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Cost Accounting

Cost

Costing is technique and process of ascertaining cost. This technique consists of principles and rules which governs the procedure to ascertaining cost of product and services. Here we are discussing about operating cost. Ex. Manufacturing cost of manufacturing industry for a unit etc

Cost Accounting

Cost Accounting is the process of classifying, recording and appropriate allocation of expenditures for the purpose of determination of cost of goods and services. In addition, suitably arranging data for the purpose of control and guidance of management. In simple term ascertaining exact cost of goods and services manufactured to fix the competitive pricing to win the market with desirable profit. Without cost accounting procedure management may not comfortably fix the pricing for their product and services. This plays vital role in essential product manufacturing companies governed by Essential goods act. Like Cement, Sugar manufacturing industries supposed to hold certified cost accountant in their company and they need share the data with Government / respective department. Certified account can be referred as member of Institute of Cost and Management of

India. Cost accounting helps to ascertain cost which enables budgeting forecasting and reasons for deviation from the forecasted budget or cost.

Cost Accounting which deals with cost of production, selling cost and distribution cost.

According to Wheldon, Cost Accounting is the application of Accounting principles and costing principles methods and techniques in the ascertainment of cost and the analysis of saving / excess cost incurred as compared to previous experience / industry standards. Thus cost accounting relates to the collecting, classification, ascertainment cost and its accounting control relating to various elements of costing.

Features of Cost Accounting

- ✓ It is a process of accounting for cost
- ✓ It records income and expenditure relating to production of goods and services
- ✓ This enables budgeting and forecasting for near future. Based on the cost ascertained management can confidently share quotation for major deals
- ✓ This enables cost ascertainment, cost control and ways to cost reduction
- ✓ This enables budget/ forecast and standards helps to ascertain the reasons for deviations if any

Meaning of Cost accountancy

Cost Accountancy is the application of costing, cost accounting principles, methods and techniques to the science art and practice of cost control and ascertainment of profitability. It includes presentation of information derived there from for the purpose of managerial decision making.

Management Accounting

Management account is the presentation of accounting information in such a way to assist management in the creation of day to day operation of undertaking, this is process to come up with a reporting/ management information system to provide managerial report on given period/ regular interval based on the financial account data extracted from Accounting system and cost accounting for the purpose of policy formulation, planning, control and decision making by management

Management account is concerned with accounting information that is useful to management by RN Anthony

Management accounting is the term used to describe accounting methods, systems and techniques which coupled with special knowledge and ability, assist management in its tasks of maximizing profit / minimizing loss. Management accountancy is the blending together into a coherent whole financial accounting and cost accounting and all aspects of financial management

Difference between Costing and Cost Accounting

<i>Basis of distinction</i>	<i>Costing</i>	<i>Cost Accounting</i>
<i>Nature</i>	<i>It is a technique and process of ascertaining cost</i>	<i>It is regarded as specialized branch of accounting`</i>
<i>Scope</i>	<i>The costing techniques includes principles and rules which govern the procedure of ascertaining the cost of goods and services</i>	<i>It involves classification, accumulation, assignment and control of cost</i>
<i>Process</i>	<i>The process of costing consists of routines of ascertaining cost by historical or conventional costing/ standard costing/ marginal costing</i>	<i>It involves establishment of budgets standard cost/ actual cost of operations, classification, recording and appropriate allocation of expenses</i>

Difference between cost & management accounting

Though cost accounting and management accounting helping management in planning, control and decision making. Both are internal tool to the organization using common tools, techniques, standards and procedures. Still we can see difference

Points of Distinction	Cost Accounting	Management Accounting
<i>Deals with</i>	<i>It deals with allocation, appointment ascertainment and aspect of costs</i>	<i>This deals with Effects and impact of cost on Business</i>
<i>Base</i>	<i>It provides base for management accounting</i>	<i>It uses data from both cost accounting and Financial accounting</i>
<i>Role</i>	<i>It is help full in collecting costing data for management</i>	<i>This is management information tool, helps management to plan budget, monitor, regulate and identify the deviations with strategic ways to improve profitability</i>
<i>Status</i>	<i>Cost Accountant comes after management accounting</i>	<i>Management accountant is the senior position/ grade in the organization than cost accountant</i>
<i>Outlook</i>	<i>Cost accountant has narrow approach. He has to refer to economic and statistical data for analyzing cost efficiencies.</i>	<i>Management accountant reports effect of cost on Business along with cost analysis</i>
<i>Tools & Techniques</i>	<i>It has standard costing, variable costing, appropriating fixed costing break even analysis</i>	<i>Along with management accounts has funds and cash flow statement ration analysis etc as its accounting tools and technique</i>
<i>Scope</i>	<i>This does not cover financial accounting, tax planning and tax accounting</i>	<i>It includes financial accounting, cost accounting, tax planning and tax accounting</i>
<i>Installation</i>	<i>It can be installed without management accounting</i>	<i>It needs cost accounting and financial accounting as base for its installation/ implementation</i>

