



CHAPTER 2

COST AND COSTING

LEARNING OBJECTIVES

After completing this chapter learners would be able to:

- (i) Define and classify of Food Cost
- (ii) Understand Elements of food cost
- (iii) Explain Function of cost
- (v) Understand the concept of Break even point

CONCEPT :

2.1 : Classification of Cost

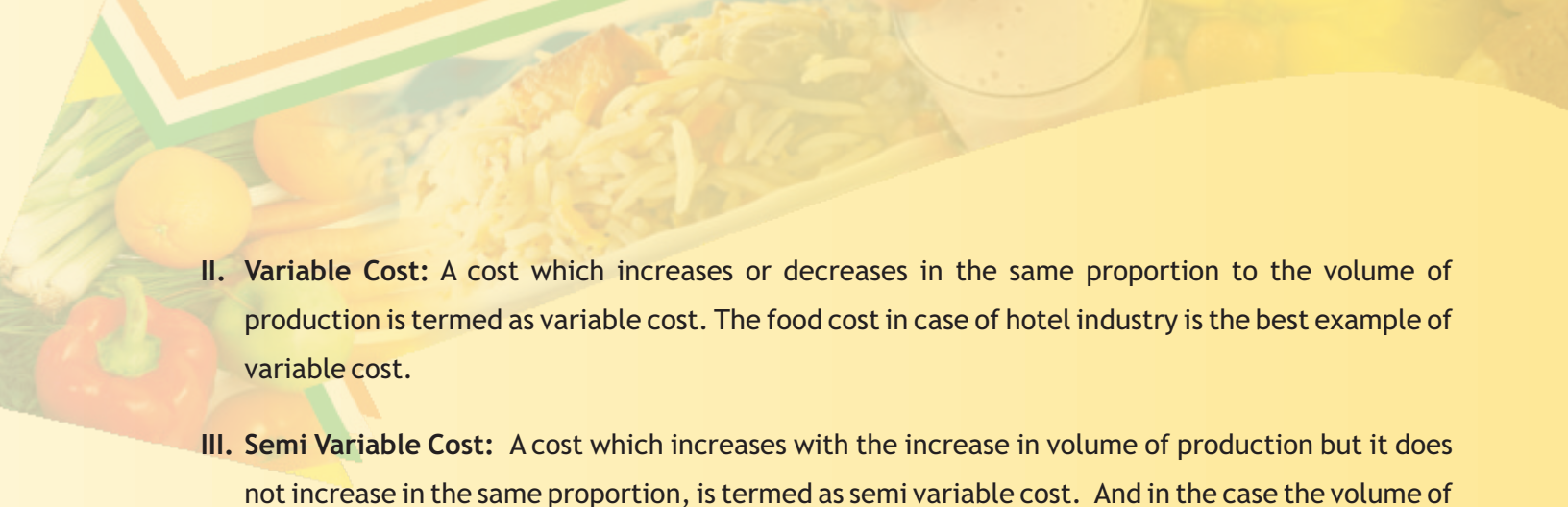
The cost can be classified / grouped in various ways depending upon their nature, elements, function, controllability, etc.

The cost can be grouped as under:

- a) Variability
- b) Controllability
- c) Functions
- d) Normality
- e) Generally Accepted Cost

a) VARIABILITY: The cost which may or may not vary depending upon the volume of production / sale is termed as variable cost. Some type of costs remains fixed and other cost may vary with the increase or decrease in production, sale, etc. Under this head the cost can be classified in the following ways:

- I. Fixed Cost:** A cost which remains constant with the increase or decrease in the volume of production is termed as Fixed Cost. But when the volume increases beyond certain level then the fixed cost jumps to the higher level and again it remains fixed in spite of increase or decrease in the volume of production and vice versa. It is also called 'capacity cost' or 'period cost'. It usually includes rent, interest, depreciation, insurance, etc.



II. Variable Cost: A cost which increases or decreases in the same proportion to the volume of production is termed as variable cost. The food cost in case of hotel industry is the best example of variable cost.

