E-content
cost accounting

3rd sem

INTRODUCTION TO COST ACCOUNTING

Human civilisation has been a witness to the concept of cost accounting from times immemorial. The nomenclature and understanding has changed over time. Earlier, the kings used to appoint their representatives to check on the adherence to costs by shopkeepers, imposing heavy penalty on those who attempted to default from the prescribed system. This helped to keep cost constant for a long period in that era.

During the First World War, most of the manufacturing was done on the **―**cost plus system. World War II witnessed a blanket control over prices due to government legislations. This made It imperative for industrialists to constantly work towards improvement of quality of products, accuracy in tracing costs of each job/product and to control costs. These objectives were not fulfilled by financial accounting.

In the modern age, although, determination of profitability has always been the root cause of all commercial activities, still cost accounting has made a place for itself as companies have come to realize that calculation and control over the cost is necessary
It is important to understand that the terms cost, costing, cost accounting and cost accountancy, which are normally used interchangeably, are not synonyms of each other. The difference can be understood as follows:
As per Chartered Institute of Management Accountants (CIMA) London, **cost** means ―the amount of expenditure (actual or notional) incurred on, or attributable to, a given thing‖, but the interpretation of the term depends on a number of factors like nature of business or industry. Moreover, it is difficult to determine an exact cost or a true cost because no figure of costis true under all circumstances and for all purposes.

1.According to Wheldon, **costing** is, ―the classifying, recording and appropriate allocation of expenditure for the determination of the costs of products or services; the relation of these costs to sales values; and the ascertainment of profit ability.‖ In general, it is understood as process for determining cost.

2.Cost Accounting is usually considered as the next step to costing. It involves meticulously Accurate analyzing, standardising, forecasting and comparing relevant costing data so as to interpret and report various concern areas to management. Its scope includes preparation of budgets, determination of standard costs based on technical estimates, identifying variances and reasons thereof, etc.

Cost Accountancy envisages application of costing and cost accounting in a business setup. It includes determination of selling price and profitability in addition to forecasting of expenses and future probable incomes. It facilitates management with cost control initiatives, ascertainment of profitability and informed decision making. Besides, costing and cost accounting, the following areas are also covered under cost accountancy:

Cost Reduction is aimed at achieving real and permanent reduction in the unit cost of goods produced or services rendered without compromising the quality or suitability

Cost Control refers to search for better and more economical ways of completing the current operations. It simply identifies and prevents waste within the existing environment.

Cost Audit includes the verification of cost accounts and a check on their adherence to the cost accounting principles, plans, procedures.

objective of cost accounting

1. Callasification of cost accounting
2. Ascertainmemt of costs.
3. Determination of selling prices
4. Ascrentainment of profit.

COST ACCOUNTING Vs FINANCIAL ACCOUNTING

Financial Accounting and Cost Accounting rest on the same basic principles and use the same records, but each deals with matters specially pertaining to itself. Financial Accounting discloses he profit/loss of business as a whole during a particular period while cost accounting makes available the unit costs and profits and/or losses of different product lines. The importance of both, cost accounting and financial accounting cannot undermined. The two are different from each other on the basis of meaning, objectives, mode of presentation, recording, analyzing profit, periodicity of reporting, degree of accuracy and method of valuation of stock.

. BASIS FOR COST ACCOUNTING FINANCIAL

NO. COMPARISON ACCOUNTING

S.no	BASIS FOR COMPARISON	COST ACCOUNTING	FINANCIAL ACCOUNTING
1.	**Meaning**	Cost Accounting facilitatesFinancial Accounting determination, tracking and records financial controlling of various costs information of the businessin curred in the business.	Financial Accounting determination, tracking and records financial controlling of various costs information of the business incurred in the business. to reflect the profitability and the correct financial

			position of the company at a particular date.
2.	**scope**	These accounts are kept in manufacturing or service providing industries .	These are maintained in all types of business and other institutions.
3.	**Nature of transactions**	It is records only those expenses which are related with the production of goods and services.	It records all expenses whether trading or non trading.
4.	**Compulsory**	It is not compulsory or statutory unless specifically ordered by the government .	It is compulsory and statutory for companies .
5.	**Audit**	Audit of these accounts is compulsory for some specific organization	Audit of these accounts is compulsory for all companies.
6.	**Based on forecast and actul facts.**	It deals party with facts and figures and party forecasts .	It deals only with actul facts and figures
7.	**Valucation of stock**	Stock is always valued at cost price ..	Stock is valued at cost or market price whichever is less.

