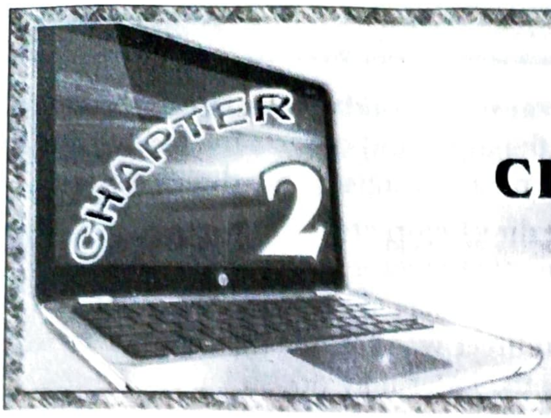

CLASSIFICATION OF COSTS AND COST SHEET

Raw materials are converted into finished products by a manufacturing concern with the help of labour, plants etc. The elements that constitute the cost of manufacture are known as the elements of cost. The elements of cost are — *(a)* material, *(b)* labour, and *(c)* expenses. Each of these elements are again sub-divided into direct and indirect.

Direct material, direct labour and direct expenses are those which can be traced in relationship with a particular process, job, operation or product. Indirect material, indirect labour and indirect expenses are those which are of general nature and cannot be traced in relationship with a particular process, operation, job or product.

Direct material Direct labour Direct expenses	together constitute prime cost
Indirect material Indirect labour Indirect expenses	of the factory together constitute factory (or works) overhead

Prime cost + Factory (or works) overhead = Factory cost or Works cost.

Factory cost + Administration overhead = Cost of production.

Cost of production + Selling and distribution overhead = Total cost or Cost of sales.

Let us have some idea about the different elements of cost mentioned above.

1 Direct Material

Direct material is the material which can be conveniently identified with and allocated to cost centres and cost units. It refers to material out of which the product is manufactured, for example, leather-shoes are produced out of leather, butter is produced out of milk, steel utensils are produced out of stainless steel and so on. Thus, leather, milk and stainless steel are the direct materials for the manufacture of shoes, butter and steel utensils respectively. More than one material may be directly required for a production.

As against direct material, another kind of material may be required in the process of manufacture, but not directly. For example, machines used for production require lubricants, jute and cotton wastes etc. These are indirect materials.

While direct material is a component of prime cost, indirect material is a component of factory overhead. Direct material directly varies with the output, but indirect material may not so vary.

2 Direct Wage

Direct wage is the wage which can be conveniently identified with and allocated to cost centres and cost units. It refers to the wages paid to the workers who actually produce the goods. In case of manual work it is not difficult to locate the direct worker, because he is one who produces the goods. In case of a work done by machine, the person who makes the input and collects the output and in whose account the output is credited for the purpose of payment of wages, is the direct worker.

There are several other workers in the factory who help the direct workers in connection with their work with regard to supply of material, power etc. and in respect of supervision and maintenance. These are indirect workers. Wages of indirect workers at different stages of production are indirect wages. Direct wage is a component of prime cost, while indirect wage is a component of factory overhead. The former directly varies with the output while the latter may not so vary.

3 Direct Expense

Besides direct material and direct labour, certain expense may be wholely and exclusively necessary for a particular production. This expense is referred to as direct expense and it can be easily identified with and allocated to cost centres or cost units. For example, if an order is received to manufacture 1,000 pieces of plastic balls with the customer's name embossed on them, the manufacturer shall have to prepare a mould exclusively for this purpose. The cost of the mould may be regarded as the direct expense of the production. Similarly, charge for hire of a special plant for production is also a direct expense and it can be easily identified with and allocated to cost centres or cost units. Cost of preparing blue print for a production is another example of direct expense.

Note Carriage for bringing direct material is a part of direct material cost.

4 Overhead

Overhead refers to the indirect expenses incurred at various levels of activities of the enterprise. These expenses cannot be conveniently identified with or allocated to cost centres or cost units.

Classification of overhead expenses according to functions may be done as below :

1. Factory or works overhead : It refers to all indirect expenses of the factory. This includes wages of all factory staff excluding those of direct workers, indirect material, rent, rates and taxes of factory, depreciation of factory assets, excise duty, canteen expenses, labour welfare expenses etc.

