

Service costing

Introduction:

There are large number of organizations where the goods are not produced but services are rendered. The cost incurred for rendering services by these organizations is termed as operating cost or service cost.

As per ICMA, "Operating cost is the cost of providing service." According to CAS-1, "Operating Costs refer to cost of undertakings which do not manufacture any product but which provide services."

MEANING OF OPERATING COSTING

In order to determine the total cost and per unit cost of services rendered by organizations providing or operating services on the basis of expenditure incurred for the services and determining the per unit selling price of service, the method which is applied is known as operating costing.

Thus, service costing or operating costing method is one designed to ascertain and control the costs of the undertakings which do not produce products but which render services.

"Operating Cost applies where standardised services are provided by an undertaking or by a service cost centre within an undertaking.

The operating cost method is similar to the Unit cost method or the output cost method as the cost per unit of the service rendered is required to be ascertained in this method by preparing the cost-sheet. The difference between the cost-sheet of the output and the cost-sheet of service obviously lies in (a) the adoption of a suitable cost unit, and (b) the collection, analysis and allocation of the costs to the cost units.

SCOPE OF OPERATING COSTING

The undertakings to which this method is applicable are, for example, as follows:

- (i) Transport Services Bus, Railway, Trams, Truck, Air & Marine Transport.
- (ii) supply Services : Gas, Water, Electricity, etc.
- (ii) Welfare Services : Hospital, Library, Hostel, Canteen, Hotel, Cafeteria, etc.
- (iv) Entertainment Services : Cinema, Circus, etc.
- (v) Municipal Services : Road Maintenance, Street Light, etc.

CHARACTERISTICS OF OPERATING COSTING METHOD

- (1) Undertakings are engaged in providing or operating services of unique nature.
- (2) A large amount of capital expenditure is invested in capital assets of the undertaking depending upon the nature of business eg., trucks, buses, wagons, equipments, buildings, railway engines, ship, etc.
- (3) The total cost has to be classified into fixed and variable cost as these have a significant effect on the cost per unit.
- (4) Low amount of working capital is required to meet out the day to day operating expenses.

Build up of costs

In building up the operating cost, the costs are collected under the following heads, viz., (1) Fixed or Standing Charges; (2) Semi-fixed or Maintenance Charges; (3) Variable or Running Charges.

Some accountants favour the collection of operating costs under two heads only:

- (I) Fixed expenses a Fixed expenses and
- (II) Variable expenses.

In this case, the semi-fixed expenses are merged into these two divisions.

COMPUTATION OF OPERATING COST OF SPECIFIC SERVICES

The services provided by various service organization differ from each other. Some main service industries are as follows which will be studied in this chapter :

- (1) Transport Operating Costing,
- (2) Power House Operating Costing,
- (3) Hotel Operating Costing,
- (4) Canteen Operating Costing,
- (5) Hospital Operating Costing, Costing.
- (6) Cinema Operating Costing.

TRANSPORT OPERATING COSTING

Transport operating costing is applied in those organisations where services are provided carriage of passengers or carriage of goods from one place to another. In these organisations cost related to services provided as regard to transportation are collected and classified in such a manner so that cost per unit of transportation service may be ascertained. Though, transport services can be related to air, water and land, but here the study deals with the cost of transport service specifically provided by means of land, especially by bus or truck.

Objects

The objects of Transport costing are :

1. To ascertain the cost per unit of operating the vehicles and to fix the rates for the carriage of goods or passengers.
2. To compare the cost per unit of the motor vehicles with the cost of other means of transport, and to find out the profitable routes.
3. To compare the cost of one motor vehicle with the cost of the other motor vehicle. This helps to ascertain the efficiency of each vehicle and to control the cost of each vehicle.
4. To keep a control over the cost of petrol, lubricants and maintenance.
5. To help to fix hire charges of the vehicles where the vehicles are given on hire.
6. To help to apportion the cost of transport in the different departments availing of the services of transport.

Unit of Cost

The cost unit of the passenger vehicles whether in bus transport or in railways is the 'Passenger-kilometre' or 'Passenger-mile'. In case of goods transport, it is 'Tonne kilometres' or 'Tonne-mile'. In both the cases, the unit is a compound unit. If 4 tonne load is carried for 8 kilometre, the service rendered would be $4 \times 8 = 32$ Tonne-kilometre. There are two possible methods of calculating 'Tonne-km' viz., (1) Absolute, and (2) Commercial.