III. Semi Variable Cost: A cost which increases with the increase in volume of production but it does not increase in the same proportion, is termed as semi variable cost. And in the case the volume of production decreases, this cost also decreases but, again, not in the same proportion. It includes the cost of telephone charges, power charges, etc. It is also termed as 'semi fixed cost'.

b) CONTROLLABLE COST: The costs which can be controlled by the department / unit head are termed as controllable. The broad divisions under this head are:

I. Controllable Cost: The costs which can be controlled by the departmental head are termed as controllable cost. It means the costs which can be controlled by a particular responsibility centre like direct material cost, direct wages, direct expenses, etc. are termed as controllable cost.

II. Uncontrollable Cost: The cost which can not be controlled by the departmental head or by a particular responsibility centre are termed as uncontrollable cost. This includes rent, interest, etc. for a Chef as he has no authority to control these costs. He is only responsible to control the food cost, fuel cost, pilferage, etc. And these will be termed as controllable for him.

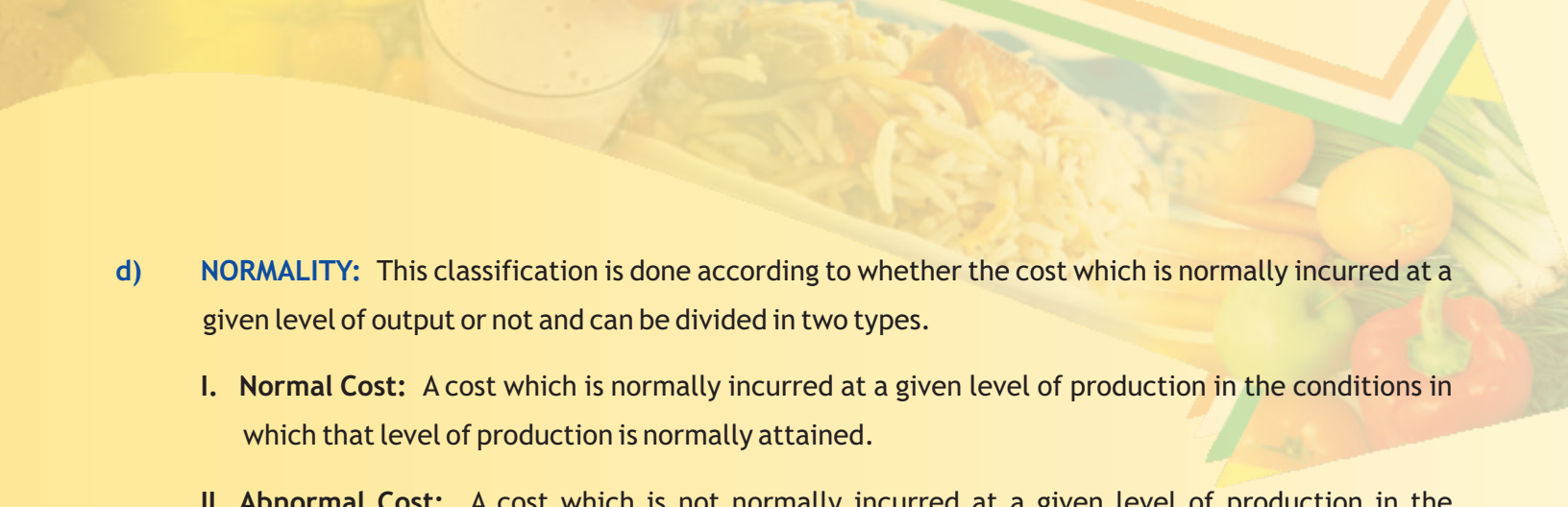
c) FUNCTIONS: The cost can be grouped according to the purposes for which they are incurred. Functional grouping / classification can be done in the following:

I. Production Cost: The production of food or goods is termed as production cost. This includes supplying materials, labour, services, finishes, packaging and storing of the product.

II. Administration Cost: The cost incurred for policy, direction, controlling are termed as administration cost but it does not include cost related to research, development, production, marketing, selling, etc.

III. Selling Cost: The cost related to marketing and selling is termed as selling cost.

IV. Distribution Cost: It includes packing of products available for dispatch and ends with making the reconditioned returned empty packages available for re-use.