2. Administration overhead : It refers to all expenses incurred in connection with general administration. Salary of the administrative staff, rent, rates, taxes of administrative accommodation, postage, telegram and telephone, stationery, lighting of administrative building, depreciation of office appliances etc. are included in administration overhead.

3. Selling overhead : It refers to all expenses incurred in connection with sales. Thus, salary of sales staff, travellers' commission, advertisement, rent, rates, taxes of sales office, depreciation of sales office appliances, cost of participation in industrial fares and exhibitions, cost of free gifts, cost of free after-sales service, normal bad debt etc. are included in selling overhead.

4. Distribution overhead : It refers to all expenses incurred in connection with delivery of the product after the sale is effected. Thus, delivery van expenses, freight and insurance, packing for delivery, loading and unloading, salary of the deliverymen, customs duty etc. are included in distribution overhead.

Classification of overhead expenses according to behaviour may be done as below :

Overhead expenses that vary proportionately with the output are variable overhead. Overhead expenses that remain fixed irrespective of change in the level of output are fixed overhead. Overhead expenses that vary with the output, but not proportionately, are semi-variable or semi-fixed overhead.

It must be remembered in this connection that, direct material, direct wages and direct expenses are variable items of direct cost . Therefore, if we like to classify cost according to behaviour we get the following classifications :

1. Fixed costs : Fixed costs include only those overhead expenses which remain fixed irrespective of the level of output. Rent and rates of building, salary of the works manager, administrative manager, sales manager etc., depreciation of buildings, insurance etc. are items of fixed costs.

2. Variable costs : Variable costs include prime cost and variable overheads. These costs vary proportionately with the output. Direct materials, direct wages, direct expenses, consumable stores, power, fuel etc. are items of variable cost.

3. Semi-variable or semi-fixed costs : These include overhead expenses that vary according to output, but not proportionately. So, these costs are partly fixed and partly variable. Examples of semi-variable costs are normal repairs and maintenance of building and plant, salary of supervisors, chargemen, foremen etc., service department expenses, depreciation of plant and machinery etc. To take a concrete example, let us consider the element 'repairs'. Normal repair is mostly fixed in nature, because within certain degree of capacity utilisation normal repair is a routine matter at regular intervals. When utilisation is beyond that certain degree, more frequent repairs shall be necessary involving further cost ; but still, such increase in cost shall not be proportionate to the increase in output. This is why the element is semi-fixed or semi-variable.

It is important to know the classification of cost behaviourwise, because the total of the variable costs per unit of output is known as marginal cost. Marginal cost represents the cost incurred in producing one extra unit. If one extra unit is to be produced, the fixed costs will not increase, only the variable costs shall come into the picture. (Here, the semi-variable costs are to be further classified into fixed and variable and thus, there shall be only two classification for the purpose).

Cost Accounting Standard-1 (CAS-1) on Classification of Costs

CAS-1 issued by the Council of the ICWAI deals with the principle of classifying costs in cost statements.

The standard on classification of costs deals with the basis of classification of costs and the practice to be adopted for classification of cost elements in regard to its nature and management objective. The statement on the standard aims at providing better understanding of classification of costs for preparation of various cost statements under legal obligations or for cost control purpose.

Objectives :

1. The first objective of this standard is to prescribe the classification of costs for ascertaining cost of a product/service and for preparing cost statements on a consistent and uniform basis so that cost of an enterprise of a relevant year becomes comparable with that of previous year or with that of other enterprises in respect of the same period.
2. The second objective is to provide better transparancy in the cost statements through classification and its disclosure.
3. The third objective is to encourage better adoption of uniform costing and interfirm comparison.

Scope :

1. This standard on classification of cost should be applied in ascertaining cost of a product or service, application of costing technique and in making management decision by the Indian industries.
2. All enterprises, whether covered under *Section 209 (1) (d)* of the Companies Act, 1956 or not, should follow this standard to classify costs in order to prepare cost statements on an uniform basis to make it relevant and understandable for effective cost management.
3. The standard has to be followed for assessing cost of production, valuation of product or valuation of stock to be certified for determining duties, taxes, tariffs and other purposes as the case may be. Cost statements prepared in accordance with this standard will be used for assessing excise duty and other taxes, and for anti-dumping measures, transfer pricing etc.

