Discuss the meaning of Joint products and By-products.
Differentiate between joint products and by-products.
Discuss the various methods of apportionment of joint costs to joint products and to by-products.
State the treatment of by-product’s cost in cost accounting.
11.1 MEANING OF JOINT PRODUCTS AND BY-PRODUCTS

Agricultural product industries, chemical process industries, sugar industries, and extractive industries are some of the industries where two or more products of equal or unequal importance are produced either simultaneously or in the course of processing operation of a main product.

In all such industries, the management is faced with the problems such as, valuation of inventory, pricing of product and income determination, problem of taking decision in matters of further processing of by-products and/or joint products after a certain stage etc. In fact, the various problems relate to

(i) apportionment of common costs incurred for various products and
(ii) aspects other than mere apportionment of costs incurred upto the point of separation.

Before taking up the above problems, we first define the various necessary concepts.

(i) Joint Products - Joint products represent “two or more products separated in the course of the same processing operation usually requiring further processing, each product being in such proportion that no single product can be designated as a major product”.

In other words, two or more products of equal importance, produced, simultaneously from the same process, with each having a significant relative sale value are known as joint products. For example, in the oil industry, gasoline, fuel oil, lubricants, paraffin, coal tar, asphalt and kerosene are all produced from crude petroleum. These are known as joint products.

(ii) By-Products - These are defined as “products recovered from material discarded in a main process, or from the production of some major products, where the material value is to be considered at the time of severance from the main product.” Thus by-products emerge as a result of processing operation of another product or they are produced from the scrap or waste of materials of a process. In short a by-product is a secondary or subsidiary product which emanates as a result of manufacture of the main product.

The point at which they are separated from the main product or products is known as split-off point. The expenses of processing are joint till the split-off point.

Examples of by-products are molasses in the manufacture of sugar, tar, ammonia and benzole obtained on carbonisation of coal and glycerin obtained in the manufacture of soap.

Distinction between Joint-Product and By-Product - The main points of distinction as apparent from the definitions of Joint Products and By-Products are:
JOINT PRODUCTS & BY PRODUCTS

(a) Joint products are of equal importance whereas by-products are of small economic value.

(b) Joint products are produced simultaneously but the by-products are produced incidentally in addition to the main products.

(iii) Co-Products - Joint products and co-products are used synonymously in common parlance, but strictly speaking a distinction can be made between two. Co-products may be defined as two or more products which are contemporary but do not emerge necessarily from the same material in the same process. For instance, wheat and gram produced in two separate farms with separate processing of cultivation are the co-products. Similarly, timber boards made from different trees are co-products.

11.2 APPORTIONMENT OF JOINT COSTS

Joint product costs occur in many industries such as petroleum, oil refinery, textiles, dairy, food processing and many other process industries. The management of business concerns require accurate and reliable cost information related with the joint products to make managerial decisions such as to process further or to sell at split-off stage. To arrive at either decision, it is necessary to know the share of joint costs to be apportioned to the different joint products.

Joint costs are the expenditures incurred up to the point of separation i.e. split-off point. The main problem faced in the case of joint products/ by-products is the apportionment of this joint costs to joint products/ or by products. For costs incurred after the split off point there is no problem, as these costs can be directly allocated to individual joint products or by-products.

11.3 METHODS OF APPORTIONMENT OF JOINT COST TO JOINT PRODUCTS

Proper apportionment of joint cost over the joint products is of considerable importance, as this affects (a) Valuation of closing inventory; (b) Pricing of products; and (c) Profit or loss on the sale of different products.

The commonly used methods for apportioning total process costs up to the point of separation over the joint products are as follows:

(i) Physical Units Method

(ii) Net Realisable Value at split-off point

(iii) Using Technical Estimates

Some other methods, which managers may also use for making decisions are:

(i) Market value at the point of separation

(ii) Market value after further processing

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(iii) Average unit cost method
(iv) Contribution margin method

(i) Physical Unit Method: This method is based on the assumption that the joint products are capable of being measured in the same units. Accordingly, joint costs here are apportioned on the basis of some physical base, such as weight, numbers etc. In other words, the basis used for apportioning joint cost over the joint products is the physical volume of material present in the joint products at the point of separation. Any loss arises during the joint production process is also apportioned over the products on the same basis. This method cannot be applied if the physical units of the two joint products are different. The main defect of this method is that it gives equal importance and value to all the joint products.

ILLUSTRATION 1
A coke manufacturing company produces the following products by using 5,000 tons of coal @ ₹1,100 per ton into a common process.