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- d) **NORMALITY:** This classification is done according to whether the cost which is normally incurred at a given level of output or not and can be divided in two types.
- I. **Normal Cost:** A cost which is normally incurred at a given level of production in the conditions in which that level of production is normally attained.
 - II. **Abnormal Cost:** A cost which is not normally incurred at a given level of production in the conditions in which that level of production is normally attained.
- e) **GENERALLY ACCEPTED COST:** The costs which are generally calculated and given importance in the hotel / hospitality industry include the following:
- I. **Food Cost:** The total cost which is incurred for the production of a dish, menu or restaurant's kitchen is termed as food cost for the dish, menu or restaurant respectively.
 - II. **Labour Cost:** The total money paid for salary, wages and other perks to employees working in a restaurant / hotel is termed as labour cost.
 - III. **Over Heads:** The money paid for other expenses like rent, depreciation, interest, electricity bill, etc. for the normal functioning of a restaurant / hotel is termed as over heads.

2.2 : Elements of Cost

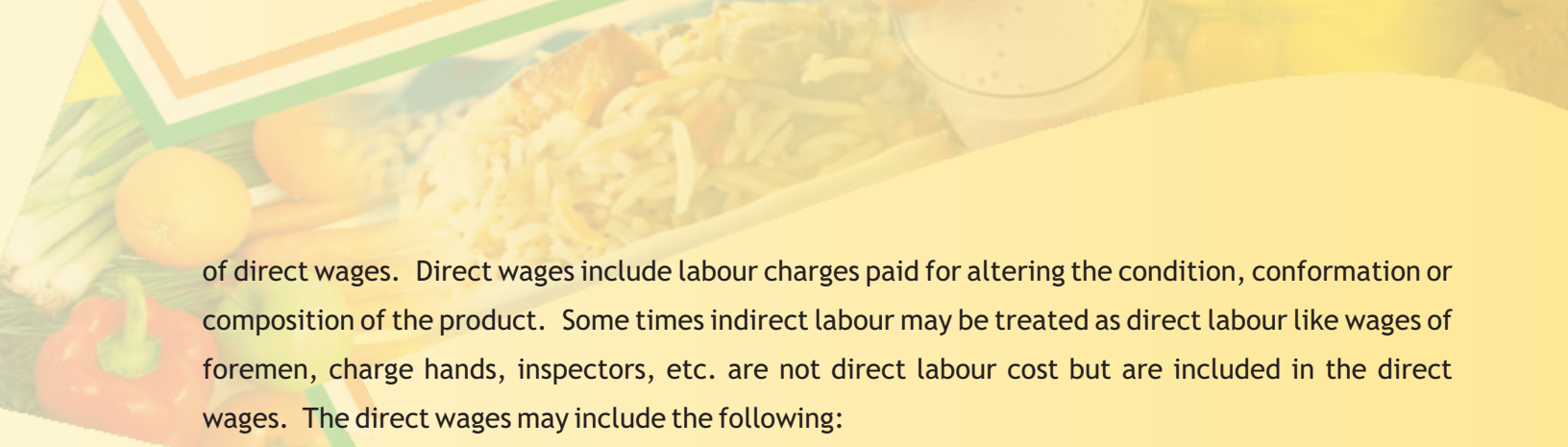
The following are the elements of cost:

a) Food Cost

- I. **Direct Materials Cost:** In case of food industry the food cost is termed as direct material cost and includes all food articles either used in the raw form or in semi cooked or cooked form in order to finish the dish and sell. In case a part of the dish is cooked in other kitchen then the cost at which the dish / portion is prepared is debited by making an inter-departmental requisition. For example the butchery prepares the standard steak and then it is transferred to the Continental Kitchen to complete the dish.

b) Labour Cost

- i) **Direct Wages:** Direct wages / salaries are the wages which can be allocated to cost centre or cost unit. Payment of direct wages and in some cases payment of indirect wages fall within the definition



of direct wages. Direct wages include labour charges paid for altering the condition, conformation or composition of the product. Some times indirect labour may be treated as direct labour like wages of foremen, charge hands, inspectors, etc. are not direct labour cost but are included in the direct wages. The direct wages may include the following:

- a) Laborers engaged in altering the condition, conformation and composition of the product.
- b) Inspectors, analysts, etc. specifically required for the production of the products.
- c) Wages paid to foremen, charge hands, etc. is termed as direct wages.