Definitions given by CAS-1

1 Cost

Cost is a measurement, in monetary terms, of the amount of resources used for the purpose of production of goods or rendering services.

Background Material : For manufacturing goods and services consumption of resources is always involved. Sacrifice made in terms of resources or price paid to acquire goods and services measures the cost. The type of cost is often refered to in costing system in relation to the purpose for which cost is incurred. For example, price paid for acquiring materials for manufacture of a product is often called material cost.

2 Cost Centre

Cost Centre is any unit of Cost Accounting selected with a view to accumulating all cost under that unit. The unit may be a product, a service, division, department, section, a group of plant and machinery, a group of employees or a combination of several units. This may also be a budget centre.

Background Material : A logical sub-unit for collection of cost represents a cost centre or cost object. There may be two types of cost centres — **(1)** Personal cost centres, and **(2)** Impersonal cost centres. A personal cost centre is represented by a group of persons. A cost centre which is not a personal cost centre is an impersonal cost centre. Cost centres may be further divided into production cost centres and service cost centres. Centres engaged in production like machine shop, assembly shop, polishing shop etc. are production cost centres. Service cost centres are centres for rendering service to the production cost centres, e.g, power house, maintenance shop, stores, purchase office, quality control department etc.

3 Cost Unit

Cost unit is a form of measurement of volume of production or service. This unit is generally adopted on the basis of convenience and practice in the industry concerned.

Background Materials : Examples of generally adopted cost units are :

Transport industry — Passenger-kilometre/Ton-kilometre.

Cement/Suger industry — Metric ton.

Brick industry — Thousand (bricks).

Automobile — Number.

Power — Mega Watt. etc., etc.

4 Basic Rules for Classification of Costs

(a) Classification of cost is the arrangement of items of costs in logical groups having regard to their nature (subjective classification) or purpose (objective classification).

(b) Items should be classified by one characteristic for a specific purpose without ambiguity.

(c) Scheme of classification should be such that every item of cost can be classified.

(d) Basis of classification :

- ***(i) Nature of expenses ;***
- ***(ii) Relation to object — traceability ;***
- ***(iii) Functions/activities ;***
- ***(iv) Behaviour — fixed, semi-variable or variable ;***
- ***(v) Management decision making ;***
- ***(vi) Production process ;***
- ***(vii) Time period.***

Background Material : Components of cost are grouped under a common head on the basis of similarities of nature, attributes or relations through a process called classification. The process identifies each item and according to common features, like items are systematically placed together. The items grouped under a common head may be further classified according to their fundamental differences. Thus, same cost may appear in several different classifications depending upon the purpose for which classification is done.

Normally cost classification is done in terms of managerial objective. Presentation of cost usually requires sub-classification. Sub-classification may be done according to nature of the cost element, functional line, areas of responsibility or other useful break-up. Appropriate sub-classification depends upon how the cost report is used.

Classification of Costs

1 Classification by Nature of Expense

Costs should be gathered together in their natural groupings such as material, labour and other expenses. Items of costs differ on the basis of their nature. The elements of cost can be classified in the following three categories of — (a) Material, (b) Labour, (c) Expenses.

(a) Material Cost is the cost of material of any nature used for the purpose of production of a product or a service.

Background Material : Material cost includes cost of procurement, freight inwards, taxes and duties, insurance etc. that can be directly attributed to the acquisition. Trade discounts, rebates, duty draw backs, refunds on account of modvat, cenvat, sales tax and similar other items are deducted while determining the cost of material.

(b) Labour Cost means the payment made to the employees, permanent or temporary, for their services.

Background Material : Labour cost includes salaries and wages paid to permanent and temporary employees. It also includes payment to labour contractors. Salaries and wages include all fringe benefits like employer's contribution to provident fund, gratuity, contribution to E.S.I., overtime wages, incentives, bonus, ex-gratia payments, cost of leave encashment, wages paid for holidays and idle time etc.

