Class: 10th
Comm. Stud.
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Tender Heart High School.
Fundamental Concepts of Cost

Good Morning students,
This lesson is for class 10th for the subject of Commercial Studies. The topic for today is 'Cost and types of Cost' which is covered in chapter 8 titled "Fundamental Concepts of Cost' of your book.
This lesson is being submitted to you on. 12/08/24.
All the students now please open page number 104 of your book.

Cost:-

Cost has different meaning for different people. For a producer cost means ~~the~~ cost of producing an article, whereas for the consumer 'cost' means the price he pays for the article. Moreover cost to the producer may ~~be~~ factory cost, office cost or cost of sales.
In accounting cost means the amount of expenditure incurred on or attributable to, a given commodity.

Elements of Cost:-

1. Materials:-
The substance from which a product is made is known as material. It may be in a raw or manufactured state. Cotton used in manufacturing cloth, sugarcane used in producing sugar

are examples of materials. Material can be direct as well as indirect.

2. Labour:-
Labour means the human effort required for converting materials into finished goods. It can be direct as well as indirect.

3. Expenses:-
Expenses include all other costs other than materials and labour which helps in production. It includes, rent, insurance, carriage, lighting, advertising etc. Expenses may be direct or indirect.

4. Overheads:-
The term 'Overhead' includes indirect material; indirect labour and indirect expenses. In other words, all indirect costs are overheads. These may be incurred in the factory or office or on selling and distribution. Overheads are of three types.
(i) Factory Overhead.
(ii) Office and Administrative overheads.
(iii) Selling and Distribution Overheads.

Classification of Cost:-
On the basis of Nature:-

1. Direct Cost:- Materials, labour and other expenses which are directly or easily traceable to a product, service or job are known as Direct Costs. In the

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production of an article, materials are purchased, wages are paid to workers and certain expenses are incurred directly. All these take an active part in the manufacture of a product and are, therefore, called Direct Costs.
Direct Cost include :-
(i) Direct Material
(ii) Direct labour
(iii) Direct Expenses.
For explanation refer to page 106 of your book.

2. Indirect Costs :-
Indirect costs refer to the expenses incurred on those items which are not directly chargeable to production. salaries of timekeeper, storekeeper, foremen are examples of indirect costs. In the running of a particular train, cost of railway station and railway staff are indirect costs. Indirect cost is incurred for the concern as a whole rather than for a particular product. Indirect Costs include :-
(i) Indirect Material
(ii) Indirect labour
(iii) Indirect Expenses
For explanation refer to page 106 of your book.

Distinction between Direct and Indirect Costs

S.No.	Basis of Distinction	Direct Costs	Indirect Costs
1.	Meaning	Costs which are directly attributable to a particular cost unit or cost centre.	Costs which are not directly attributable to a particular cost unit or cost centre.
2.	Elements	Direct labour, direct material and direct expenses.	Indirect material, indirect labour and indirect expenses.
3.	Exam[illegible]s	[illegible] used to m[illegible]ure sugar.	Salary of sugar mill manager.

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On the Basis of Behaviour:-

(1) Fixed Cost:-

Fixed cost are those costs which remain fixed or which do not change with a change in output up to a given range of activity. For example rent of the building will remain same even if 1000 units are produced or 10000 units are produced. These costs do not change with the change in production. Other examples of fixed cost are property Tax, Insurance, Interest on loan, salary of permanent staff etc.

(2) Variable Cost:-

Variable costs are those costs which vary directly in proportion to changes in the volume of output. Cost of direct material and direct labour, power etc. are examples of variable costs. When output is increased, variable cost increases. When output is decreased, variable cost decreases.

(3) Semi Variable Cost:-

Semi Variable Costs are those costs which do not vary proportionately but do not remain constant with changes in the volume of output. Such costs are known as semi-variable costs. For example, in telephone costs, basic rental charge is fixed but call charges are variable

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Distinction between Fixed Cost and Variable Cost

S.No.	Basis of Distinction	Fixed Cost	Variable Cost
1.	Behaviour or nature	Fixed costs remain constant within a given range of activity and a given time period inspite of changes in the volume of output.	Variable costs vary in proportion to changes in the volume of output.
2.	Basis	Fixed costs are time based.	Variable costs are activity based.
3.	Total and per unit cost	Fixed costs are fixed in total but vary per unit. These decrease with increase in the volume of output.	Variable costs are fixed per unit but vary in total. These increase with increase in the volume of output.
4.	Control	Fixed costs are not controllable in the short run.	Variable costs are controllable in the short run.
5.	Example	Rent, insurance, salary.	Raw material, direct labour.

Before going further, lets take a short break. Write the answers of following questions during the break.

1. What is Material Cost?
2. What are Semivariable costs?
3. Give two difference between Direct Cost and Indirect Cost.

Classification of Cost on the basis of Control

(1) Controllable Cost:-

Controllable costs are those costs which can be influenced and regulated by the person or level of management which is managing the cost centre. For example, the head of marketing department can control the advertising expenses of the firm. Therefore, advertising costs are controllable costs in relation to the marketing manager.

(2) Uncontrollable Costs:-

Uncontrollable costs are those costs which are beyond the control of a given person during a given period of time. In other words, such costs cannot be regulated by the actions of a specific manager. For example, the marketing manager of a company cannot control the fee charged by an advertising agency for preparing advertisements. Similarly, he cannot control the charges made by newspapers and TV for release of advertisements.

Other types of Cost

1. **Outlay Cost:-**

Outlay costs are those costs which involve cash payment to other parties. While producing or acquiring a product or service, payments are made to other factors of productions, Such payment are known as outlay cost or out of pocket costs. These costs are recorded in the books of accounts. For example, salary, wages, rent, material costs etc.

2. **Opportunity Cost:**

Opportunity costs means the benefit sacrificed for selecting a particular course of action. It is the maximum advantage that could be obtained if the resource was put to an alternative use.
For example, a business firm can buy a lathe machine or a paper pressing machine with its limited resources. He can earn annually ₹50,000 and 40,000/- respectively from the two machines. The firm buys the lathe machine. Then the opportunity cost of lathe machine is ₹40000.

Opportunity cost is not recorded in books of accounts. It is useful in comparing alternatives and in making decisions.

3 Shut Down Cost:-

A business firm may have to suspend its operations for a period due to some temporary problems, e.g. shortage of raw materials, non-availability of required labour or power etc. During this period though no work is done yet certain fixed costs such as rent, insurance, depreciation etc. of plant may have to be incurred. Such costs of the idle plant are known as shut down costs.

4. Sunk Cost:-

Sunk Costs are historical costs which have already been incurred. Investment in plant and machinery is a sunk cost which has to be kept idle if not required at present. Such a cost cannot be changed by any decision and it is, therefore, not useful for decision making.

5. Product Cost:-

Product costs are those costs which are associated with production and which become part of the cost of a product. Raw materials and direct wages are examples of Product cost

6. Period Cost:-

Costs which are associated with period not

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products are called period costs. These costs are associated with the period for which they are incurred. Rent, insurance, interest, salaries of managers are examples of period costs.

7. Historical Costs:-
Historical costs or original costs mean the price at which an asset was originally acquired.

8. Replacement Costs:-
Replacement cost means the cost which the firm would have to incur to replace an old asset or to acquire a new asset now. Difference between historical cost and replacement cost arises due to increase in price level.

With this, I am ending my topic here. Write the answers of following questions in your note-books.

Q1. What is Product cost?
2. What is Opportunity Cost?
3. What are Period Costs?
4. What is uncontrollable cost? Give example

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