<table>
<thead>
<tr>
<th>Products</th>
<th>Coke</th>
<th>Tar</th>
<th>Sulphate of ammonia</th>
<th>Benzole</th>
<th>Wastage</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output (in ton)</td>
<td>3,500</td>
<td>1,200</td>
<td>52</td>
<td>48</td>
<td>200</td>
<td>5,000</td>
</tr>
<tr>
<td>Wastage (in ton)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Refer Note-1)</td>
<td>146</td>
<td>50</td>
<td>2</td>
<td>2</td>
<td>(200)</td>
<td></td>
</tr>
<tr>
<td>Net weight (in ton)</td>
<td>3,646</td>
<td>1,250</td>
<td>54</td>
<td>50</td>
<td></td>
<td>5,000</td>
</tr>
<tr>
<td>Share of Joint Cost @ ₹1,100 per ton (in ₹)</td>
<td>40,10,600</td>
<td>13,75,000</td>
<td>59,400</td>
<td>55,000</td>
<td></td>
<td>55,00,000</td>
</tr>
</tbody>
</table>
Joint Products & By Products

Note-1: Apportionment of wastage of 200 tons over the four products is as follows:

- Coke: \[
\frac{200}{4,800} \times 3,500 \text{ tons} = 146 \text{ tons}
\]
- Tar: \[
\frac{200}{4,800} \times 1,200 \text{ tons} = 50 \text{ tons}
\]
- Sulphate of ammonia: \[
\frac{200}{4,800} \times 52 \text{ tons} = 2 \text{ tons}
\]
- Benzole: \[
\frac{200}{4,800} \times 48 \text{ tons} = 2 \text{ tons}
\]

(ii) Net Realisable Value at Split-off Point Method: In this method of joint cost apportionment the followings are deducted from the sales value of joint products at final stage i.e. After processing:

(i) Estimated profit margins,
(ii) Selling and distribution expenses, if any, and
(iii) Post split-off costs.

The resultant figure so obtained is known as net realisable value of joint products. Joint costs are apportioned in the ratio of net realisable value.

<table>
<thead>
<tr>
<th>Sales Value (Units after processing $\times$ Selling Price)</th>
<th>Product- A Amount (₹)</th>
<th>Product- B Amount (₹)</th>
<th>Product- C Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Profit Margin</td>
<td>(xxx)</td>
<td>(xxx)</td>
<td>(xxx)</td>
</tr>
<tr>
<td>Less: Selling &amp; Distribution costs</td>
<td>(xxx)</td>
<td>(xxx)</td>
<td>(xxx)</td>
</tr>
<tr>
<td>Less: Post split-off cost</td>
<td>(xxx)</td>
<td>(xxx)</td>
<td>(xxx)</td>
</tr>
<tr>
<td>Net Realisable Value</td>
<td>xxx</td>
<td>xxx</td>
<td>xxx</td>
</tr>
</tbody>
</table>

Example: An entity incurs a joint cost of ₹ 64,500 in producing two products A (200 units), B (200 units) and earns a sales revenue of ₹ 86,000 by selling @ ₹ 170 per unit of product A and product B @ ₹ 260 per unit. Further processing costs for products A and B are ₹ 4,000 and ₹ 32,000 respectively the Joint cost can be apportioned to products A and B as follows:

<table>
<thead>
<tr>
<th>Sales Value</th>
<th>Product- A Amount (₹)</th>
<th>Product- B Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Value (₹170 × 200 units)</td>
<td>34,000</td>
<td>52,000</td>
</tr>
<tr>
<td>Less: Post split-off cost (Further processing cost)</td>
<td>(4,000)</td>
<td>(32,000)</td>
</tr>
</tbody>
</table>
The net realisable value at split-off point method is widely used in the industries. This method is used when the realisable value of joint products at split-off is not known.

(iii) Using Technical Estimates: This method uses technical estimates to apportion the joint costs over the joint products. This method is used when the result obtained by the above methods does not match with the resources consumed by joint products or the realisable value of the joint products are not readily available.

Other Methods

The followings are the methods which are used by management for taking managerial decisions:

(i) Market value at the point of separation: This method is used for the apportionment of joint costs to joint products up to the split-off point. It is difficult to apply this method if the market value of the products at the point of separation is not available. It is a useful method where further processing costs are incurred disproportionately.

