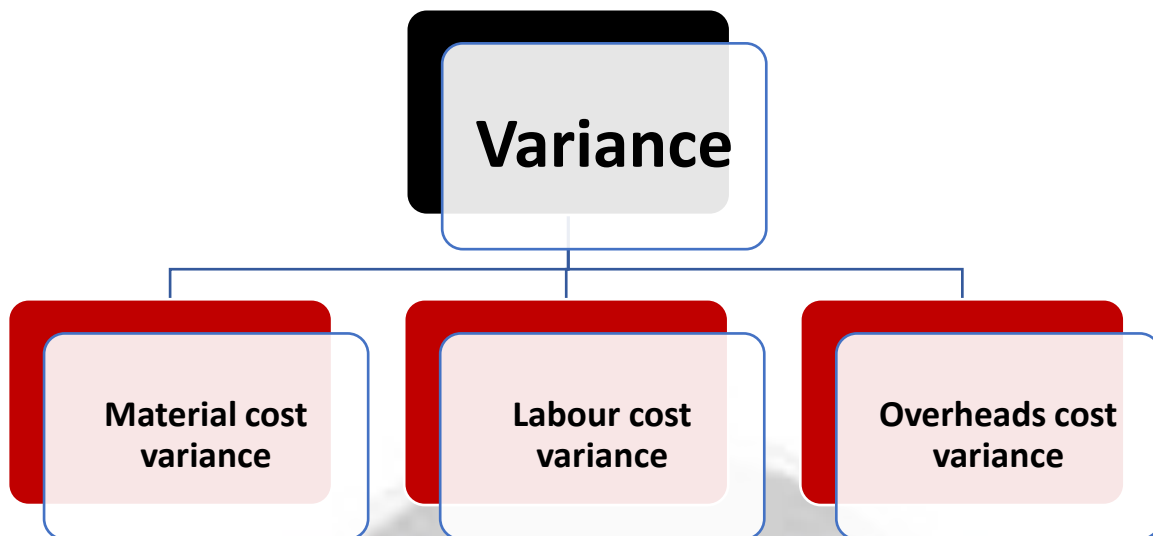
It determines predetermined **cost per unit of time or hour of labour used in the production process**. It represents the expected or planned cost of employing labour resources

STANDARD OVERHEAD COSTS

- It refers to the predetermined costs **allocated to indirect expenses associated with the production process**.
- It represents the expected or planned expenses incurred to **support production activities** that cannot be directly attributed to specific units of output.

VARIANCE ANALYSIS

- It is process of **comparing and analyzing the differences** between actual results and planned or expected results.
- It is a technique used to understand the **causes and effects of deviations** from predetermined **standards, budgets, or targets**.



MATERIAL COST VARIANCE

- It is a **difference between** the **actual cost of materials used in production** and the **standard cost of materials** that were expected or planned.
- It is a key component of **variance analysis in cost management** and provides insights into the **efficiency and effectiveness** of material utilization.

Material price variance

It refers to the difference between the **actual cost paid for materials** and the **standard cost** that was expected or planned for those materials.

Causes

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- Fluctuations in market conditions and **supply and demand dynamics.**
- Changes in **commodity prices, inflation rates, and currency exchange rates.**
- Supplier-related factors such as **pricing policies, negotiations, and changes in sourcing.**
- Contractual agreements with suppliers that **include price adjustments.**
- Changes in material **specifications or requirements.**
- Inefficient inventory management practices, **leading to overstocking or stockouts.**

Material usage variance

It is a measure of the **difference between** the **standard or expected quantity of materials** that should have been used for a specific production output and the **actual quantity of materials used.**

Causes

- **Inferior quality** of purchased materials.
- Increased wastage due to careless **handling during manufacturing.**
- Non-compliance with **standard production procedures.**

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- Deviations in the quality of finished goods **compared to the standard.**

LABOUR COST VARIANCE

- It is a measure of the difference between the **standard or expected labour cost** for a specific level of production and the **actual labour cost incurred.**
- It helps assess the **efficiency and effectiveness** of labour utilization in a production process

Labour rate variance

It is a component of labour cost variance that specifically measures the difference between the **standard or expected labour rate and the actual labour rate paid to employees.**

Causes

- Wage rate changes, including salary increases and adjustments.
- Variations in skill levels and **corresponding wage differentials.**
- Overtime payments and **shift differentials.**

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- Changes in employment agreements, such as **revised compensation structures.**
- Changes in labour regulations and policies.

