

# A whole lot of costs going on

PQ magazine's troubleshooter Phil Dunn explains everything you ever wanted to know about costs

**Problem:** I am a Level 3 student and wish to understand a number of terms associated with cost that includes: cost, cost centre, cost unit, cost allocation and cost apportionment, direct cost, indirect cost or overhead. *This article should be of interest to AAT and ICB students and those preparing for Level 3 Apprenticeship.*

**Answer:** You will find as you progress your studies of cost and management accounting you will encounter a vast amount of terminology – enjoy your journey.

- **Cost:** This is simply the amount of expenditure incurred or attributable to a specific item or activity.
- **Cost or expense centre:** A location or activity to which cost can be allocated or apportioned. Such costs are the responsibility of the expense/cost centre manager.  
Example: Cricket ball manufacturer (cutting, stitching and finishing).
- **Cost unit:** A unit of product or service to which cost can be allocated or apportioned.

Examples:

- Education – per student hour
- Quarrying – per tonne
- Brewing – per barrel
- Hospital – per outpatient day.
- Restaurant – per cover/meal served

- **Cost allocation:** The allotment of whole items to cost centres or cost

units. Example: the analysis of payroll costs to specific cost centres by the use of cost codes.

- **Cost apportionment:** The allotment of proportions of whole items to cost centres or cost units. Example: rent and rates would be apportioned to cost centres on the basis of area occupied.
- **Direct cost:** One that can be directly identified with and allocated to a cost centre or cost unit. For example, in the manufacture of cricket boots the direct labour would be that cutting, stitching and finishing the product. The direct material would include the leather for the upper, the rubber sole and metal spikes, the eyelets and the laces.
- **Indirect cost or overhead.** Such costs are jointly incurred and are apportioned to cost/expense centres.
- These are classified as: production, administrative and selling and distribution overhead. Examples in the case of a business manufacturing cricket boots would include: production – heat light and power, repairs and maintenance and rent and business rates of the productive unit; administrative – expenditure on items such as office salaries, insurance of the office building, postage and telephone charges; selling and distribution – includes both marketing and costs related to the distribution of finished product.

• **Dr Philip E Dunn is a freelance author and technical editor for Kaplan and Osborne Books**