To determine the apportionment of joint costs over joint products, a factor known as multiplying factor is determined. This multiplying factor on multiplication with the sales values of each joint product gives rise to the proportion of joint cost.

\[
\text{Multiplying factor: } \frac{\text{Joint Cost}}{\text{Total Sales Revenue}} \times 100
\]

Example: An entity incurs a joint cost of ₹ 64,500 in producing two products A (200 units), B (200 units) and earns a sales revenue of ₹ 86,000 by selling @ ₹ 170 per unit of product A and product B @ ₹ 260 per unit.

The multiplying factor in this case is obtained by dividing the total joint cost by total sales revenue and finally multiplying the figure so obtained by 100. The multiplying factor based on the data can be computed as follows:

\[
\text{Multiplying Factor: } \frac{₹ 1,00,000}{2,000 \text{ ton}} \times 100 = 75\%
\]

Joint cost apportioned over product A = Sales revenue of product A × 75%
= ₹ 34,000 × 75%
= ₹ 25,500

Joint cost apportioned over product B = Sales revenue of product B × 75%
= ₹ 52,000 × 75%
= ₹ 39,000
Alternatively - This joint cost may be apportioned in the ratio of sales values of different joint products.

(ii) Market value after further processing: Here the basis of apportionment of joint cost is the total sales value of finished products and involves the same principle as discussed above. Suppose that in the example given above, if sales prices of products A and B after further processing are ₹ 200 and ₹ 300 respectively the joint cost apportioned over Products A and B is as follows:

The pre-separation costs of ₹ 64,500 will be apportioned in the ratio of (2: 3) as follows:

Market sales value after further processing

\[
\begin{align*}
A & : 200 \text{ units} \times ₹ 200 = ₹ 40,000 \\
B & : 200 \text{ units} \times ₹ 300 = ₹ 60,000 \\
& \quad \text{Total} = ₹ 100,000
\end{align*}
\]

Joint cost apportionment:

\[
\begin{align*}
A & = ₹ 64,500 \times \frac{₹ 1,00,000}{2,000 \text{ ton}} = ₹ 25,800 \\
B & = ₹ 64,500 \times \frac{₹ 60,000}{₹ 1,00,000} = ₹ 38,700
\end{align*}
\]

The use of this method is unfair where further processing costs after the point of separation are disproportionate or when all the joint products are not subjected to further processing. The net realisable value method which is discussed as above overcomes the shortcoming of this method.

(iii) Average Unit Cost Method: Under this method, total process cost (upto the point of separation) is divided by total units of joint products produced. On division average cost per unit of production is obtained.

\[
\text{Average unit cost} = \frac{\text{Total process cost (upto the point of separation)}}{\text{Total units of joint product produced}}
\]

This is a simple method. The effect of application of this method is that all joint products will have uniform cost per unit. If this method is used as the basis for price fixation, then all the products may have more or less the same price. Under this method customers of high quality items are benefitted as they have to pay less price on their purchase.

**ILLUSTRATION 2**

Find out the cost of joint products A, B and C using average unit cost method from the following data:

(a) Pre-separation Joint Cost ₹ 60,000
(b) Production data:

<table>
<thead>
<tr>
<th>Products</th>
<th>Units produced</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>500</td>
</tr>
<tr>
<td>B</td>
<td>200</td>
</tr>
<tr>
<td>C</td>
<td>300</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,000</strong></td>
</tr>
</tbody>
</table>

**SOLUTION**

Average cost per unit = \( \frac{\text{Total joint costs}}{\text{Units produced}} = \frac{\text{₹ 60,000}}{1,000} = \text{₹ 60} \)

The joint costs apportioned @ ₹ 60 are as follows:

<table>
<thead>
<tr>
<th>Products</th>
<th>Units</th>
<th>Cost per unit (₹)</th>
<th>Value (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>500</td>
<td>60</td>
<td>30,000</td>
</tr>
<tr>
<td>B</td>
<td>200</td>
<td>60</td>
<td>12,000</td>
</tr>
<tr>
<td>C</td>
<td>300</td>
<td>60</td>
<td>18,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>60,000</strong></td>
<td><strong>60</strong></td>
<td><strong>60,000</strong></td>
</tr>
</tbody>
</table>

(iv) **Contribution Margin Method**: According to this method, joint costs are segregated into two parts - variable and fixed. The variable costs are apportioned over the joint products on the basis of units produced (average method) or physical quantities. In case the products are further processed after the point of separation, then all variable cost incurred be added to the variable costs determined earlier. In this way total variable cost is arrived which is deducted from their respective sales values to ascertain their contribution. The fixed costs are then apportioned over the joint products on the basis of the contribution ratios.

**ILLUSTRATION 3**

Find out the cost of joint products A and B using contribution margin method from the following data:

**Sales**

- A : 100 kg @ ₹ 60 per kg.
- B : 120 kg @ ₹ 30 per kg.

