UNIT-4

METHOD OF COSTING – PROCESS COSTING

PROCESS COSTING:

- A manufacturing unit that can differentiate its processes and produces a standard product will use process costing method to determine cost of production. This is done by allocating all process cost to the total units produced.
- In simple words, if an unit passes through different processes and the processes are easily distinguishable then the cost of the unit will be cost of process that it goes through.
- In process costing a separate account is opened for every process and on completion of the process the cost is transferred to the next process.

Definition:

- Process Costing is defined as a branch of **operation costing**, that determines the cost of a product at each stage, i.e. process of production. It is an accounting method which is adopted by the factories or industries where the standardized identical product is produced, as well as it passes through multiple processes for being transformed into the final product.

- simple words, **process costing is a cost accounting technique, in which the costs incurred during production are charged to processes and averaged over the total units manufactured**. For this purpose, process accounts are opened in the books of accounts, for each process and all the expenses relating to the process for the period is charged to the respective process account

Features of Process Costing:

- The plant has various divisions, and each division is a stage of production.
- The production is carried out continuously, by way of the simultaneous, standardized and sequential process.
- The output of a process is the input of another.
- The production from the last process is transferred to finished stock.
- The final product is homogeneous.

- Both direct and indirect costs are charged to the processes.
- The production may result in joint and by-products.
- Losses like normal and abnormal loss occur at different stages of production which are also taken into consideration while calculating the unit cost.
- The output of one process is transferred to another one at a price that includes the profit of the previous process and not at the cost.

Treatment of Normal and Abnormal Loss in Process Costing:

- When we start the production of goods through different processes, normal loss and abnormal loss will happen with this. Due to this our total cost of production will increase. If we do not treat the normal and abnormal loss, our total cost of production will less than exact cost of production. Due to this, our sale price will not estimate correctly. So, for making good plan of selling and controlling our losses, we need to treat the normal loss and abnormal loss in process accounts.

1. Treatment of Normal Loss in Process Accounts:

- Normal losses are those which we can not stop. These are natural wastage.

  For example, if you doing the business of timber on the basis of their weight. It is sure that after cutting of tree, weight of wood will decrease. So, this loss is normal loss. In process account's credit side, we just show the normal loss's units. Now, our total produced units will decrease. This will increase our cost of production per unit in any process.

2. Treatment of Abnormal Loss in Process Accounts

- All those losses which happen due to abnormal reasons are called abnormal losses. Following are its main example.

  1. If you use bad quality raw material in the production, there is big risk of wastage in production. So, use of bad quality raw material is the reason of abnormal loss.

  2. Careless is also reason of abnormal loss. For example, due to the careless of worker, 5 units waste the products during production. So, loss of 5 units is the abnormal loss.

  3. All those losses which are not normal will be the abnormal loss. For treating the abnormal loss in the process account, we need to calculate the value of abnormal loss.