(c) Expenses are other than material cost and labour cost which are involved in an activity.

Background Material : Expenditure incurred on account of utilities, payment for bought out services, job processing charges etc. are included in expenses.

2 Classification by relation to Cost Centre

(a) Classification should be on the basis of method of allocation of cost to a cost unit. If an expenditure can be allocated to a cost centre or cost object in an economically feasible way, then it is called direct, otherwise the cost component will be termed as indirect. According to this criteria for classification, material cost is divided into direct material cost and indirect material cost, labour cost into direct labour cost and indirect labour cost and expenses into direct expenses and indirect expenses. Indirect cost is also known as overhead.

(b) Direct Cost has three components — direct material cost, direct labour cost and direct expenses ; and indirect cost has three components — indirect material cost, indirect labour cost and indirect expenses. Sum of all direct costs is called prime cost.

(c) Direct Material Cost is the cost of material which can be directly allocated to a cost centre or a cost object in a econimically feasible way.

Background Material : Direct materials consumed for production of a product or service being identifiable in the product or service represent direct material cost. Direct material cost includes cost of procurement of such material and also freights inward, taxes and duties, insurance etc. in connection with such procurement subject to deduction for trade discount, duty drawbacks, refunds on account of modvat, cenvat, sale tax and similar other items.

(d) Direct Labour Cost is the cost of wages of those workers who are readily identified or linked with a cost centre or cost object.

Background Material : Wages of workers in this case include all the fringe benefits i.e., employer's contribution to provident fund and E.S.I., gratuity, wage for overtime work/holidays/idle time, incentives, bonus, ex-gratia payment, leave encashment etc.

(e) Direct Expenses are the expenses other than direct material and direct labour which can be identified or linked with the cost centre or cost object.

Background Material : Examples of direct expenses are — cost of special moulds required by a cost centre, cost of hire of special tools and equipments for a cost centre, royalties payable in connection with a product, job processing cost etc.

(f) Indirect Material is the cost of material which cannot be directly allocable to a particular cost centre or cost object.

Background Material : Materials of small value not capable of being identified in or allocated to a cost centre or cost object are normally termed as indirect materials. Examples are — consumable spares and parts, lubricants, jute/cotton wastes etc.

(g) Indirect Labour Cost is the wages of the employees which are not directly allocable to a particular cost centre.

Background Material : Salaries of staff in administration, security, accounts, canteen, time office etc. are examples of indirect labour.

(h) Indirect Expenses are the expenses other than of the nature of material or labour and cannot be directly allocable to a particular cost centre.

Background Material : Examples of indirect expenses are — insurance, taxes, duties etc. which are not allocable directly to a particular cost centre.

3 Classification by Functions/Activities

(a) Costs should be classified according to the major functions for which the elements are used into the following four major functions : (i) Production ; (ii) Administration ; (iii) Research and Development ; and (iv) Selling and Distribution.

(b) Production Cost is the cost of all items involved in the production of a product or service. It includes all direct costs and all indirect costs related to the production.

(c) Production Overhead is the indirect costs involved in the production process.

Background Material : Production overhead is also called factory overhead or manufacturing overhead. Examples of production overhead are — salaries for production planning, technical supervision, factory supervision, fire and accident precaution ; normal idle time cost ; cost of stores management ; security expenses of factory ; labour welfare expenses ; medical and canteen expenses ; depreciation of plant and machinery ; insurance of factory assets ; repairs and maintenance of factory assets ; cost of quality control etc.

(d) Administration Costs are expenses incurred for general management of an organisation. These are in the nature of indirect costs and are also termed as administrative overhead.

Background Material : Examples of administrative overhead items are — salaries of administrative and accounts staff ; rent, rates, taxes, lighting, telephone, postage, and stationery of general office ; bank charges ; audit fees ; legal expenses ; depreciation, repair and maintenance of office building etc.

(e) Selling Costs are indirect costs related to selling of products or services and include all indirect cost in sales management for the organisation.

