

Competitive Exams Accountancy: Item cost

Determine Item Cost

Explain the process of determining the cost of an item, describe through a table the component of total cost

the process of determination of cost involves the following steps

1 Collection And Classification Of Costs: After costs are collected from some basic or subsidiary document, they have to be classified and analyzed according to the needs of the organization. Cost may be classified according to their nature and number of other characteristics, such as function, variability, controllability, normality etc.

2 Analysis Of Costs: If management is to be provided with the data required for cost control it is necessary to analyze costs. The total cost of production or service can be ascertained without such analysis and in most cases an average unit cost can also be obtained, but one of the advantages of an analyzed cost would be available. As such the total cost is necessary analyzed by what is known as elements of cost.

3 Allocation And Apportionment Of Costs Centers Or Cost Units:

Allocation implies identification of the overhead costs with particular cost center or production or service department to which they relate. It is the process of charging the full amount of overhead costs to a particular cost center. This is possible when the nature of expense is such that it can be easily identified with a particular cost center. For example the salary paid to a foreman of a particular production department can be directly identified with that department and therefore it should be directly charged to that production department. Apportionment refers to the distribution of overhead among department of cost centers on an equitable basis.

4 Absorption Of Overhead:

Absorption refers to charging of overhead of cost to different cost units in such a way that each cost unit bears an appropriate portion of its share overheads. This is done by means of overhead rates. Overhead rates refer to the rates at which the overheads are to be charged to different cost units. The rate may be in the form of a percentage of a rate per unit.

5 Determination Of Cost: After the costs are analyzed into different elements the next step is to proceed towards determining the total cost. In arriving at the total cost of the product from the different elements of cost, the build up is done in four stages successfully known as

1 Prime cost

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2 Works cost factory cost

3 Cost of production

4 Total cost cost of sales

Major Factors

- **Direct material:** These refer to those materials which can be easily identified with the product and become a part of the product/in other words these are the material which can be, measured and charged directly to the cost of the product
- **Direct labour:** It refers to all labour expended in altering the construction, composition, conformation or condition of the product. The wages paid to skilled and unskilled workers for his labour can be allocated specifically to a particular product or the process as the case may be.
- **Direct expenses:** These refer to those expenses other than direct material or direct labour that are specifically incurred for a particular product or process.
- **Prime cost:** Direct material plus direct labour plus direct expenses together make up the prime cost. This is also know as direct cost first cost, flat cost etc.
- **Works cost:** Prime cost plus works overhead together male up the works cost. This is also known as factory cost, production cost, manufacturing cost etc.
- **Cost of production:** Works cost plus office and administration overhead together make up the cost of production. This also known as office cost, administration cost etc.