Scope of cost accounting

Scope of cost accounting can be classified into 3 activities like

Cost ascertainment

It deals with the collection and analysis of expenses, measurement of production of different product at different stages. Collection of cost can be classified into Historical or actual cost, estimated cost and standard cost. In addition varying procedure for the measurement of production have resulted different method of costing, like Specific costing , operation costing, marginal costing, total cost and direct cost techniques are evolved to link cost with production.

Cost Accounting

Cost accounting is the process accounting for the cost which begins with recording of expenditure and ends with preparation of statistical data. This is the mechanism by which cost of goods and services are being ascertained and controlled. Mostly cost and financial accounts are tightly plugged together to maintain accuracy, if they are maintained independently reconciliation also needs to be performed to ascertain the accuracy.

Cost Control

Cost control guidance and control and regulation by executive action of the cost of operating an undertaking. It aims at guiding actual performance towards the line of target regardless the actuals if they vary / deviate from the target.

Why cost Accounting

Cost accounting is the branch of accounting and has been developed due to limitation of financial accounting. Primarily financial accounting concerned with recording of all the financial transaction with target of preparation of P/L and Balance sheet on given date to exhibit financial status of Business. It has few limitations as part of costing.

1. No clear idea of operating efficiency.
2. Weakness of operational efficiency not identified
3. Not efficient tool to fix pricing.
4. No classification of expenses and accounts
5. No data for comparison and decision making

Difference between Cost & Financial account

Points of distinction	Financial Accounting	Cost Accounting
Purpose	To exhibit financial position of Business on given date	It provides information to management for planning, tracking controlling and analyzing reason for deviation if any with a view to improve operating cost efficiency
Form of account	Designed in such a way to meet the requirement of companies act and income tax act	This is kept internally to meet the management expectations. As per company act essential goods companies are directed by company act to main Cost accounting system in place

Recording	Transaction recorded by classifying transaction based on nature of transaction	Expenditure recorded based on the purpose for which incurred
Period of reporting	Publishes results at given interval like monthly, quarterly and Yearly	It provide information/ report to management as and when needed
Analysis of profit	This provides profit for the Business as a whole	It calculates cost and profit for the product individually
Reporting Cost	Cost are calculated in aggregate as Business	Cost are calculated for a unit/ product wise also
Information	Monetary information only used to generate report	It deals with monetary and non-monetary
Fixing selling price	Financial accounts are not being maintained with a target of fixing pricing for product	It provides sufficient data to fix the competitive price with desired profit
Figures	Financial account deals with actual facts and figures	It deals with facts and figures partially and deals with estimates

Principles of cost accounting

Cause effect relationship

Cost has to be collected and shared by the respective units/ department through which product pass through. Cost effect relationship should be established for each item of cost

Charge of cost only after its incurrence.

Unit / Department cost should be considered only after the cost incurred.

Past cost should not form part of future cost.

The cost incurred past and the same not recovered from the past cannot be factored in the future cost as it will not affect the true results of future period but also distort other statements

Exclusion of abnormal cost from cost accounts

All cost incurred due to abnormal situations like fire, theft, loss due to natural calamities, should not be taken into consideration while computing unit cost

Principles of double entry should be followed perfectly

To reduce / eradicate chance of errors I cost kedger and cost control accounts as far as possible should be maintained in double entry principles. This will ensure correctness of cost sheet and statements.

Characteristics of an ideal costing system

- ❖ Suitability to the Business
- ❖ Simplicity, Flexibility and economical
- ❖ Comparability
- ❖ Capability of presentation at any time
- ❖ Minimum change in the existing set up
- ❖ Uniformity of forms and minimum clerical work
- ❖ Efficient system of material control
- ