

Chapter 9

Cost Management

Cost Management

Introduction: Cost Management is the process whereby companies use cost accounting to report or control the various costs of doing business. Cost Management has a broad focus. It includes but is not confined to the continuous control of costs. Cost Management is not practiced in isolation. It is an integral part of general management strategies and their implementation. It is a company-wide systematic and structured approach, which provides a holistic framework to control, reduce and eliminate costs, throughout the value chain. In today's cut throat competition, all telecom operators are under pressure to reduce prices. In order to maintain profitability cost cutting and operational efficiency is must. This handout gives an overview of cost accounting and corresponding regulations in BSNL.

Lesson Objectives:

- Definitions in Cost Accounting
- Cost accounting Regulations and BSNL Guidelines
- Reporting Formats
- Classification of Cost

Definitions in Cost Accounting

1. **Cost:** Cost is a measurement, in monetary terms, of the amount of resources used for the purpose of production of goods or rendering services. Cost is measured by the sacrifice made in terms of resources or price paid to acquire goods or services. The type of cost is often referred in the costing system depends on the purpose for which cost is incurred.
2. **Cost Centre:** Any unit of Cost Accounting selected with a view to accumulating all cost under that unit. The unit may be a product, a service, division, department, section, a group of plant & machinery, a group of employees or a combination of several units.
3. **Cost Unit:** It is a unit of quantity of product, service or time in relation to which costs may be ascertained or expressed. Cost Unit is a form of measurement of volume of production or service. This unit is generally adopted on the basis of convenience and practice in the industry concerned.
4. **Cost Accounting:** It is the process of accounting for costs. It embraces the accounting procedures relating to recording of all income and expenditure and the preparation of periodical statements and reports with the object of ascertaining and controlling costs. It is thus the formal mechanism by means of which costs of products or services are ascertained and controlled.
5. **Cost Audit:** It is the verification of cost accounts and a check on the adherence to the cost accounting plan.
6. **Points of difference between cost accounting and financial accounting**
 - a. Objectives
 - b. Mode of presentation
 - c. Recording
 - d. Analysing Profits
 - e. Periodicity of reporting

- f. Degree of accuracy
- 7. **Cost Allocation:** Allocation is the process of charging the full amount of cost to a particular cost center. This is possible when the nature of expense is such that it can be easily identified with a particular cost center.
- 8. **Cost Apportionment:** It is the process of splitting up an item of cost and charging it to the cost centers on an equitable basis. This is done in case of those items which cannot be wholly allocated to a particular cost center.
- 9. **Cost Control:** It is exercised by a variety of techniques like standard costing, budgetary control and quality control etc.
- 10. **Other control Techniques**
 - a. Ratios and key performance indicators like Gross Profit Ratio, Operating Expenses to Sales Ratio, Return on Capital Employed Ratio, Profit per employee, Liquidity Ratios
 - b. Trend Analysis
- 11. **Cost Management** is the process whereby companies use cost accounting to report or control the various costs of doing business. Cost Management has a broad focus. It includes but is not confined to the continuous control of costs. Cost Management is not practiced in isolation. It is an integral part of general management strategies and their implementation.

Costing in BSNL

References

1. Cost Audit Report Rules, 2001 [Notification dated 27.12.2001]
2. Cost Accounting Records (Telecommunications) Rules, 2002 [Notification dated 08.10.2002]
3. Circular No. 20 (No. 600-22/2002-03/CA dated 31.03.2003) regarding Revised Accounting Procedure & Account Codes w.e.f 01.04.2003.
4. Circular No. 23 (No. 500-142/2003-CA-1/BSNL dated 18.05.2004) regarding Maintenance of costing records as per Cost Accounting Records (Telecommunications) Rules, 2002.

Objectives of Costing System

1. To maintain Cost Accounting Records according to Cost Accounting Records (Telecommunication) Rules, 2002.
2. To compile Cost Centre wise cost information.
3. To allocate/apportion the cost of Service Cost Centres to Operation Cost Centres or Service-products.
4. To determine the cost of different service-products.
5. To identify profitable/non-profitable operation centers.
6. To generate data to facilitate fixing tariff.
7. To provide essential cost information for strategic decision-making.
8. To provide base for cost reduction programme.
9. To generate cost information for reports for submission to Regulatory Authority or other bodies.