IMPORTANCE OF COST ACCOUNTING.

The management of the company requires detailed information with respect to cost of operations so as to equip the executives with relevant information required for planning, scheduling,controlling and decision making. This is facilitated by Cost Accounting. By cost management, waste elimination, utilization of idle capacity, cost accounting helps to increase the overall productivity of an organization.

The importance of cost accounting can be summarized by categorizing the major parties benefiting and the respective benefits accruing as follows:

Management

- **Aids in price fixation**
- **Helps in preparing estimate**
- **Supports channelising production on right lines**
- **Assists in elimination of wastages**
- **Makes comparison possible across periods and across product lines**

- **Provides data for periodical profit and loss accounts**
- **Aids in determining and enhancing efficiency**
- **Helps in inventory control**
- **Facilitates cost reduction**
- **Assists in increasing productivity**

Employess

- **Makes available systems of incentives, bonus plans etc.**
- **Indirectly benefits through increase in consumer goods and directly**
- **through continuous employment and higher remuneration.**

Creditor.

Provides a base for judgement about the profitability and further prospects of the company.

OBJECTIONS TO COST ACCOUNTING

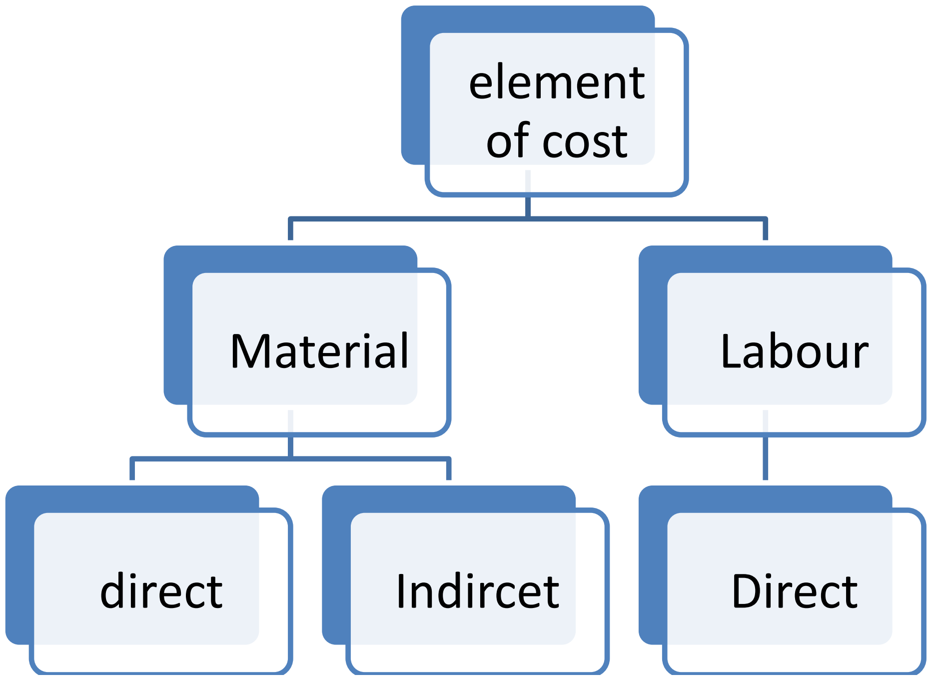
Despite numerous advantages, some objections are generally raised against cost accounting. As has been discussed earlier, cost accounting is voluntary and no specific stereotyped formats orsystems of cost accounting are applicable to all industries. Thus, there is no uniform procedure. This leads to difference in understanding and application of concepts, methods and techniques of cost accounting by different industries.

