

## ***MIGRATION OF ORDER COST TO PERIOD COST***

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## **1. Objective:**

The objective of this approach paper is to enable faster completion of period end activities and fast MIS reporting. This paper gives comparison of product cost by period vs. product cost by order. Steps and prerequisites for migrating from order to period approach and how to use period approach of cost reporting.

Major benefits expected out of this document are as under: (For process where “Back flush” being used for production confirmation)

1. Faster completion of period end closing activities
2. Check against cost spill over from period to other period
3. Manual financial entries for balance adjustment in books can be avoided
4. Cost reporting and variance analysis becomes more meaningful as available at material level.

For process where “back flush” is not being used for production confirmation, In such cases further study required for understanding the business process and possibilities of using back flush for confirmation of production.

## **2. What is product cost by period?**

This is classical and widely used method of costing used by most of the cost accounts for preparation of costing statements for manufactured materials. This approach collects all the related cost of production such as; raw materials, conversion cost & overhead cost pertaining to output materials for a period. All kind of MIS reports can be generated by this approach of cost collection. Following are the important MIS reports normally asked by managements;

1. Total actual cost of production at material level for a period.
2. Periodic variance reporting at material level i.e. quantity variance, usage variance and price variance.
3. Actual cost of production at output material.
4. For one material if two manufacturing facility available then comparative cost statement for both facilities.
5. Likewise there can be many more MIS reports can be generated.

### 3. What is product cost by order?

This is a special method of costing used specifically for collection of cost in case specific process is followed for production of material as per the requirement of customer. This approach collects all cost pertaining to that specific order and reflects the correct cost for that order. This approach is useful typically in “make to order” production environment. Where cost of each order need to be analyzed closely and based on that MIS can be prepared. Following are the important MIS reports normally asked by managements in this scenario;

1. Total cost of production for each order.
2. Variance reporting at order level
3. Comparison of actual and standard cost at order level
4. Work in process reporting if work partially completed.
5. Likewise there can be many more MIS reports can be generated.

### 4. Comparison of Period vs. Order Approach of cost

Point of comparison	Period approach	Order Approach
Where cost collected	Product cost collector at material and production version level	Process/ Production order level
Applicability in terms of process	Make to stock production, where production confirmation is on “back flush” process only.	Make to order production or where order wise cost reporting is required.
Production version wise total cost reporting	Available as collected at that level only	Not available, orders need to be grouped
Variance calculation	At output material level for each period	At order level for each period
Settlement posting	“TECO” i.e. tech. comp. status for order is not required.	“TECO” i.e. tech. comp. status for order is required.

System Performance	Much better as no. of cost object is low	Takes relatively more time as no. of cost object is high.
WIP valuation	At standard cost, It also required additional reporting point confirmation from production side.	At actual cost
Cost spill over periods	Cost posted in one period can not be settled / moved to the next period settlement run.	Cost posted in period if not settled in that period then settled in next settlement period. Hence cost gets spilled over.
Cost Reporting	At material level	At order level

## 5. Steps/Pre requisite for migrating from order cost to period cost:

1. Production confirmation must be done by using “back flushing” only
2. Configuration change in production / process order type.
3. Configuration change in product cost setting relevant to the above order types.
4. Production version need to be maintained for each finished/semi finished materials.
5. Selection parameter in material master need to be based on “production version”
6. Product cost collector need to be created at material and production version level.
7. Preliminary costing need to be executed for each product cost collectors.
8. Complete testing of existing production process and confirmation from PP and CO team is required.

## 6. Example for explaining the concept

Finished Materials: F1, F2 and F3

In Product cost by order approach separate process order will be created for F1, F2 and F3 let's assume one on daily basis. So for each material in one period there will be 30 orders and in total 90 orders for 3 materials.

In product cost by period approach one order per material is required and hence only 3 orders are required.

Product cost by order				Product cost by period
Order no.	101	102	....130	100
Material	F1	F1	F1	F1
Actual cost of RM	100	110	120	330
Conversion Cost	50	55	60	165
<b>Cost of production</b>	<b>150</b>	<b>165</b>	<b>180</b>	<b>495</b>
Goods Receipt	150	145	145	440
<b>Balance</b>	<b>0</b>	<b>20</b>	<b>35</b>	<b>55</b>
Analysis of different scenarios & its implication in Process				
Order Status set as TECO	No variance	Variance = 20	Variance = 35	Order status is not relevant & hence variance = 55
If no TECO then following can be the possibilities				
WIP calculation executed in system	No WIP	WIP = 20	WIP = 35	WIP calculation not required in this case & hence variance = 55 only
WIP calculation not executed in system	No variance & No WIP	No variance & No WIP	No variance & No WIP	WIP calculation not required in this case & hence variance = 55 only

In product cost by order approach it is required that the order shall have the status "TECO" then only the variance calculation and settlement process will work. In case the orders have not the "TECO" status then Work in process (WIP) calculation should be carried out and accounting entries with respect to WIP shall be posted at the time of settlement run.

In product cost by period approach it is the pre requisite that production confirmation shall takes place by “back flush” method only. As a result of that the Input material and activity type quantity confirmed to the extent of output material received from the process. Here the difference will be considered as variance only and WIP calculation is not recommended in this scenario.

Analysis of cost by both approach of cost:

Point of Analysis	Cost by order	Cost by period
Cost collection	In 30 different orders	In one order
Cost reporting at material level	All 30 order need to be grouped and reported	Available in one order directly.
Variance calculation	Available at each order level and not at material level	Available at material level
Settlement cost object for one material in a period	30	1
Setting of TECO status	Required for all 30 orders	Not required

## 7. Advantages of using period cost

- Check the spillover of cost over the period, Hence the periodic cost will not be disturbed because of this.
- If order status in not TECO and WIP calculation also not executed then the balance will remain in order in product cost by order approach, where as in product cost by period approach this scenario is taken care.
  - Generally in most of the cases, for the balance in order if not settled through variance or WIP then by using manual financial entry in books of accounts the same used to be adjusted. Such manual adjustment entries also can be stopped for balance adjustment, by using product cost by period approach.
- No. of cost object in product by period approach in very less as compared to product cost by order approach, as a result of that the period end closing process will take less time, so period end closing activities will be completed at a faster pace.
- Cost reporting and analysis of variance at material level will definitely add value to the MIS reporting.



## **8. Recommendation:**

Product cost by period concept is recommended in following business scenarios:

1. Production process and nature of product is make to stock;
2. Input material must be purchased in bulk and not specific for a particular order;
3. Confirmation of production must be posted in system by using back flush method.
4. Cost reporting and variance analysis required for MIS purpose at material level and not at order level.
5. Valuation of in process material is not required, here in process material represents issue of input material and output is not yet confirmed from process.
6. For production of one material if more than one production version (combination of BOM and Routing) is there and it is required to report cost for each such production version.

If all of the business scenarios are there then it is recommended to go for product cost by period concept.