**Joint costs**

- Marginal cost ₹ 4,400
- Fixed cost ₹ 3,900

**SOLUTION**

The marginal cost (variable cost) of ₹ 4,400 is apportioned over the joint products A and B in the ratio of their physical quantity i.e 100 : 120

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Marginal cost for Product A: \(\text{₹} \times 4,400 \times \frac{100}{220} = \text{₹} 2,000\)

Marginal cost for Product B: \(\text{₹} \times 4,400 \times \frac{120}{220} = \text{₹} 2,400\)

The fixed cost of \(\text{₹} 3,900\) is apportioned over the joint products A and B in the ratio of their contribution margin i.e. 40 : 12

(Refer to working note)
- Product A: \(\text{₹} 3,900 \times \frac{40}{52} = \text{₹} 3,000\)
- Product B: \(\text{₹} 3,900 \times \frac{12}{52} = \text{₹} 900\)

**Working Note:**

*Computation of contribution margin ratio*

<table>
<thead>
<tr>
<th>Products</th>
<th>Sales revenue (₹)</th>
<th>Marginal cost (₹)</th>
<th>Contribution (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>6,000</td>
<td>2,000</td>
<td>4,000</td>
</tr>
<tr>
<td>B</td>
<td>3,600</td>
<td>2,400</td>
<td>1,200</td>
</tr>
</tbody>
</table>

Contribution ratio is 40 : 12

**ILLUSTRATION 4**

Inorganic Chemicals purchases salt and processes it into more refined products such as Caustic Soda, Chlorine and PVC. In the month of July, Inorganic Chemicals purchased Salt for \(\text{₹} 40,000\). Conversion of \(\text{₹} 60,000\) were incurred upto the split off point, at which time two sealable products were produced. Chlorine can be further processed into PVC.

The July production and sales information is as follows:

<table>
<thead>
<tr>
<th></th>
<th>Production (in ton)</th>
<th>Sales Quantity (in ton)</th>
<th>Selling price per ton (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Caustic Soda</td>
<td>1,200</td>
<td>1,200</td>
<td>50</td>
</tr>
<tr>
<td>Chlorine</td>
<td>800</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>PVC</td>
<td>500</td>
<td>500</td>
<td>200</td>
</tr>
</tbody>
</table>

All 800 tons of Chlorine were further processed, at an incremental cost of \(\text{₹} 20,000\) to yield 500 tons of PVC. There was no beginning or ending inventories of Caustic Soda, Chlorine or PVC in July.

There is active market for Chlorine. Inorganic Chemicals could have sold all its July production of Chlorine at \(\text{₹} 75\) per ton.
Required:

(1) To calculate how joint cost of ₹1,00,000 would be apportioned between Caustic Soda and Chlorine under each of following methods:

(a) Sales value at split-off point;
(b) Physical unit method, and
(c) Estimated net realisable value.

(2) Lifetime Swimming Pool Products offers to purchase 800 tons of Chlorine in August at ₹75 per ton. This sale of Chlorine would mean that no PVC would be produced in August. How the acceptance of this offer for the month of August would affect operating income?

**SOLUTION**

1. (a) Sales value at split-off point method

<table>
<thead>
<tr>
<th>Products</th>
<th>Sales (in Ton)</th>
<th>Selling Price per Ton (₹)</th>
<th>Sales Revenue (₹)</th>
<th>Joint Cost Apportioned (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Caustic Soda</td>
<td>1,200</td>
<td>50</td>
<td>60,000</td>
<td>50,000</td>
</tr>
<tr>
<td>Chlorine</td>
<td>800</td>
<td>75</td>
<td>60,000</td>
<td>50,000</td>
</tr>
<tr>
<td></td>
<td>1,20,000</td>
<td></td>
<td>1,00,000</td>
<td></td>
</tr>
</tbody>
</table>

Apportionment of joint cost

\[
\text{Joint cost apportioned to Caustic Soda} = \frac{\text{Total joint cost}}{\text{Total sale value}} \times \text{Sale revenue of each product}
\]

\[
= \frac{₹1,00,000}{₹1,20,000} \times ₹60,000 = ₹50,000
\]

Joint cost apportioned to Chlorine

\[
= \frac{₹1,00,000}{₹1,20,000} \times ₹60,000 = ₹50,000
\]

(b) Physical measure method

<table>
<thead>
<tr>
<th>Products</th>
<th>Sales (in Ton)</th>
<th>Joint Cost Apportioned (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Caustic Soda</td>
<td>1,200</td>
<td>60,000</td>
</tr>
<tr>
<td>Chlorine</td>
<td>800</td>
<td>40,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