10. To prepare statements of Cost & Revenue for Rural Operation Centres for claim of subsidy / grants from Government.

Cost Centres in BSNL

1. Cost Centre – Unit for accumulating cost. In case of BSNL Costing System, different functional areas are taken as cost centers. Cost Centres are divided into two types – Operation Cost Centres and Service Cost Centres.
2. Operation Cost Centre – Functional area engaged in telecom operation. Operational Cost Centres (OCC) are:

Operation Cost Centres	Functional Area
Secondary Switching Areas Units of Metro Districts Units of Regional Maintenance Circle	Operation Maintenance Administration Project Execution
Data Network	Internet Service

3. Service Cost Centres – Functional areas engaged in support service to Operation. Serviced Cost Centres (SCC) are:

Service Cost Centres	Function
Corporate Office	Administration Planning
Telecom Circles Regional Maintenance Circle Office TCO, Kolkata	Administration Operation Planning Project Execution
Factories	Production of Equipment Maintenance
Material Management & Stores	Material procurement planning Material Procurement
CPAO (ITI Bills)	Clearance of ITI Bills
National Centre of Electronic Switching	Repair & Maintenance
Training Centres	Training to employees
Technical Development Circle	Technology Development
Quality Assurance Circle	Quality Control
Project Circles	Equipment & Network Development
IT Centre	Software Development
Civil Division	Civil Work
Electrical Division	Electrical Work

Service Products

Service Products means the different services offered by BSNL to the Subscribers (consumers) as product.

Service products (Activities) are given below with codes:

Service Products	Service Product Code
Basic Telephony	01
National Long Distance Service	02
International Long Distance Service	03
Cellular Mobile	04
Telex	05
Telegraph	06
WILL	07
Leased Circuit	08
Internet Services	09
PSPDN	10
VSAT	11
Value Added Service	12
Common Services (used for Asset Register)	99

Maintenance of following information required

Cost Accounting Records (Telecommunications) Rules have specified maintenance of nine sets of different information which are given below:

- I. Assets – Service-product wise
- II. Costs - Cost centre / service- product wise
- III. Revenue – Service product wise
- IV. Activity – Operation and Service product wise
- V. Statistical / Technical records
- VI. Captive Consumption
- VII. Reconciliation of Cost and Financial Accounts
- VIII. Adjustment of Cost Variances when Standard Costing is used
- IX. Records on Related Party transactions

Proformas required to be prepared

- Proforma - A: Asset Register
- Proforma - B: Cost information on Operation Cost
- Proforma - C: Part I: Statistical (Quantitative) Information
- Proforma - C: Part II: Cost Information on Service Cost

- Proforma - D: Apportionment of Cost to Service-Products; Revenue Information Service product wise; Margin etc

Proforma A

- Proforma 'A' is to be maintained by both 'Operation cost centres' & 'Service Cost Centres' i.e. all units including administrative offices of BSNL for recording assets particulars.
- Proforma 'A' is to be built up from the existing Asset Register maintained for financial accounting.
- Asset Register is to be maintained at all cost centers. Assets are to be maintained service-product wise under following components:
 - Land
 - Building
 - Apparatus & Plants
 - Motor Vehicle & Launches
 - Cables
 - Lines & Wires
 - Installation & Test Equipments
 - Office Machinery & Equipments
 - Electrical fittings & Appliances
 - Furniture & Fixtures
 - Computer
 - Masts & Aerials
 - Satellite Earth Station etc.

Proforma B

Proforma 'B' is to be maintained for compiling the operation cost of various 'service products'. 'Operation Cost Centres' i.e. SSA of Territorial Telecom Circles, Units of Metro District, Units of Maintenance Region & Units of Data Network Circle will maintain Proforma 'B'.

Proforma C

Proforma 'C' has two parts namely (i) Quantitative information (ii) Cost Information.

Proforma C (Part I): Quantitative information' part of Proforma 'C'

This part will be maintained by SSA, Units of Metro District, Units of Maintenance Region & Data Network. This part is meant for recording technical data and as such the same will be prepared & maintained by the Planning/Development Section. At the end of financial year the Units will submit this part of Proforma 'C' to their respective Circle HQ for consolidation at that end.