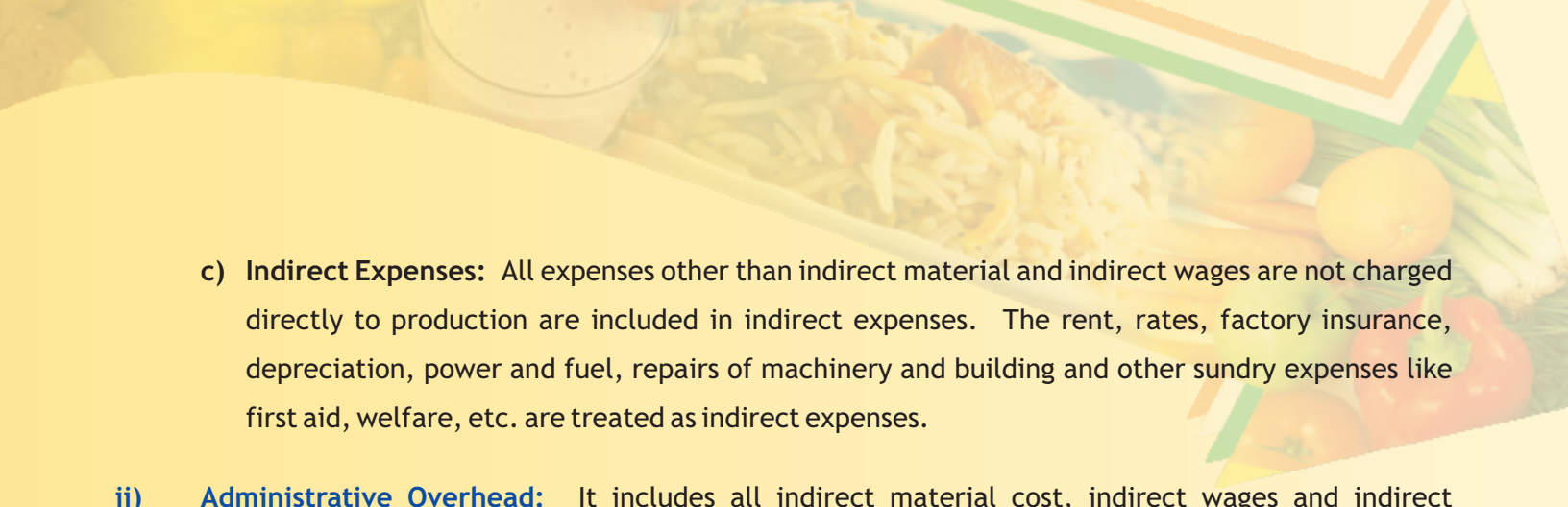
ii) Direct Expenses: The direct expenses other than the direct material cost and direct wages which can be identified with and allocated to cost center of cost unit are termed as direct expenses. It includes the following:

- a) Cost of special designs, drawings or layout.
- b) Hire of special tools or equipments for a specific job.
- c) Maintenance costs of tools and equipments used in production.

c) Over head

i) Production Overhead: Production overhead includes all indirect material cost, indirect wages and indirect expenses incurred for the production of goods in a unit or business house. The expenses for the purpose of production overhead include expenses from the receipt of the order until the completion of order for dispatch of goods. It includes the following groups of indirect items:

- a) Indirect Material:** The material which can not be traced in the finished products but is a part of the material used for production of goods. Usually this indirect material is of such a small nature that it is not included in the direct expenses and includes lubricants, waste cotton, grease, oils, nails, threads, glue, etc.
- b) Indirect Wages:** The wages which are not charged directly to direct wages are termed as indirect wages. The emoluments paid to foremen, supervisors, charge hands, inspectors, general labour, maintenance labour, works clerical staff, security guards, etc. are generally included in the indirect wages. Idle time wages, free food and conveyance allowance paid to staff doing overtime, night shift allowance and other fringe benefits are included in the indirect wages.



c) **Indirect Expenses:** All expenses other than indirect material and indirect wages are not charged directly to production are included in indirect expenses. The rent, rates, factory insurance, depreciation, power and fuel, repairs of machinery and building and other sundry expenses like first aid, welfare, etc. are treated as indirect expenses.