Background Material : Selling costs are costs incurred in connection with regular sales and sales promotion. Examples of selling costs are — salaries, commission and travelling expenses for sales staff ;

cost of advertisement ; cost of participation in fairs and exhibition ; legal expenses for debt realisation ; cost of free samples ; cost of market research ; royalty on sales ; cost of after-sales services etc.

(f) Distribution Costs are the costs incurred in handling a product from the time it is completed in the works until it reaches the ultimate customer.

Background Material : Distribution costs are the costs relating to the distribution of product to customers. Examples of distribution costs are — transportation cost ; cost for warehousing the saleable products ; cost of delivery of the product to customer's place etc.

Note Primary packaging cost is included in production cost but secondary packaging cost is included in distribution cost. In case of heavy industries supplying equipments, installation cost at delivery site for heavy equipments which involves assembling of parts, testing etc. is included in production cost and not in distribution cost. For example, cost of installation of a gas turbine at plant site is included in the cost of production of gas turbine.

(g) Research and Development Costs are the costs for undertaking research to improve quality of a present product or improve process of manufacture, develop a new product, market research etc. and commercialisation thereof.

Background Material : Cost of research includes cost relating to development of a new product, improving an existing product, improving the process and equipment, finding new uses for known products, solving technical problems arising in manufacture and application of products etc. Development cost includes cost incurred for commercialisation and implementation of research findings.

Cost Sheet using classification by Function/Activities :

	Rs.
Direct material cost	....
Direct labour cost	....
Direct expenses	....
Prime cost	....
Production overhead	....
Works/Factory cost	....
Administrative overhead	....
Research and development cost (apportioned)	....
Cost of production	....
Selling cost (for goods sold)	....
Distribution cost (for goods delivered)	....
Total cost/Cost of sales	....

Note Adjustments are necessary for opening and closing raw materials, work-in-progress and finished goods to arrive at value at different points.

4 Classification by Behaviour

Costs are classified based on behaviour as fixed cost, variable cost and semi-variable cost depending upon response to the changes in the activity levels.

(a) Fixed Cost is the cost which does not vary with the change in the volume of activity in the short run. These costs are not affected by temporary fluctuation in activity of an enterprise. These are also known as period costs.

Background Material : Salaries, rent, depreciation, audit fees etc. are examples of fixed cost.

(b) Variable Cost is the cost of elements which tends to directly vary with the volume of activity. Variable cost has two parts — (i) variable direct costs, and (ii) variable indirect costs. Variable indirect costs are termed as variable overhead.

Background Material : Materials consumed, direct labour, sales commission, utilities, freight, packing etc. vary with the change in activity and hence they are examples of variable costs.

(c) Semi-Variable Costs contain both fixed and variable elements. They are partly affected by fluctuations in the level of activity.

Background Material : Factory supervison cost, maintenance cost, power cost etc. vary with the variation of the level of activity, but partly only. These are examples of semi-variable costs.

Note Fixed costs remain fixed within an output range. If output increases fixed cost per unit decreases.
Althouth total variable costs vary directly with the variation in the level of activity, variable cost per unit of output remains constant within a range of activity

5 Classification for Management Decision Making

Costs are classified for the purpose of management decision making under different circumstances as — (a) Marginal Cost, (b) Differential Cost, (c) Opportunity Cost, (d) Replacement Cost, (e) Relevant Cost, (f) Imputed Cost, (g) Sunk Cost, (h) Normal Cost, (i) Abnormal Cost, (j) Avoidable Cost, and (k) Unavoidable Cost.

(a) Marginal Cost is the aggregate of variable costs i.e., prime cost plus variable overhead. Marginal cost per unit is the change in the amount at any given volume of output by which the aggregate cost changes if the volume of output is increased or decreased by one unit.

Background Material : Marginal cost is used in marginal costing system. Since the fixed costs do not change due to change in the output within a range, marginal cost represents the additional cost incurred for producing an extra unit or it represents the cost saved if production is reduced by one unit. For producing one extra unit only the variable costs are required. So, marginal cost represents the aggregate of variable costs. The variable part of semi-variable costs is calculated and added with the variable costs to arrive at the marginal cost.