The major objections are:

- ***It is expensive***: Installation and maintenance of cost accounting system requires resources as analysis, allocation, absorption and apportionment of overheads require considerable amount of clerical work.Unless benefits accruing from cost accounting are more than the costs involved, it should not be sought.
- ***Different Results from Financial Records***: The results shown by the cost accounts generally differ from those shown by the financial accounts due to a number of reasons. Preparation of reconciliation statements frequently is necessary to verify their accuracy. This leads to increase in work load.
- ***It is inapplicable:***Lack of common formats and systems makes it impossible to apply costaccounting to all industries uniformly. Consequently, the systems need to be adapted by therespective industry on the basis of their nature or the nature of the product manufactured or service rendered.
- ***It is unnecessary:*** Maintenance of cost records leads to duplication of work i.e. preparation of financial accounts as well as cost accounts. Moreover, costing system itself does not control costs or improve efficiency. If the management is alert andefficient, it can control costs without the aid of the costing system.
- ***The system is complex***: Cost accounting requires identification, categorization and allocation of the different types of expenses, which is generally considered as complicated.
- ***Lack of Accuracy***: Use of notional cost such as standard cost, estimated cost hampers the accuracy of the cost results.
- ***Use of Secondary Data***: Cost accounting depends largely on financial statements. The limitations and errors in the financial information directly affect the cost results.

ELEMENTS OF COST

The basic elements of cost can be illustrated as follows:



Brief explanation of the elements has been given below:

Material: The basic substance used for producing the product is referred to as material. Material can be direct or indirect in nature.

Direct Material: The materials which directly contribute to the production of the product andare easily identifiable in the finished product are called direct materials. Cloth in shirt, paper inbooks, wood in furniture are examples of direct materials.

Indirect Material: Other material which is ancillary in the production of any finished productand cannot be conveniently assigned to specific physical units is called indirect material. Forexample, printing in stationery, scissors used in cutting cloth for shirt, nails in shoes or furniture.

Labour .refers tothe human effort needed for conversion of materials into finished goods.Labour can be direct or indirect.

Direct Labour:Labour which takes an active and direct part in the production of a particularcommodity and can be directly co-related to any specific activity of production is termed as
direct labour. Process labour, productive labour, operating labour, manufacturinglabour, direct wages etc are used synonymously with direct labour.

Indirect Labour:Employees who do not directly take part in the manufacturing process andwhose cost cannot be identified with the individual cost centre are included under indirect labour. Such labour does not alter the construction, composition or condition of theproduct. Salary of foreman, salesmen and director are some examples of indirect labour.

Expenses: Costs incurred in the production process but not included under material or labour are generally expenses. They can be direct or indirect.

-*Direct Expenses:*These are expenses which can be directly, conveniently and wholly allocatedto specificcost centres or cost units. Direct expenses are sometimes also described as—chargeable expenses.

Indirect Expenses:**All** expenses other than direct expenses are indirect in nature.

OVERHEADS

People generally use the terms overheads and indirect expenses synonymously. But, it needs to be understood that —overheads‖ has a wider meaning than the term —indirect expenses‖. Overheadsinclude the cost of indirect material, indirect labour besides indirect expenses. Indirect expenses may be classified under the following three categories:

Factory (Manufacturing, works or production) Overheads: All expenses incurred in the factoryfor its smooth functioning including production management expenses are included here. Examples: Rent, rates, insurance, power etc. of factory.

sincludeexpensespertaining to the management and administration of business. Example: Rent of office, lighting, heating, printing, stationery, etc.

Selling and Distribution Overheads: These are expenses incurred for marketing of a commodity, for securing orders for the articles, despatching goods sold, and for making efforts to find and retain customers.