Apportioned joint cost

\[
\text{Joint cost apportioned to Caustic Soda} = \frac{\text{Total joint cost}}{\text{Total physical value}} \times \text{Physical units of each product}
\]

\[
= \frac{₹1,00,000}{₹1,20,000} \times 1,200 \text{ ton} = ₹60,000
\]
Joint cost apportioned to chlorine
\[
\frac{\text{\textcurrency 1,00,000}}{2,000 \text{ ton}} \times 800 \text{ ton} = \text{\textcurrency 40,000}
\]

(c) Estimated net realisable value method:

<table>
<thead>
<tr>
<th></th>
<th>Caustic Soda Amount (\textcurrency)</th>
<th>Chlorine Amount (\textcurrency)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Value</td>
<td>60,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>(\textcurrency 50 \times 1,200 tons)</td>
<td>(\textcurrency 200 \times 500 tons)</td>
<td></td>
</tr>
<tr>
<td>Less: Post split-off cost (Further processing cost)</td>
<td>-</td>
<td>(20,000)</td>
</tr>
<tr>
<td>Net Realisable Value</td>
<td>60,000</td>
<td>80,000</td>
</tr>
<tr>
<td>Apportionment of Joint Cost of \textcurrency 1,00,000 in ratio of 3:4</td>
<td>42,857</td>
<td>57,143</td>
</tr>
</tbody>
</table>

2. Incremental revenue from further processing of Chlorine into PVC

\[(500 \text{ tons} \times \text{\textcurrency 200} – 800 \text{ tons} \times \text{\textcurrency 75})\] = \text{\textcurrency 40,000}

Less: Incremental cost of further processing of Chlorine into PVC = \text{\textcurrency 20,000}

Incremental operating income from further processing = \text{\textcurrency 20,000}

The operating income of Inorganic Chemicals will be reduced by \text{\textcurrency 20,000} in August if it sells 800 tons of Chlorine to Lifetime Swimming Pool Products, instead of further processing of Chlorine into PVC for sale.

11.4 METHODS OF APPORTIONMENT OF JOINT COST TO BY-PRODUCTS

The following methods may be adopted for the accounting of by-products and arriving at the cost of production of the main product:

(i) Net Realisable Value method: The realisation on the disposal of the by-product may be deducted from the total cost of production so as to arrive at the cost of the main product. For example, the amount realised by the sale of molasses in a sugar factory goes to reduce the cost of sugar produced in the factory.

When the by-product requires some additional processing and expenses are incurred in making it saleable to the best advantage of the concern, the expenses so incurred should be deducted from the total value realised from the sale of the by-product and only the net realisations should be deducted from the total cost of production to arrive at the cost of production of the main product. Separate accounts should be maintained for collecting additional expenses incurred on:

(a) further processing of the by-product, and

(b) selling, distribution and administration expenses attributable to the by-product.
(ii) **Standard cost in Technical Estimates:** By-products may be valued at standard costs. The standard may be determined by averaging costs recorded in the past and making technical estimates of the number of units of original raw material going into the main product and the number forming the by-product or by adopting some other consistent basis.

This method may be adopted where the by-product is not saleable in the condition in which it emerges or comparative prices of similar products are not available.

(iii) **Comparative price:** Under this method, the value of the by-product is ascertained with reference to the price of a similar or an alternative material.

Suppose in a large automobile plant a blast furnace not only produces the steel required for the car bodies but also produces gas which is utilised in the factory. This gas can be valued at the price which would have been paid to a gas company if the factory were to buy it from outside sources.

(iv) **Re-use basis:** In some cases, the by-product may be of such a nature that it can be reprocessed in the same process as part of the input of the process. In that case the value put on the by-product should be same as that of the materials introduced into the process. If, however, the by-product can be put into an earlier process only, the value should be the same as for the materials introduced into the process.

### 11.5 TREATMENT OF BY-PRODUCT COST IN COST-ACCOUNTING

By-product cost can be dealt in cost accounting in the following ways:

(a) **When they are of small total value:** When the by-products are of small total value, the amount realised from their sale may be dealt in any one the following two ways:

1. The sales value of the by-products may be credited to the Costing Profit and Loss Account and no credit be given in the Cost Accounts. The credit to the Costing Profit and Loss Account here is treated either as miscellaneous income or as additional sales revenue.

2. The sale proceeds of the by-product may be treated as deductions from the total costs. The sale proceeds in fact should be deducted either from the production cost or from the cost of sales.