Example

Output		*50,000 units*
	Fixed cost	Variable cost
Cost :	Rs. *(in lakhs)*	Rs. *(in lakhs)*
1. Material Cost		6·50
2. Labour Cost		3·00
3. Fixed Cost	7·50	—
4. Variable Production and Selling Overhead	—	2·50
5. Semi-variable Cost	3·00	2·00
Total Marginal Cost		14·00

Marginal Cost per unit (Rs. 14,00,000 ÷ 50,000) = Rs. 28·00

(b) Differential Cost is the change in cost due to change in activity from one level to another.

Background Material : Principle highlighting the points of differences in costs by adoption of different alternatives is used to find diffential cost. This technique is used in export pricing of new products and pricing goods to be promoted in new markets either within the country or abroad.

The algebric difference between the relevant cost at two levels of activities is the differential cost. If the level of activity is increased the differential cost is known as 'incremental cost' and if the level of activity is reduced the decrease in cost is known as 'decremental cost'. The following chart will classify.

Output *Unit (in lakh)*	*Differential* *Unit (in lakh)*	*Total cost* *Rs. (in lakh)*	*Differential cost* *Rs. (in lakh)*	*Differential cost Per unit* *Rs.*
(x) 2·00	—	50·00	—	—
(y) 2·50	50 ($y-x$)	65·00	15·00[1]	30·00
(z) 1·75	25 ($x-z$)	46·00	(–) 4·00[2]	(–) 16·00

Note (1) Incremental cost ; (2) Decremental cost.

(c) Opportunity Cost is the value of the alternatives foregone by adopting a particular strategy or employing resources in specific manner.

Background Material : Opportunity cost is the expected return on the investment other than the present one. Rs. 50,000 is invested on a project. The expected return on the amount if it is invested elsewhere is Rs. 15,000. The opportionity cost is Rs. 15,000. Opportionity cost is considered for selection of a project with a view to justifying an investment or studying the viability of an investment option.

(d) Replacement Cost is the cost of an asset in the current market for the purpose of replacement.

Background Material : Replacement cost is generally considered for determining the optimum time of replacement of an equipment or machine having regard to the maintenance cost of the existing one and its productive capacity.

(e) Relevant Costs are costs relevant for a specific purpose or situation.

Background Material : While making a decision on a specific issue only those costs which are relevant are considered. An item of cost may be relevant in one situation and irrelevant in other situations. For example, if a decision is taken for sale of a machine the present depreciation cost is considered relevant ; but if it is decided to replace the machine the present depreciation cost is considered irrelevant.

(f) Imputed Costs are hypothetical or notional costs, not involving cash outlay, computed only for the purpose of decision making.

Background Material : The word 'imputed' indicates an ascribed value having no criteria of absolute monetary value for such purpose. While national income is estimated, wages of house wives are considered, although house wives are not paid wages for their services. Therefore, such wages represent imputed cost. Similarly, wages and salaries of owner for cultivating his own land, interest on capital invested by the owner, rent of building belonging to the owner are all examples of imputed cost. Imputed cost becomes important particularly in uniform costing.

(g) Sunk Costs are historical costs which are incurred i.e., 'sunk' in the past and are not relevant to the particular decision making problem being considered.

Background Material : Sunk costs imply costs incurred for a project and which will not be recovered if the project is terminated. When a machine is considered for replacement its depreciated book value is irrelevant, because the amount is a sunk cost to be written off at the time of actual replacement.

(h) Normal Cost is a cost that is normally incurred at a given level of output in the conditions in which that level of output is achieved.

Background Material : Costs occuring in normal situation of production process or in the normal environment of the business are normal costs. Normal idle time is to be included while ascertaining normal cost.

(i) Abnormal Cost is an unusual or a typical cost whose occurence is usually irregular and unexpected and due to some abnormal situation of the production.

Background Material : Abnormal cost arises due to idle time caused by heavy breakdown/dislocation or abnormal process loss. Abnormal cost is not included in cost of production for decision making, but is written off to profit and loss account.

(j) Avoidable Costs are those costs which under given conditions of performance efficiency should not have been incurred.

