

Tamralipta Mahavidyalaya
Study Material
B.com (4th sem.)
Sub: Cost Accounting (C8T)
Unit-4
By
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1. What is Process Costing? Write the features of it.

Ans. 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.

In 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.

Hence, it ascertains the total cost and unit cost of a process, for all the processes carried out in industry. Further, the average cost represents the cost per unit, wherein the total cost is divided by the total number of outputs produced during the period to arrive at the cost per unit. The cost per unit can be calculated using First in First Out Method (FIFO), Average Method and Weighted average Method.

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.
- At the end of the period, if there remains the stock of finished goods, then it is also expressed in equivalent completed units. It can be calculated as:
Equivalent units of semi-finished goods or WIP = Actual number of units in process × Percentage of work completed

Process costing is employed by the industries whose production process is continuous and repetitive, as well as the output of one process is the input of another process. So, chemical industry, oil refineries, cement industries, textile industries, soap manufacturing industries, paper manufacturing industries use this method.

2. What is normal loss or spoilage in process costing? Write the treatment of normal loss.

Ans. The normal loss is the unavoidable loss of units in a processing department that occurs majorly due to the nature of production operation or the nature of raw materials being processed. This loss cannot be avoided under normal and efficient production environment and is considered within the normal or acceptable tolerance limit for machines and human errors.

In many industries, the normal loss is a highly expected or anticipated loss and is sometimes also termed as the standard loss. It is a known loss and in many situations its quantum can be easily estimated in advance of the start of production process. Since, the normal losses are inherent in certain manufacturing processes, the companies mostly make a provision for such losses before starting their manufacturing processes.

The normal loss is not presented as a separate cost element on the cost of production report (CPR) of the concerned department. The cost of lost units is just spread over the number of good units which results in an increased per unit cost for total output of the relevant processing department.

Treatment of normal loss

If the normal loss occurs in first processing department, it only increases the unit cost of the remaining good output because the total cost is divided by only the good units to obtain the per unit cost of the departmental output. The normally lost units are not considered while computing equivalent units which results in a decreased number of equivalent units and increased unit cost for materials, labor and manufacturing overhead. The increased per unit cost of these three cost elements results in an increased total per unit cost in the department.

$$\text{Cost per unit} = \frac{\text{Total process cost} - \text{Scrap value of Normal Loss}}{\text{Input unit} - \text{Units of Normal Loss}}$$

Journal entries for normal loss

1. Normal loss A/C.....Dr. (for selling of scrap)
 To Respective Process A/C
2. Cash/Bank A/C.....Dr. (for realisation of scrap value)
 To Normal Loss A/C

3. What is abnormal loss or spoilage in process costing? Write the treatment of abnormal loss.

Ans. In process costing, abnormal loss can be defined as the loss or spoilage of units in a processing department that should not occur under normal and efficient working conditions. The abnormal loss signifies that the production operation has one or more serious issues that need to be identified and fixed quickly. Major factors that may contribute towards the occurrence of abnormal loss in a production process include use of faulty equipment, unskilled or untrained workers, use of substandard raw materials, improper supervision, frequent electricity breakdown and working conditions with a lot of room for improvements etc.

The abnormal loss, is referred to as controllable loss because it can be avoided under normal and efficient working conditions. It is essentially an unnecessary loss because it occurs due to carelessness, use of low quality materials, use of inefficient or faulty machines in manufacturing process and other similar factors that are controllable in nature.

Treatment of normal loss

Process account is to be credited by abnormal loss account with cost of material, labour and overhead equivalent to good units and the loss due to abnormal is transferred to Costing Profit and Loss Account.

Journal Entries:

(i) Abnormal Loss A/cDr.
 To Process A/c

(ii) Cash/Bank A/cDr. (Scrap value)
 Costing Profit & Loss A/cDr.
 To Abnormal Loss A/C

$$\text{Cost per unit} = \frac{\text{Total process cost-Scrap value of Normal Loss}}{\text{Input unit- Units of Normal Loss}}$$

4. What is Abnormal Gain? Write the treatment of it in process costing?

Ans. If the actual loss of a Process is less than that of expected loss then the difference between the two will be treated as abnormal gain. In another way we can define it as the difference between actual production and expected production.

Accounting Treatment:

The value of abnormal gain is transferred to the debit side of the relevant process and ultimately closed by crediting it to the Costing Profit and Loss Account.

Journal Entries:

(i) Process A/cDr.
 To Abnormal Gain

(ii) Abnormal Gain A/cDr.
 To Normal Loss
 To Costing Profit & Loss A/c

$$\text{Cost per unit} = \frac{\text{Total process cost-Scrap value of Normal Loss}}{\text{Input unit- Units of Normal Loss}}$$

5. What are the differences between job-costing and process costing?

Particulars	Job Costing	Process costing
Meaning	Job costing is the cost of a special assignment or contract where work is done based on clients needs and instructions	Process Costing is the cost calculated based on various processes
Production	Customized.	Standardized.
Assignment	Calculating the cost of each job	The cost, in this case, is first determined on the basis of the process and then decided based on the units produced.
Cost Calculation Basis	The cost calculation is done based on Job	The cost calculation is done based on Process
Reduction in Cost	There are fewer scopes of reduction in costs	There is a higher scope of reduction in costs
Cost Transfer	The cost cannot be transferred	The cost can be transferred from one process to another
Individuality	Since each job is different from another all the products have their own individuality	Products are produced in large volume and consequently, therefore, they do not have any individuality
Industry	This process is suitable for industries that customize products based on customers' demands.	This process is suitable for industries where mass production is possible
Losses	Losses cannot be segregated.	Losses can be bifurcated based on processes.
WIP(Work In Progress)	WIP may or may not exist	WIP in this process will always be present in the beginning and at the end of the period.
Examples	Furniture, Interior Decoration and Shipbuilding.	Soap, paint, cold drinks, snacks.
Size of Job	Used for small production units.	Used for large production units.