(b) **When the by-products are of considerable total value:** Where by-products are of considerable total value, they may be regarded as joint products rather than as by-products. To determine exact cost of by-products the costs incurred up to the point of separation, should be apportioned over by-products and joint products by using a logical basis. In this case, the joint costs may be divided over joint products and by-products by using relative market values; physical output method (at the point of split off) or ultimate selling prices (if sold).
(c) Where they require further processing: In this case, the net realisable value of the by-product at the split-off point may be arrived at by subtracting the further processing cost from the realisable value of by-products.

If total sales value of by-products at split-off point is small, it may be treated as per the provisions discussed above under (a).

In the contrary case, the amount realised from the sale of by-products will be considerable and thus it may be treated as discussed under (b).

**SUMMARY**

- **Joint Products.** Two or more products of equal importance, produced, simultaneously from the same process, with each having a significant relative sale value are known as joint products.

- **Co-Products.** Two or more products which are contemporary but do not emerge necessarily from the same material in the same process.

- **By-Products.** Products recovered from material discarded in a main process, or from the production of some major products.

- **Methods of apportioning joint cost over joint products:**
  The commonly used methods for apportioning total process costs upto the point of separation over the joint products are as follows:
  
  (i) Physical Units Method
  
  (ii) Net Realisable Value at split-off point
  
  (iii) Using Technical Estimates

  Some other methods, which managers may also use for making decisions are:

  (i) Market value at the point of separation
  
  (ii) Market value after further processing
  
  (iii) Average unit cost method
  
  (iv) Contribution margin method

- **Methods of apportioning joint cost over by-products:**

  (i) Net Realisable Value Method- The realisation on the disposal of the by-product may be deducted from the total cost of production so as to arrive at the cost of the main product.

  (ii) Standard cost in technical estimates- The standard may be determined by averaging costs recorded in the past and making technical estimates of the number of units of original raw material going into the main product and the number forming the by-product or by adopting some other consistent basis. This method may be adopted where the by-product is not saleable in the
condition in which it emerges or comparative prices of similar products are not available.

(iii) Comparative price- Value of the by-product is ascertained with reference to the price of a similar or an alternative material.

(iv) Re-use basis- The value put on the by-product should be same as that of the materials introduced into the process.

• **Treatment of By-Product Cost in Cost-Accounting**

(i) When they are of small total value:

1. The sales value of the by-products may be credited to the Profit and Loss Account and no credit be given in the Cost Accounts. The credit to the Profit and Loss Account here is treated either as miscellaneous income or as additional sales revenue.

2. The sale proceeds of the by-product may be treated as deductions from the total costs. The sale proceeds in fact should be deducted either from the production cost or from the cost of sales.

(ii) When the by-products are of considerable total value - The joint costs may be divided over joint products and by-products by using relative market values; physical output method (at the point of split off) or ultimate selling prices (if sold).

(iii) Where they require further processing - The net realisable value of the by-product at the split-off point may be arrived at by subtracting the further processing cost from the realisable value of by-products.

If total sales value of by-products at split-off point is small, it may be treated as per the provisions discussed above under (i).

In the contrary case, the amount realised from the sale of by-products will be considerable and thus it may be treated as discussed under (ii).

--- TEST YOUR KNOWLEDGE

**MCQs based Questions**

1. In sugar manufacturing industries molasses is also produced along with sugar. Molasses may be of smaller value as compared with the value of sugar and is known as

   (a) Common product
   (b) By- product
   (c) Joint product
   (d) None of them

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2. Method of apportioning joint costs on the basis of output of each joint product at the point of split offs
   (a) Sales value method
   (b) Physical unit method
   (c) Average cost method
   (d) Marginal cost and contribution method

3. In the Net realisable value method, for apportioning joint costs over the joint products, the basis of apportionment makes use of
   (a) Selling price per unit of each of the joint products
   (b) Selling price multiplied by units sold of each of the joint products
   (c) Sales value of each joint product less further processing costs of individual products
   (d) Both (b) and (c)

4. The main purpose of accounting of joint products and by-products is to
   (a) Determine the opportunity cost
   (b) Determine the replacement cost
   (c) Determine profit or loss on each product line
   (d) None of the above

5. Under net realizable value method of apportioning joint costs to joint products, the selling & distribution cost is:
   (a) Added to joint cost
   (b) Deducted from further processing cost
   (c) Deducted from sales value
   (d) Ignored

6. Which of the following is a co-product:
   (a) Diesel and Petrol in an oil refinery
   (b) Edible oils and oil cakes
   (c) Curd and butter in a dairy
   (d) Mustard oil and Sunflower oil in an oil processing company.

