

## MEANING OF COSTS

### TYPE OF COSTS CONTINUED

#### Association based

##### *Period Costs*

Costs which are not assigned to the product but for a period. Eg. Selling cost and distribution costs.

##### *Product Cost*

Cost which are assigned to the product.

#### Relevant Cost

1. Marginal Cost
2. Differential Cost
3. Opportunity Cost
4. Out-of-pocket Cost
5. Replacement Cost
6. Imputed Cost
7. Discretion Cost

#### Irrelevant Cost

1. Sunk Cost
2. Committed Cost
3. Absorbed Cost

#### *Marginal Cost*

Cost of producing additional unit of Production

#### *Differential Cost*

It is the change in costs due to change in level of activity (or) pattern (or) method of production. When it increases, it is incremental cost. When it reduces, it is called decremental cost.

*Opportunity Cost*

Value of sacrifice made (or) benefit of opportunity foregone in accepting an alternative course of action. It is not available in the financial statement, but only in decision making.  
Eg. Expansion of firm by with drawing bank deposits, interest loss on it is called 'o.c'

*Out of Packet Cost*

It is opposed to the cost such as depreciation, which do not require any cash out lay. Cost that relevant to decision making, as they will occur in near future.

*Replacement Cost*

Cost incurred towards purchase of an assets/material that replaces a existing assets.

*Imputed Cost*

Cost that appearing in the cost accounts only.

Eg. Notional rent charges, interest on capital for which no interest has been paid.

*Discretionary Cost*

There are escapable (or) avoidable. By selecting a next course of action, it can be avoided. That is can be avoided if a particular course of action is not choosen.

*Irrelevant Cost*

(not relevant for decision making)

⇒ Sunk Cost

Cost that are already incurred (or) Sunk in past not relevant in decision making

Obsolete stock of material

– Rs. 10,000

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Which can be sold as Sunk cost – Rs. 2,000

Can be utilized in special job with the opening Stock – Rs. 10,000/-

*Committed Cost*

Already committed by management.

*Absolute fixed Cost*

Fixed costs do not change due to increase (or) decrease in activity.

|                    | <b>Explicit</b>                      | <b>Implicit</b>  |
|--------------------|--------------------------------------|--|
| Meaning            | Cost involves immediate cash payment | Cash which do not involve immediate cash payment                         |
| Otherwise known as | Out of pocket Cost                   | Economic Costs / Notional Costs / Imputed Costs                          |
| Recording          | Recorded in the books of accounts    | Not recorded in the books of accounts                                    |
| Eg.                | Salaries, Wages, Advt.,              | Interest on own Capital, Rent of own premises, Salary of proprietor etc. |

*Incremental Cost*

*Estimated Cost*

Expected costs eg. Manufacturing (or) acquisition of a unit of product. Information available in advance.

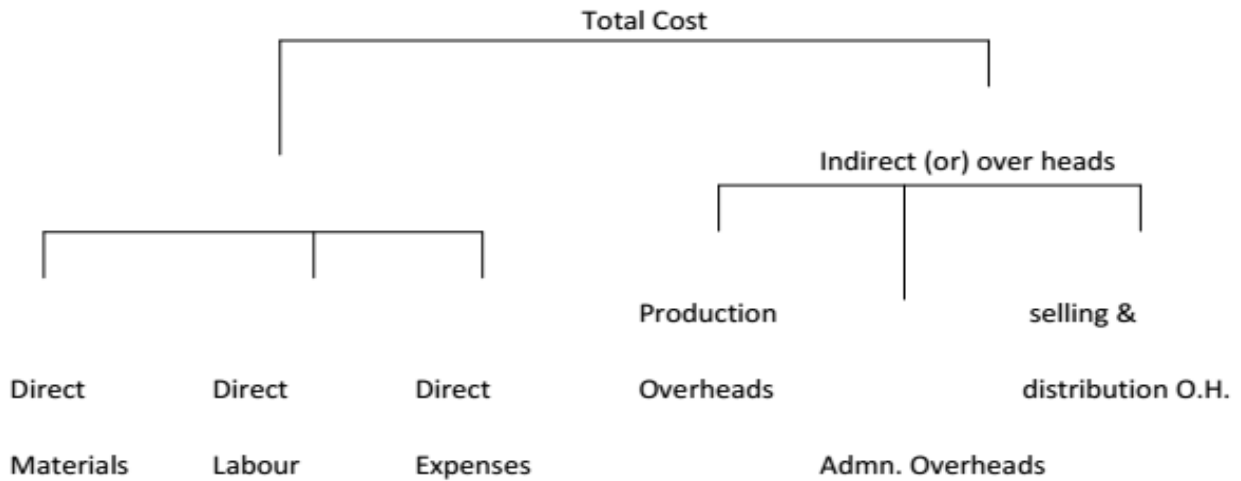
*Shut down Costs*

Costs which continue to be incurred even when a plant is temporarily shut down.

Eg. Rent, rates, depreciation etc.,

**Absolute Cost**

Cost refer to cost of any product, process (or) unit in its totality.



| <b>Shut down cost</b>  | <b>Abandonment cost</b>   |
|--|---|
| <p>Those costs which would be incurred in the event of suspension of the grant operation and which would be saved if the operations are continued – that is temporary closure of a business.</p> <p>Ex: cost of shellening the grant &amp; equipment coast of sheds for storing exposed property and additional cost for re-employment &amp; training.</p> | <p>Costs which are incurred in abandoning a particular fixed asset from service.</p> <p>Ex.: in missing field – do not yield any minerals after certain stage.</p> <p>Continue – Pram services in Bombay &amp; Delhi</p> <p>Replacing the cycle rickshaws by auto – rickshaws</p> |

*Cost concepts:*

Economic cost: Cost incurred for the factors of production ie. Resources such as land, labour and capital etc.,

| a) | Factors hired | Rs.         | Self owned    |             |              |
|----|---------------|-------------|---------------|-------------|--------------|
|    | Seed          | 750         | Family labour | 3500        |              |
|    | Labour        | 1900        | land          | <u>5000</u> | 8500         |
|    | Tractor       | 2000        |               |             |              |
|    | Fertilizer    | 1100        |               |             |              |
|    | Tube well     | <u>1250</u> |               |             |              |
|    |               | <u>7000</u> |               | Total       | <u>15500</u> |

- ✓ Implicit & Explicit ( Cash goes out) Cost
- ✓ Total Cost: Includes explicit & implicit cost
- ✓ Average cost:  $\frac{\text{Total cost}}{\text{Total quantity}} = \frac{\text{Rs.15500}}{10 \text{ tonnes}} = \text{Rs. 1550 per tonne}$

$$\text{Marginal cost} = \frac{\text{Change in total cost}}{\text{Change in output}}$$

|              |   |                     |
|--------------|---|---------------------|
| Total cost   | - | Break even analysis |
| Average cost | - | Profit margin       |

Decision making in management

**Long run and short run : (time based)**

|                        | <b>Long run</b>                             | <b>Short run</b>                          |
|------------------------|---|---|
| a) Relates to          | Long run of production                      | Short run of production                   |
| b) fixed & variables   | All factors of production subject to change | At least on factor of production is fixed |
| c) Production capacity | All possible production capacity            | Refer to the given production capacity    |
|                        | Long total cost                             | Short run total cost                      |
|                        | Long average cost                           | S.R. Average cost                         |
|                        | Long run marginal cost                      | S.R. Marginal cost                        |
|                        | LTC / LAC / LMC                             | STC / SAC / SMC                           |
| d) Decision making     | To decide the Mart size                     | To decide the optimum output              |