TRANSPORT OPERATING COSTING PROCEDURE

In order to determine the cost of transport services provided by the transport organisations, the following accounting procedure is followed :

- (1) Collection of transport cost
- (2) Classification of transport cost
- (3) Construction of operating cost sheet

(1) Collection of Transport Cost

For determination of service cost in transport organisation, all the cost related to transport service is collected continuously. Generally, in these type of organisations detailed information as regard to each vehicles is collected. For this purpose a separate log book is kept for each vehicle.

(2) Classification of Transport Cost

The transport cost can be classified into three parts:

1. **Running or Operating Charges** : The expenses which are incurred on running the vehicles or keeping the vehicles in mobility are called as running or operating charges. It means that if the vehicle stands still or does not operate any day then these expenses will not be incurred.

These expenses of each vehicle may vary day to day.

The examples of such charges are as follows

- (i) Depreciation-It is calculated on km basis;
- (ii) Cost of petrol, diesel, lubricants, etc;
- (iii) Payment to Drivers, Conductors, Cleaners, etc. if such payment is made on the basis of time (per day, per hour) or on the basis of distance covered;
- (iv) Overtime to Drivers, Conductor, Cleaner, etc.

2. Maintenance Charges : These expenses are incurred on the up-keep and on maintaining the vehicle in running condition. The examples of such expenses are :

- (i) Repairs & Maintenance;
- (ii) Renewal & Overhauling of Vehicles;
- (iii) Cost of Tyre, Tubes, etc,
- (iv) Salary and expenses of Garage Staff,
- (v) Consumable stores and minor equipments.

2. Fixed Charges or Standing Charges : These expenses are those expenses which are bound to be incurred irrespective of the fact whether vehicle is running or not. For example :

- (i) Interest on financing of vehicles.
- (ii) Road licence fee;
- (iii) Insurance premium of vehicle; Road Tax;
- (iv) Depreciation-if it is charged on the basis of time or fixed percentage of depreciation;
- (v) Garage Rent;
- (vi) Monthly salary of Driver, Conductor or Cleaner,
- (vii) Salary of Supervisor;
- (viii) Stationery Expenses;
- (ix) Office Expenses, etc.

In place of above classification, the expenses as regard to transport service may be classified into two parts only, viz.

(A) Fixed Charges and (B) Variable Charges.

Expenses incurred on running or operating the service can be regarded completely as Variable expenses, whereas maintenance charges can be treated as semi-variable (i.e. fixed + variable expenses).

By classifying the expenses in fixed and variable expenses, the fixed portion of semi-variable expenses can be included in fixed expenses whereas variable portion of semi-variable expenses can be included in variable expenses. For example, rent of garage and salary to garage staff can be treated as fixed expenses while expenses on repairs, lubricants, etc. used in garage can be treated as variable expenses.

Classification of expenses either in three parts or two parts doesn't matter. Both the classification may be considered as correct. However, the variable expenses may sometimes be ascertained separately on per unit basis too

(3) Construction Of Operating Cost Sheet

This is a cost sheet prepared monthly or quarterly and it contains the items of expenses in the classified form to show the cost per unit. This cost sheet is an important document in operating costing and should be prepared carefully. The proforma of operating cost sheet is presented as follows:

PROFORMA
Operating Cost Sheet

Vehicle No.....

Month ended.....

Carrying Capacity.....

		Amount
		₹
A. Standing Charges :		
Depreciation of vehicle (period basis or percentage basis)		
Insurance of vehicle		
Tax, Licence fee, etc.		
Interest		
Administration Expenses		
	Sub-Total
B. Maintenance Charges :		
Garage Staff Salaries		
Garage Other Expenses		
Repairs & Renewals		
Overhauling Expenses		
Cleaning Expenses		
	Sub-Total
C. Operating or Running Charges :		
Petrol		
Oil & Grease		
Salaries of Running Staff		
Driver		
Mechanic		
Cleaner		
Depreciation—Tyres		
Battery		
	Sub-Total
D. Total Operating Cost (A + B + C)		
Operating Cost per ton km = $\frac{\text{Total Operating Cost}}{\text{Total Ton-km}}$		
Operating Cost per Passenger km = $\frac{\text{Total Operating Cost}}{\text{Total Passenger-km}}$		
E. Revenue		
F. Net Profit		
G. Tonne-kilometre Carried		
H. Cost per Tonne-kilometre		

If there is only one vehicle and per km operating cost is to be calculated, the following simple format can be used :

Operating Cost Sheet		
Particulars	Per annum or per month	per km
Standing Charges	₹	₹
...	...	
...	...	
...	...	
Total Standing Charges	...	
Standing Charges per km		...
Running & Maintenance Charges :		
...		...
...		...
...		...
Operating Cost per km		...



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