Background Material : Avoidable costs are logically associated with some activity or situation. These are ascertained by the difference of actual cost with the happening of the situation and the normal cost. Spoilage occuring in excess of normal limit is an example of avoidable cost. Controllable cost variances may also be termed as avoidable cost.

(k) Unavoidable Costs are inescapable costs which are essentially to be incurred within the limits or norms provided for. It is the cost that must be incurred under a programme of business restriction. It is fixed in nature and inescapable.

6 Classification by Nature of Production Process

Costs are also classified on the basis of nature of production or manufacturing process.

(a) Batch Cost is the aggregate cost related to a cost unit which consists of a group of similar articles which maintain its identity throughout one or more stages of production.

(b) Process Cost : When the production process is such that goods are produced from a sequence of continuous or repetitive operations or processes, the cost incurred during a period is considered as process cost. The process cost per unit is derived by dividing the process cost by number of units produced in the process during the period.

Background Material : Process cost accounts are maintained separately for all processes for a period. Average cost per unit produced during the period is process cost per unit.

(c) Operation Cost is the cost of a specific operation involved in a production process or business activity.

Background Material : There may be distinctly seperate operations involved in a process. Cost of each operation is ascertained for effective control mechanism.

(d) Operating Cost is the cost incurred in conducting a business activity. Operating costs refer to the cost of undertakings which do not manufacture any product but which provide services.

(e) Contract Cost is the cost of a contract with some terms and conditions of adjustment agreed upon between the contractee and the contractor.

Background Material : Contract cost is associated with major long-term contracts as distinct from short-term job costs. In the contract, escalation clause and sometimes deescalation clause are provided to protect the interest of the parties in case of fluctuation in material price, labour cost etc.

(f) Joint Costs are the common cost of facilities or services employed in the output of two or more simultaneously produced or otherwise closely related operations, commodities or services.

Background Material : Some production process is such that from a set of same input two or more distinguishably different products are produced together, products of greater importance are termed joint products and products of minor importance are termed by-products. All costs upto the point of separation of the products are termed joint cost. For example, in a petroleum refinery process, petrol, diesel, kerosene, naptha, tar etc. are produced jointly. Cost of by-products is the cost assigned to the by-products.

7 Classification by Time

A cost item is related to a specific period of time and cost can be classified according to the system of assessment and specific purpose as indicated in the following ways :

(a) Historical Costs are the actual costs of acquiring assets or producing goods or services.

Background Material : Historical costs are ascertained after the costs have been actually incurred by postmortem analysis. Historical costs represent the cost of actual operational performance. Accounting under historical costing system records all costs actually incurred or as relevant from time to time.

(b) Pre-determined Costs for a product are computed in advance of production, on the basis of a specification of all the factors affecting cost and cost data. Pre-determined costs may be either standard or estimated.

(c) Standard Costs : A pre-determined norm applied as a scale of reference for assessing actual cost, whether these are more or less. The standard cost serves as a basis of cost control and as a measure of productive efficiency when ultimately posed with an actual cost. It provides management with a medium by which the effectiveness of current results is measured and responsibility of deviation placed.

Background Material : Standard cost represent the 'cost that should be' in the existing conditions. It is used to compare actuals with standards with a view to finding variances, if any, analysing the causes of variances and taking proper measure to control them.

(d) Estimated Costs of a product are prepared in advance prior to the performance of operations or even before the acceptance of sale orders.

Background Material : Estimated cost is worked out with specific reference to the particular product and level of activity of the plant. It has no relationship with actual and hence it is not so accurate as standard cost.

Presentation and Disclosure :

1. ***The classification of cost item should be done on 'basis of classification' chosen with pre-determined objective.***
2. ***The classification cost item should be followed consistently from period to period and preparation of cost statements should be made with reference to a period of time.***
3. ***A change in classification should be made only if it is required by law or for compliance with a Cost Accounting Standard or the change would reset in a more appropriate preparation or presentation of cost statements of an enterprise.***
4. ***Any change in classification of cost which has a material effect on the cost of the product should be disclosed in the cost statements. Where the effect of such change is not ascertainable wholly or partly, the fact should be indicated in the cost statement.***