- ii) **Administrative Overhead:** It includes all indirect material cost, indirect wages and indirect expenses incurred in the direction, control and administration of a production house or unit. Printing and stationery, salaries paid to administrative directors, secretaries, accountants, managers, cash collection, treasures, lighting, heating and cleaning of administrative block, legal charges, audit fee, etc. are included in the administrative overhead.
- iii) **Selling Overhead:** It includes all indirect material cost, indirect wages and indirect expenses incurred in the promotion of sales and retention of customers. It includes printing and stationery, mailing literature, catalogues, price lists, salaries paid to sales managers and sales department personnel and rent, insurance premium paid for showrooms and sales offices. It also includes bad debts and collection charges, cash discount allowed, after sales services, etc.
- iv) **Distribution Overhead:** It includes all indirect material cost, indirect wages and indirect expenses incurred with making the packed product available for dispatch and ends with making the re-conditioned returned empty packages available for reuse. It includes packing cases, maintenance and up keep of delivery vehicles, wages of packers, van drivers, dispatch clerks, etc. It also includes carriage and freight outwards, rent, rates, deprecation and insurance of vehicles, warehouses, etc.

Break Even Point

Break Even Point is the point of sale at which one makes neither profit nor loss. In other words, it means that the sale is equal to the total cost. This can be explained in the chart below. (see table 1)

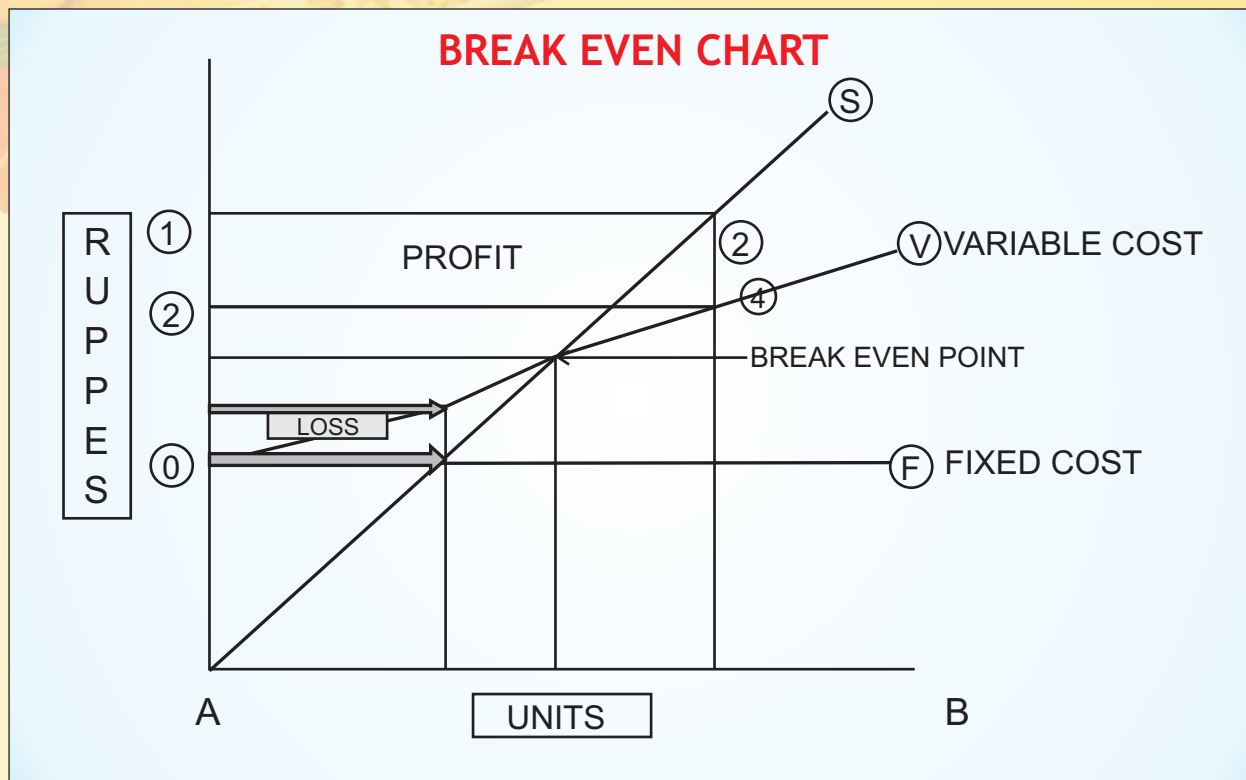


Table : 1

SUMMARY / RECAPITULATION:

1. Food cost is the total cost of raw material (food) used in the production of food / dish / menu.
2. Labour cost consists of total salary, wages and other perks given to staff.
3. All other costs like depreciation, administrative cost, rent, interest, telephone bills, selling expenses, etc. are termed as Over Heads.
4. Bread Even Point is the point of sale at which restaurant neither makes profit nor loss.