7. Which of the following is an example of by-product
   (a) Diesel and Petrol in an oil refinery
   (b) Edible oils and oil cakes
   (c) Curd and butter in a dairy
   (d) Mustard seeds and mustard oil.
8. Which of following method can be used when the joint products are of unequal quantity and used for captive consumption:
   (a) Technical estimates, using market value of similar goods
   (b) Net Realisable value method
   (c) Physical Units method
   (d) Market value at split-off method.

9. Which of the following statement is not correct in relation to Co-products:
   (a) Co-products may also have joint products
   (b) Costing for co-products are done according to process costing method
   (c) Co-products do not have any by-products
   (d) Co-products are treated as a separate cost object for costing purpose.

10. When a by-product does not have any realisable value, the cost of by-product is:
    (a) Transferred to Costing Profit & Loss A/c
    (b) By-product cost is borne by the good units
    (c) By-product cost is ignored
    (d) By-product cost is determined taking value of similar goods

**Theoretical Questions**

1. Distinguish between Joint products and By-products
2. Discuss the treatment of by-product cost in Cost Accounting.
3. How apportionment of joint costs upto the point of separation amongst the joint products using net realizable value method is done? Discuss.
4. Describe briefly, how joint costs upto the point of separation may be apportioned amongst the joint products under the following methods:
   (i) Average unit cost method
   (ii) Contribution margin method
   (iii) Market value at the point of separation
   (iv) Market value after further processing
   (v) Net realizable value method.

**Practical Question**

1. Sun-moon Ltd. produces and sells the following products:

<table>
<thead>
<tr>
<th>Products</th>
<th>Units</th>
<th>Selling price at split-off point (₹)</th>
<th>Selling price after further processing (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>2,00,000</td>
<td>17</td>
<td>25</td>
</tr>
<tr>
<td>B</td>
<td>30,000</td>
<td>13</td>
<td>17</td>
</tr>
</tbody>
</table>
Raw material costs ₹35,90,000 and other manufacturing expenses cost ₹5,47,000 in the manufacturing process which are absorbed on the products on the basis of their ‘Net realisable value’. The further processing costs of A, B, C and E are ₹12,50,000; ₹1,50,000; ₹50,000 and ₹1,50,000 respectively. Fixed costs are ₹4,73,000.

You are required to prepare the following in respect of the coming year:
(a) Statement showing income forecast of the company assuming that none of its products are to be further processed.
(b) Statement showing income forecast of the company assuming that products A, B, C and E are to be processed further.

Can you suggest any other production plan whereby the company can maximise its profits? If yes, then submit a statement showing income forecast arising out of adoption of that plan.

ANSWERS/ SOLUTIONS

Answers to the MCQs based Questions
1. (b) 2. (b) 3. (d) 4. (c) 5. (c) 6. (d)
7. (b) 8. (a) 9. (c) 10. (b)

Answers to the Theoretical Questions
1. Please refer paragraph 11.1
2. Please refer paragraph 11.5
3. Please refer paragraph 11.3
4. Please refer paragraph 11.3

Answers to the Practical Questions
1. Working Note:

Apportionment of joint costs on the basis of Net Realisable Value method

<table>
<thead>
<tr>
<th>Products</th>
<th>Sales Value (₹)</th>
<th>Post separation Cost (₹)</th>
<th>Net Realisable Value (₹)</th>
<th>Apportioned Cost (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>50,00,000</td>
<td>12,50,000</td>
<td>37,50,000</td>
<td>26,25,000</td>
</tr>
<tr>
<td>B</td>
<td>5,10,000</td>
<td>1,50,000</td>
<td>3,60,000</td>
<td>2,52,000</td>
</tr>
</tbody>
</table>

(2,00,000 units × ₹25) (30,000 units × ₹17)
Total joint cost = Raw material costs + Manufacturing expenses
= ₹ 35,90,000 + ₹ 5,47,000 = ₹ 41,37,000

Apportioned joint cost = \( \frac{\text{Total joint cost}}{\text{Total net realisable value}} \times \text{Net realisable value of each product} \)

Apportioned joint cost for Product A = \( \frac{₹ 41,37,000}{₹ 59,10,000} \times ₹ 37,50,000 = ₹ 26,25,000 \)

Similarly, the apportioned joint cost for products B, C, D and E are ₹ 2,52,000, ₹ 1,75,000, ₹ 1,40,000 and ₹ 9,45,000 respectively.