Proforma C (Part II)

This part will be maintained by 'Service Cost Centre' & 'Operation Cost Centre'

Proforma D

Proforma D is for allocation and apportionment of operation cost, service cost and other costs to service-products. Revenue also will be posted service-product wise.

Additional Reading Material

Classification of Cost

1. By Nature of Expense

- a. **Material Cost:** It is the cost of material of any nature used for the purpose of production of a product or a service.
- b. **Labour Cost:** It means the payment made to the employees, permanent or temporary, for their services.
- c. **Expenses:** Expenses are other than material cost or labour cost which are involved in an activity.

2. By Relation to Cost Centre

- a. **Direct Cost:** If expenditure can be allocated to a cost center or cost object by economically feasible way then it is called direct cost. Sum of all direct cost is called prime cost.
 - i. Direct Material Cost
 - ii. Direct Labour Cost
 - iii. Direct Expenses
- b. **Indirect Cost:** If an expenditure can not be allocated to a cost center or cost object by economically feasible way then it is called indirect cost. Indirect Cost is also known as overhead.
 - i. Indirect Material Cost
 - ii. Indirect Labour Cost
 - iii. Indirect Expenses

3. By Functions / Activities

- a. **Production Cost:** It is the cost of all items involved in the production or a product or service. It includes all direct costs and all indirect costs (Production overhead) related to the production.
- b. **Administration Costs:** These are the expenses incurred for general management of an organization. These are of the nature of indirect costs and are also termed as administrative overhead.
- c. **Research & Development Costs:** These refer to the costs for undertaking research to improve quality of a present product or improve process of manufacture, develop a new product, market research etc. and commercialization thereof.
- d. **Selling Costs:** These are indirect costs related to selling of products or services and include all indirect cost in sales management for the organization.
- e. **Distribution Costs:** These are the costs incurred in handling a product from the time it is completed in the works until it reaches the ultimate consumer.

4. By Behaviour

- a. **Fixed Cost:** It refers to the cost which does not vary with the change in the volume of activity in the short run. These costs are not affected by temporary fluctuation in activity of an enterprise. These are also known as period costs.
- b. **Variable Cost:** It refers to the cost of elements which tends to directly vary with the volume of activity. Variable cost has two parts – (a) Variable direct cost; and (b) Variable indirect costs. Variable indirect costs are termed as variable overhead.
- c. **Semi-variable Costs:** It contains both fixed and variable elements. They are partly affected by fluctuation in the level of activity.

5. For Management Decision Making

- a. **Marginal Cost:** It is the aggregate of variable costs i.e. prime cost plus variable overhead. Marginal Cost per unit is the change in the amount at any given volume of output by which the aggregate cost changes if the volume of output is increased or decreased by one unit.
- b. **Opportunity Cost:** It is the value of the alternatives foregone by adopting a particular strategy or employing resources in specific manner.
- c. **Relevant Cost:** These refer to the costs relevant for a specific purpose or situation.
- d. **Shut Down Costs:** Costs of idle plant. A manufacturer rendering service may have to suspend its operation for a period on account of some temporary difficulties e.g. shortage of raw material, non-availability of requisite labour. During this period though not work done certain fixed costs are incurred like rent and insurance of buildings, maintenance etc. which are referred to as 'shut-down cost'.
- e. **Avoidable Costs:** These are those costs which under given conditions of performance efficiency should not have been incurred.
- f. **Unavoidable Costs:** These are inescapable costs which are essentially to be incurred, within the limits or norms provided for. It is the cost that must be incurred under a programme of business restriction. It is fixed in nature and inescapable.

6. Classification by time

- a. **Historical Costs:** These are the actual costs of acquiring assets or producing goods or services.
- b. **Standard Costs:** A predetermined norm applied as a scale of reference for assessing actual cost, whether these are more or less. The standard cost serves as a basis of cost control and as a measure of productive efficiency when ultimately posed with an actual cost. It provides management with a medium by which the effectiveness of current results is measured and responsibility of deviation placed.

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