

Management Accounting

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Components of Cost

1. Prime Cost
2. Work Cost or Factory Cost
3. Production Cost
4. Total Cost

1. **Prime Cost:** The aggregate of the direct material cost, direct labour cost and direct expenses. It is also called flat cost, first cost and direct cost.

Formula:

Prime cost = direct material cost + direct wages cost + direct expenses.

2. **Work Cost:** The prime cost plus the factory overhead or work overhead and comprises the aggregated direct material cost, direct labour cost, direct expenses and factory overhead. Factory cost is also known as work cost, production cost or manufacturing cost.

Formula:

Factory cost = prime cost + factory overhead.

3. **Production Cost:** The factory cost plus the office and administrative overhead, it is also known as gross cost or cost of production or office cost.

Formula:

Production cost = Factory cost + office & administrative overhead.

4. **Total cost:** Made up of the cost of production plus the selling and distribution overhead.

Formula:

Total cost = office cost + selling & distribution overhead.

Type of Costs in Cost Accounting:

1. Fixed Cost
2. Variable Cost
3. Operating Cost
4. Direct Cost

1. **Fixed Cost:** These cost are do not change based on the number of items produced. For example, the depreciating value of a building or the prize of a piece of equipment.
2. **Variable Cost:** These cost are tied to a company's level of production. For example, a bakery spends \$10 on labour and \$5 on raw materials to produce each of cakes. These variable cost changes based on the number of cakes the company bakes.
3. **Operating Cost:** These cost are those expenses incurred by an organization to maintain the product on a day to day basis. Travelling cost, telephone expenses, office supplies are some of the things that come under operating cost.
4. **Direct Cost:** These cost can be directly associated with production. For example, if a furniture manufacturing company takes five days to produce a product, it includes the raw material cost and labour charges for five days.

Cost Brek-Even Point:

The break-even point is the point at which total cost and total revenue are equal. There is no loss or gain for the business.

It is situation under which the cost of operating two alternative plans are equal. For example, say X limited has fixed cost of Rs. 10,000 vrs Y limited has fixed cost of Rs. 1,00,000, selling similar products X limited will be able to break-even with sale of lesser products as compared Y limited.

Formula:

$$\text{Break-even point (unit)} = \frac{\text{Fixed cost}}{\text{Sales price per unit} - \text{Variable cost per unit}}$$

Composite Break-even point:

When a firm is engaged in producing two or more products, it is better to compute composite break-even point for the enterprise as a whole. Composite break-even point is the manufacturing two or more products it is determined by dividing the total fixed cost.

Formula:

$$\text{Composite break-even point (In sales value)} = \frac{\text{Total fixed cost}}{\text{Composite P/V ratio}}$$

$$\text{Composite p/v rati} = \frac{\text{Total contribution}}{\text{Total sales}} \times 100$$

Cost Control:

1. Cost control focuses on decreasing the total cost of production.
2. Cost control is a temporary process in nature.
3. The process of cost control will be completed when the specified target is achieved.
4. Cost control does not guarantee quality maintenance of products.
5. Cost control is a preventive function because it ascertains the cost before its occurrence.

Cost Reduction:

1. Cost reduction focuses on decreasing per unit cost of a product.
2. Cost reduction which is a permanent process.
3. The process of cost reduction is a continuous process. It has no visible end.
4. Cost reduction assured 100% quality maintenance.
5. Cost reduction is a corrective function.