(a) Statement showing income forecast of the company assuming that none of its products are further processed

<table>
<thead>
<tr>
<th>Products</th>
<th>A (₹)</th>
<th>B (₹)</th>
<th>C (₹)</th>
<th>D (₹)</th>
<th>E (₹)</th>
<th>Total (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales revenue</td>
<td>34,00,000</td>
<td>3,90,000</td>
<td>2,00,000</td>
<td>2,00,000</td>
<td>10,50,000</td>
<td>52,40,000</td>
</tr>
<tr>
<td>(₹ 17 × 2,00,000)</td>
<td>(₹ 13 × 30,000)</td>
<td>(₹ 8 × 25,000)</td>
<td>(₹ 10 × 20,000)</td>
<td>(₹ 14 × 75,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Apportioned Costs (Refer Working note)</td>
<td>26,25,000</td>
<td>2,52,000</td>
<td>1,75,000</td>
<td>1,40,000</td>
<td>9,45,000</td>
<td>41,37,000</td>
</tr>
<tr>
<td></td>
<td>7,75,000</td>
<td>1,38,000</td>
<td>25,000</td>
<td>60,000</td>
<td>1,05,000</td>
<td>11,03,000</td>
</tr>
<tr>
<td>Less: Fixed Cost</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>4,73,000</td>
</tr>
<tr>
<td>Profit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>6,30,000</td>
</tr>
</tbody>
</table>

(b) Statement showing income forecast of the company: assuming that products A, B, C and E are further processed (Refer to working note)

<table>
<thead>
<tr>
<th>Products</th>
<th>A (₹)</th>
<th>B (₹)</th>
<th>C (₹)</th>
<th>D (₹)</th>
<th>E (₹)</th>
<th>Total (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Sales revenue</td>
<td>50,00,000</td>
<td>5,10,000</td>
<td>3,00,000</td>
<td>2,00,000</td>
<td>15,00,000</td>
<td>75,10,000</td>
</tr>
<tr>
<td>B. Apportioned Costs</td>
<td>26,25,000</td>
<td>2,52,000</td>
<td>1,75,000</td>
<td>1,40,000</td>
<td>9,45,000</td>
<td>41,37,000</td>
</tr>
<tr>
<td>C. Further processing cost</td>
<td>12,50,000</td>
<td>1,50,000</td>
<td>50,000</td>
<td>-</td>
<td>1,50,000</td>
<td>16,00,000</td>
</tr>
</tbody>
</table>
Suggested production plan for maximising profits:

On comparing the figures of excess of revenue over cost of manufacturing in the above statements one observes that the concern is earning more after further processing of A, C and E products but is loosing a sum of ₹ 30,000 in the case of product B (if it is processed further). Hence the best production plan will be to sell A, C and E after further processing and B and D at the point of split off. The profit statement based on this suggested production plan is as below:

### Profit statement based on suggested production plan

<table>
<thead>
<tr>
<th>Products</th>
<th>A (₹)</th>
<th>B (₹)</th>
<th>C (₹)</th>
<th>D (₹)</th>
<th>E (₹)</th>
<th>Total (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Sales revenue</td>
<td>50,00,000</td>
<td>3,90,000</td>
<td>3,00,000</td>
<td>2,00,000</td>
<td>15,00,000</td>
<td>73,90,000</td>
</tr>
<tr>
<td>B. Apportioned Costs</td>
<td>26,25,000</td>
<td>2,52,000</td>
<td>1,75,000</td>
<td>1,40,000</td>
<td>9,45,000</td>
<td>41,37,000</td>
</tr>
<tr>
<td>C. Further processing cost</td>
<td>12,50,000</td>
<td>-</td>
<td>50,000</td>
<td>-</td>
<td>1,50,000</td>
<td>14,50,000</td>
</tr>
<tr>
<td>D. Total processing cost (B+ C)</td>
<td>38,75,000</td>
<td>2,52,000</td>
<td>2,25,000</td>
<td>1,40,000</td>
<td>10,95,000</td>
<td>55,87,000</td>
</tr>
<tr>
<td>E. Excess of sales revenue (A-D)</td>
<td>11,25,000</td>
<td>1,38,000</td>
<td>75,000</td>
<td>60,000</td>
<td>4,05,000</td>
<td>18,03,000</td>
</tr>
<tr>
<td>F. Fixed Cost</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>4,73,000</td>
</tr>
<tr>
<td>G. Profit (E - F)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>13,30,000</td>
</tr>
</tbody>
</table>

Hence the profit of the company has increased by ₹ 30,000.