Labour time Variance

It is a component of labour cost variance that measures the **difference between** the **actual hours worked** and the **standard hours** expected to complete a particular task or production output.

Causes

- Variations in **skill levels and experience of workers.**
- Inadequate training or lack of knowledge **affecting task completion time.**
- Changes in work methods or processes.
- Production disruptions or **equipment breakdowns.**
- Inefficient use of resources or materials.
- Inaccurate estimations of standard hours.

OVERHEADS COST VARIANCE

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It is the difference between the **actual overhead cost incurred and the standard overhead cost** allowed for the actual output achieved.

Variable Overhead expenditure variance

It is a **component of overhead variance analysis** that measures the difference between the actual variable overhead costs incurred and the **budgeted or standard variable overhead costs** for a specific level of activity.

Fixed Overhead Expenditure Variance

It measures the difference between the **actual fixed overhead costs** incurred and the **budgeted or standard fixed overhead costs**. It helps assess the efficiency and cost control of fixed overhead expenses.

ACCOUNTING TREATMENT OF VARIANCES

Transfer to Costing Profit and Loss Account

- **Work-in-progress, finished goods, and cost of sales** are maintained at standard cost and Variances are charged to the costing profit and loss account.

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- **Variances are allocated proportionally** to the closing values of finished goods, work-in-progress, and cost of sales.
- Each account receives a share of the **variances based on their respective values.**

Transfer to Reserve Account

- Positive variances are carried forward as **deferred credits in a reserve account.**
- These **positive variances can be adjusted against any negative variances** in future accounting periods.

REPORTING OF VARIANCES TO MANAGEMENT

Frequency and Format

- Variances should be reported regularly, typically on a **monthly basis or as per the management's requirements.**
- The format of the report should be **clear, concise, and easily understandable**, presenting the variances in a meaningful manner.

Variance Analysis

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- Provide a detailed analysis of **the significant variances, focusing on the causes and potential impact** on the organization's performance.
- It must highlight both **favourable and unfavourable variances** to provide a comprehensive view of the performance.

Comparative Analysis

Compare the current period variances with previous periods, such as month-to-month or year-over-year comparisons, to identify trends and patterns.

Advantages of Standard Costing

- It guides the management to **evaluate the production performance.**
- It helps the management in **fixing standards.**
- It is useful in formulating production **planning and price policies.**
- It guides as a measuring rod for **determination of variances.**
- It facilitates **eliminating inefficiencies** by taking corrective measures.

Limitations of Standard Costing

- It is **expensive** and a small concern may not meet the cost.
- Due to lack of technical aspects, it is **difficult to establish standards**.
- Standard costing **cannot be applied** in the case of a concern where **non-standardised products are produced**.

Q: 1XYZ Co. has determined that it should take 10 units of Material X to produce one unit of their flagship gadget.

What does this represent?

- a) Materials Usage Standard
- b) Materials Price Standard
- c) Materials Quantity Standard
- d) All of the above