ANSWER THE QUESTIONS:

- Q. 1. What do you mean by cost? How will you classify the different costs?
- Q. 2. Write in detail the food cost with examples.
- Q. 3. What do you mean by Labour Cost? Explain with examples.
- Q. 4. What types of costs come under the head of Over Heads? Explain.
- Q. 5. What do you mean by Break Even Point? Explain with diagram.

CHAPTER 3

INTRODUCTION TO COST CONTROL CYCLE

LEARNING OBJECTIVES

After completing this chapter learners would be able to:

- (i) Understand Cost Control Cycle
- (ii) Explain Concept of Purchasing, Receiving, Storing, Issuing, Production Control & Sales Control

3. COST CONTROL CYCLE :

The motive of a Restaurant / hotel is to make reasonable profit at the end of the day. To make profit, it is not only that the sale is to be increased but the cost / total cost of the product is also to be controlled without affecting the portion of the dish or without deteriorating the quality of the dish.

At all levels, from purchasing, receiving, storing, issuing, production (cooking) and sale, the cost have to be controlled. At any level if the cost is not controlled than the restaurant / hotel will not make profit in spite of having a very good sale.

3.1 : PURCHASING:

The purchase department must ensure that the right quality of food, at competitive price and right quantity of raw material should be procured to keep the cost control.

3.2: RECEIVING AND STORING OF RAW MATERIAL:

The raw material received by stores must be inspected for the quality and the quantity desired, and in case it is not found up to requirement, it should be returned to the supplier for replacement. All raw material received must be stored at a proper place. It is saying that in stores there should be , 'a place for every thing and every thing in place'. The store keeper must ensure that no food item should get spoiled and if it happens then it is charged to store keeper.

3.3 : STORING

All raw material received must be stored properly in the stores department attached to the receiving department. In some hotels the perishable items are received in consultation with the Chef or the head of other department who ordered the material. The department who ordered is asked to take the delivery and shift the material to their department.

3.4: ISSUING:

All goods should be issued after a proper requisition. The store keeper must follow the rule of 'FIRST IN FIRST OUT (F.I.F.O.)', which means the goods received first are issued first.



3.5 : PRODUCTION CONTROL AND PROPER STORING OF COOKED FOOD:

The chef must ensure that the standard recipe is strictly followed in kitchens. The dishes served must have the similar presentation with identical accompaniments at all times. In case the cooked food is left at the end of the day then it must be stored at a proper temperature so that it can be used on the following day, if so required. Chefs can Re-Chafe the dishes to give a fresh look and better presentable. The cooks must ensure that there should be as far as possible no spoilage of food in the kitchen.

3.6: SALES CONTROL

In case food is allowed to be picked up without proper bill then this will increase the food cost.

To have a better cost control cycle there are other numerous factors apart from above mentioned points which affect the cost control and these are:

- a) **POLICY:** Policy of purchasing, menu finalisation, interior decoration of the restaurant, etc. should be as per the market requirement. There is no need to design or plan menu which people, at large, do not relish. For example, planning a Thai Menu for a small restaurant where guests do not have the liking of Thai Menu.
- b) **MENU:** Keeping in view the menu / dish, the quantity of raw material should be ordered. For example, for soups one may order for small sized but red coloured tomatoes but for salads tomatoes should be red, large and round.
- c) **VOLUME:** If possible, large volume of raw material should be purchased as the bulk purchasing will be always cheaper. But the large quantity should only be bought if it can be used without losing the quality of the raw material.

SUMMARY / RECAPITULATION:

The controlling of cost on purchasing, receiving, storing, issuing, etc. is a must to make net profit. Otherwise, in spite of large sale, the restaurant may make loss.

ANSWER THE QUESTIONS:

- Q1. How will you ensure a profitable venture for your restaurant?
- Q2. It is not only sale which determines a profitable restaurant. What are the other factors which affect the profitability of the restaurant?