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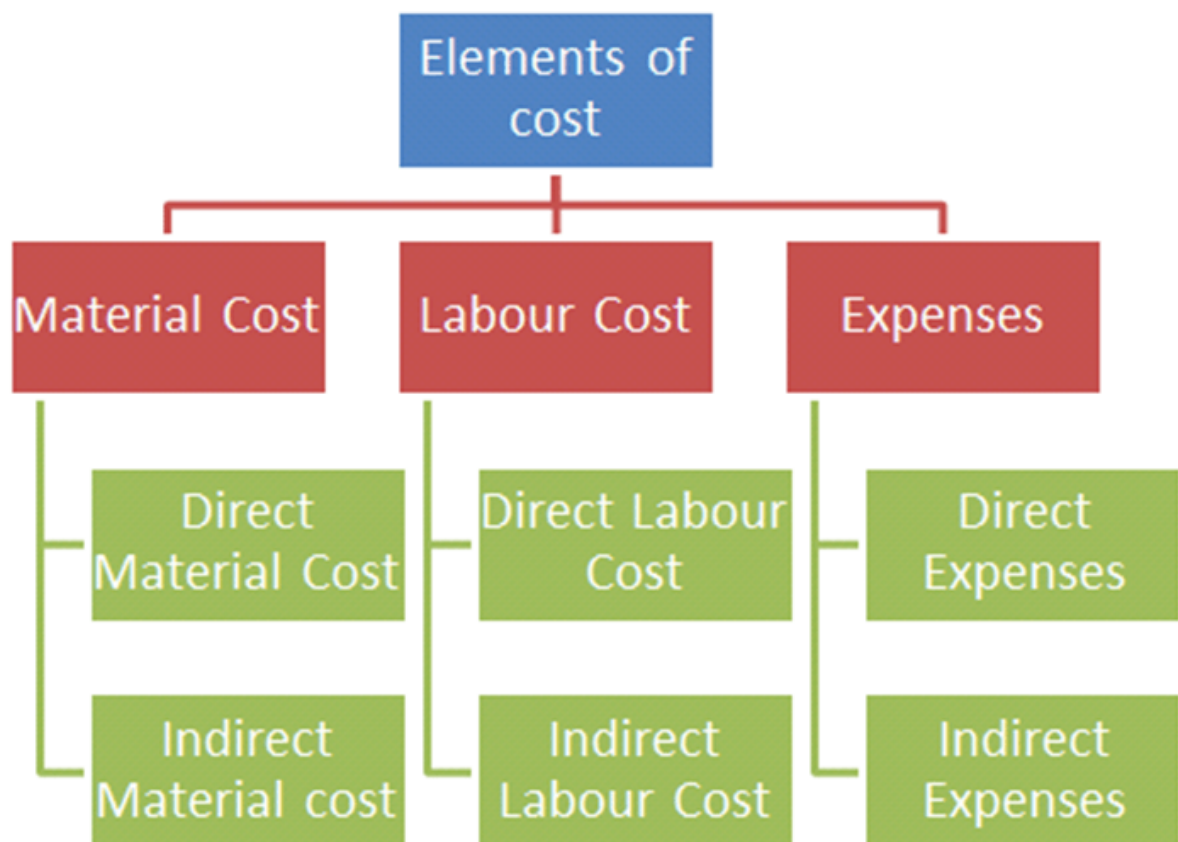
Accounting: Basic Cost Concepts: Elements of Cost and Overheads Are Classified into Three Categories

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- Any business entity incurs cost in order to produce products or services. If we consider manufacturing entity will incur costs for raw material, labour expenses and many other expenses. For better cost accounting we need to know concept of cost.
- Definition: According to ICWA, Cost – “It is the measurement in monetary terms of the amount of resources used for the purpose of production of goods or rendering services.”

Elements of Cost

Cost of production/manufacturing consists of various expenses incurred on production or manufacturing of goods or services. Elements of the cost are Material, Labour and Expenses.



Material Cost

To produce any product, we need material. The material may be directly or indirectly related to the product.