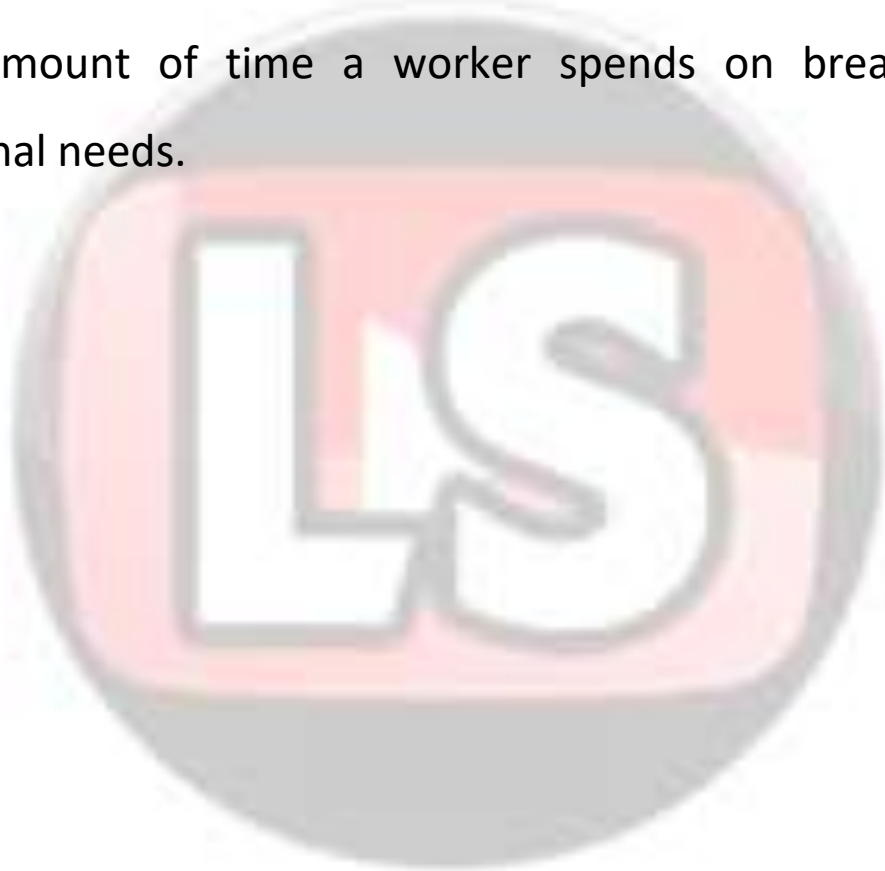
Q: 2 Which of these statement defines Materials Price Standard ?

- a) It refers to the predetermined cost per unit or quantity of materials used in the production process. It represents the expected or planned price at which materials should be acquired.
- b) It refers to the actual cost per unit or quantity of materials used in the production process. It represents the fluctuating market price at which materials are acquired.
- c) It refers to the predetermined cost per unit or quantity of finished goods sold. It represents the expected or planned revenue from selling the products.
- d) All of the above

Q: 3 Standard labour time is a important component of standard labour cost what is meaning of standard labour.

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- a) The average time a worker takes to complete a task, regardless of skill level
- b) The time it takes the slowest worker in the company to complete a task
- c) The predetermined amount of time a qualified worker should take to complete a task efficiently.
- d) The amount of time a worker spends on breaks and personal needs.



Q: 4A company manufactures fans and based on historical data and market research, the company determines that the standard cost for labor is 20 rupees per hour. This rate includes wages, benefits, and other labor-related expenses. This represents _____.

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- a) Actual Labour Rate
- b) Labour Overhead Rate
- c) Labour Rate Standard
- d) Standard Labour Time

Q: 5 Which of these statements is correct regarding Basic Standards?

- I. This is a standard which is established for us over a long period of time.
- II. Basic standards remain constant and serve as long-term benchmarks.
- III. It is a more immediate and temporary standard that reflects the current state of the organization

- a) I, II,
- b) I, II, III
- c) II, III,
- d) I, II, III,

Q: 6XYZ Company sets a standard labor rate of ₹150 per hour. However, due to increased labor union demands wage increases, the actual rate paid to employees rises to ₹160 per hour. If XYZ Company worked 1,000 hours during the month, the labor cost based on the standard rate would be ₹150,000. But with the actual rate, the cost amounts to ₹160,000. This represents which type of variance?

- a) Labour rate variance
- b) Labour time Variance
- c) Rate variance
- d) All of the above

Q: 7 Labour time Variance is a component of labour cost variance that measures the difference between the actual hours worked and the standard hours expected to complete a particular task or production output. Which of these is a reason for Labour time Variance?

- I. Variations in skill levels and experience of workers.
- II. Changes in work methods or processes.
- III. Production disruptions or equipment breakdowns.
- IV. Inadequate training or lack of knowledge affecting task completion time.

- a) I, II, IV
- b) I, II, III
- c) II, III, IV
- d) I, II, III, IV