

# Costing Methods

## AAT Level II

### AFC - Advanced Financial Accounting & Costing

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AAT 02  
Advanced Financial Accounting and Costing

## Costing Methods

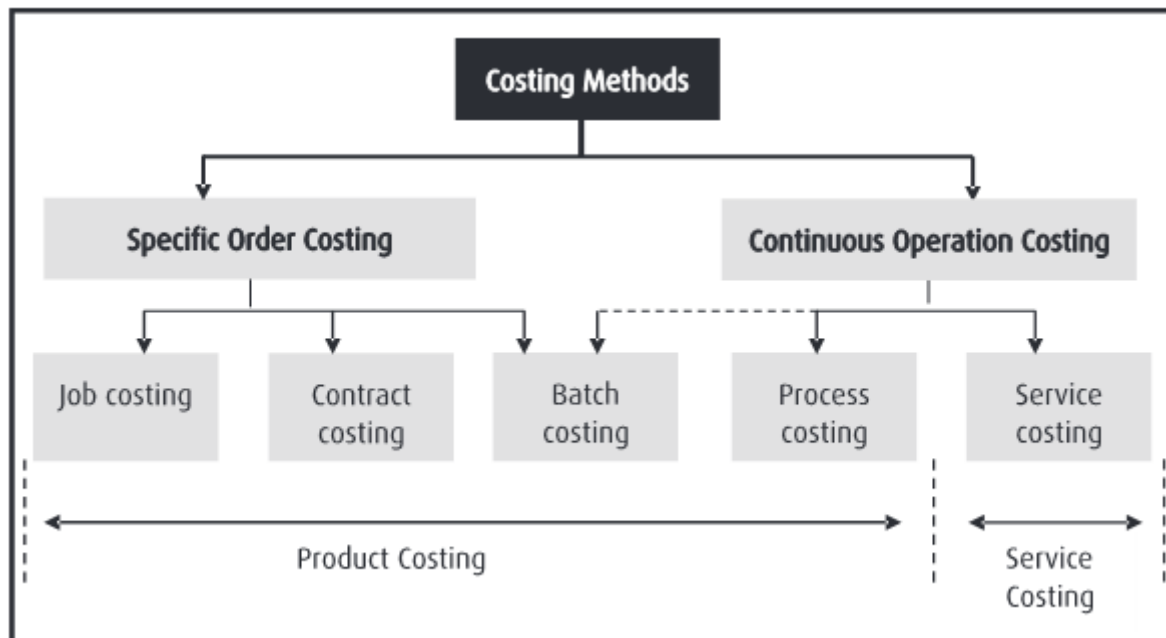


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A costing method is a method of costing which is designed to suit the way goods are processed or manufactured or the way that services are provided.



## 7.1 Job Costing

### 7.1.1 When used

When work is undertaken according to customers' special requirements and each order is of comparatively short duration (as compared with, say, constructing a new office building).

A wide range of products or jobs are produced, not necessarily within a factory or workshop, and each order is unique and requires different amounts and types of:

- labour (e.g. skilled and unskilled);
- materials;
- overheads.

Job costing is suited to industries producing specialized or made-to-order outputs. For example:

- accounting/legal advice;
- property maintenance/landscape gardening;
- service engineering/garage repairs.

### 7.1.2 Cost Records

The cost of each order is calculated separately. Costs are accumulated via a "job card" (or "job cost sheet").

#### Direct costs:

- materials purchases from goods received notes (GRNs)/ suppliers' invoices;
- materials from stores requisitions;
- direct wages from time sheets;
- direct expenses from invoices.

**Indirect cost:** factory overhead is usually charged at a predetermined overhead rate, for example, on a direct labour hour basis

**Abnormal costs:** these are the costs of rectification or re-working. Depending on their cause, they may be:

- charged to a job (e.g. if the customer changed the specification); or
- written off to a separate account (from where it may be recharged as an overhead).

#### Example 01

Chipboard collects cost data in a job order cost system. The following data relates to Job 139:

| Direct Material Issues | Rs.   | Direct Labour | Hours | Rate (Rs.) |
|------------------------|-------|---------------|-------|------------|
| 14 October             | 2,200 |               |       |            |
| 17 October             | 950   | 17 October    | 180   | 13.00      |
| 22 October             | 450   | 24 October    | 140   | 14.50      |

Overheads are charged at \$9 per direct labour hour.

#### Required:

**Calculate** the cost of Job 139.

## 7.2 Batch Costing

### 7.2.1 When used

Batch Costing is used when similar articles are manufactured in batches (either for sale or use). Articles may also have individual as well as common characteristics.

Examples of articles which involve variations of a single design and require a sequence of standardised operations include:

- footwear;
- clothing;
- furniture

### 7.2.2 Calculating the cost per unit



#### Example 02

Carrie uses a batch costing system in her cuckoo clock manufacturing business. Last month the following were used in manufacturing a batch of 120 clocks:

- Direct materials of Rs.17,800
- 500 labour hours in the clockworks department (Department A)
- 750 labour hours in the assembly and finishing department (Department B)
- Direct labour costs of Rs.10 an hour in Department A and Rs.8 an hour in Department B. Production overheads are absorbed at 120% of labour cost.

#### Required:

- (a) Calculate the total production cost of the batch and the unit production cost of a clock.

## 7.3 Batch Costing

### 7.3.1 When used

Service costing means accounting for specific services or functions. This method is used,

- To ascertain the cost of providing a unit of service (*e.g. on railway networks*).
- In both private and public sectors.
- Applies to services for resale and provided within organizations

Examples of service industries and internal services are as follows

#### Service industries –

- Electricity/Gas generation
- Telephone
- Transport—road, rail, sea, air
- Television and broadcasting
- Hospitals
- Theatres/museums
- Hotels and restaurants

#### Internal Services -

- Canteens
- Training
- Service departments  
(e.g. stores/ maintenance)
- Staff welfare
- Laundry/cleaning
- Boiler-house

### 7.3.2 Composite Cost Unit

When the cost unit is made up with two or more components as discussed in previous chapters, then such cost units are identified as composite cost units.

| Service Industry    | Possible Composite Cost Unit |
|---------------------|------------------------------|
| Passenger transport | Per passenger – Kilometre    |
| Goods transport     | Per tone – Kilometre         |
| Hospitals           | Patient – days               |
| Electricity supply  | Per Kilowatt hour (KWH)      |
| Canteen             | Per meal person              |
| Cinema theatre      | Per man show                 |
| Gas work            | 1,000 cubic feet produced    |
| Lodge               | Per person per day           |

### 7.3.2 Calculating the cost per unit

#### Example 03

A transport company which keeps a fleet of lorries, gives the following information to the month of April 2020.

- KMs run for the months – 30,000 KM
- Wages for month – Rs.60,000
- Garage rent – Rs.30,000
- Diesel and oil – Rs.120,000
- Depreciation to be allowed per annum – 25% on cost
- Original cost of vehicles – Rs.6,000,000
- Repairs for the month – Rs.360,000
- License, Insurance – etc for the year – Rs.360,000

**Required:**

**Calculate** the total service cost for the period and the cost per running kilometre.