- **Direct Material:** Direct Material is that material which can be easily identified and related with specific product, job, and process. And it is the integral part of the finished product. Example: Sugarcane for making sugar, Gold for making jewelry
- **Indirect Material:** Indirect Material is that material which cannot be easily and conveniently identified and related with a particular product, job, process, and activity. They include consumable things, oils, printing and stationary etc. The indirect material useful both in factory and administrative office.

Labour Cost

Labour is the human resource needed to convert raw materials into product with the help of machinery or manual action. Labour may involve in the production process directly or indirectly. Based on this

- **Direct Labour:** Labour which takes active and direct part in the production of a commodity. Direct labour is also known as process labour, productive labour, operating labour, direct wages, manufacturing wages, etc. Direct labour costs are specially and conveniently traceable to specific products. Direct labour varies directly with the volume of output. Example: Carpenter for making furniture.
- **Indirect Labour:** Indirect labour is that labour which cannot be easily identified and related with specific product, job, process, and activity. They do not directly involve in manufacturing process. Labour employed for the purpose of carrying out tasks incidental to goods or services provided is indirect labour. They are useful in office works and selling and distribution activities. They get salaries for their work. Indirect labour may not vary directly with the volume of output. Example: Salaries to sales men, salary of store-keepers etc.

Expenses

In production process we need many other resources apart from raw material and labour. The remaining costs are considered as expenses.

- **Direct Expenses:** These are expenses which are directly, easily, and wholly allocated to specific cost center or cost units. All direct cost other than direct material and direct labour are termed as direct expenses. Example: Cost incurred for patents and royalties, cost of special designs etc.
 - **Cost Center:** Cost center means a location, person, or item of equipment or group of these for which costs may be ascertained and used for the purpose of cost control.
- **Cost Object:** Cost object is anything for which a separate measurement of cost is desired. It may be a product, service, project, or a customer
- **Indirect Expenses:** These expenses cannot be directly, easily, and wholly allocated to specific cost center or cost units. All indirect costs other than indirect material and indirect labour are termed as indirect expenses. Indirect expenses are treated as part of overheads.

Indirect Expenses = Indirect cost – Indirect material – Indirect labour.

Example: Rent on buildings, Repair charges, depreciation on fixed assets etc.

Overheads

- Overheads include the cost of indirect material, indirect labour and indirect expenses.
- Overhead = Indirect material + Indirect labour + Indirect expenses
- Overheads vary from business to business and they are inseparable parts associated with the smooth running of the business. They vary with the level of production (Variable Overheads) or they may be altogether independent of the level of output (Fixed overheads) or mix of both (Semi-variable cost) . Company needs to look into costs of overheads and keep them in control in order to be more effective.

Overheads Are Classified into Three Categories

Factory/Works Overheads

All indirect costs incurred in the factory for production of goods are termed as factory/works overheads. The indirect costs relating to material, labour and expenses.

Examples:

Overheads due to Indirect Material:

- Grease, oil, lubricants, cotton waste etc.
- Small tools, brushes for sweeping, sundry supplies etc.
- Cost of threads, gum, nails, etc.
- Consumable stores
- Factory printing and stationery

Overheads due to Indirect Labour:

- Salary of factory manager, foremen, supervisors, clerks etc.
- Salary of storekeeper
- Salary and fee of factory directors and technical directors
- Contribution to ESI, PF, Leave pay etc. of factory employee.

Overheads due to Indirect Expenses:

- Rent for factory building and land
- Insurance of factory building, plant, and machinery
- Municipal taxes of factory building
- Depreciation of factory building, plant and machinery, and their repairs and maintenance charges.
- Power and fuel used in factory
- Factory telephone expenses.

Office and Administrative Overheads

These are the expenses incurred for management and administration of the business. They include the expenses incurred from indirect material, indirect labour and indirect expenses for administrative activities.

Example:

- Office printing and stationary
- Cost of brushes
- Salaries to security guards, legal advisers
- Cost of furniture, office lighting
- Telephone charges
- Audit fee etc.