

Quadrant II - Notes

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Module Name: Meaning and Nature of Operating Costing

Module No: 06

Notes

Introduction

Cost accounting has been traditionally associated with manufacturing companies. However in the modern competitive market, cost accounting has been increasingly applied in service industries like banks, insurance companies, transportation organisations, port trusts and other service organisations.

Meaning of Operating Costing

Operating costing is a method of ascertaining cost of providing or operating a service. This method of costing is applied by those undertakings which provide services rather than the production of goods. Operating costing is also known as service costing. Industries which are suitable for operating costing are:

- ✓ Transport Services: Bus, Taxi, Truck, Railways etc.
- ✓ Welfare Services: Canteens, Hospitals, Libraries etc.
- ✓ Utility Services: Gas, Electricity, Water etc.
- ✓ Municipal Services: Street lighting, Road maintenance etc.

According to CIMA, London, "Operating costing is that form of operation costing which applies where standardized services are rendered either by an undertaking or by a service cost centre within an undertaking".

Operating costing is applied to determine the cost of providing a service, whereas operation costing is a refinement and more detailed application of process costing.

Nature of Operating Costing

- **Intangible Products:** Service costing deals with the operating cost of products which do not have any physical form but satisfies consumer needs and wants.
- **Collection of Cost Data:** The documents used for service costing of products include cost sheet, bills payable, daily log sheet, etc.
- **Unique and Standard Service:** The services offered by organizations are specialized and exclusive.
- **Less Working Capital:** The service costing involves less working capital since the direct cost of raw material and other direct expenses is comparatively low.
- **Cost per Unit:** Here, the cost unit is determined by the type of service industry the business belongs to, and it usually differs from company to company. Like, in the case of goods transport it is 'tonne-miles'; whereas, in boilers, it is 'per cubic centimetre-litre'.
- **Internal or External Service:** The service costing can be performed internally, to determine the operating cost of the supporting activities in manufacturing industries. It can be also carried out externally by the companies rendering services.
- **Cost Classification by Behaviour:** In operating costing, all the costs are classified according to their behaviour, i.e., fixed costs, semi-variable costs and variable costs.
- **Periodic or Order Wise Computation:** The service costing records the overheads at regular intervals, i.e., monthly or yearly but for operating cost of vehicles like tractors and JCB machines, order wise computation is adopted.

Conclusion

Operating costing is the method of determining the cost of producing and maintaining a service.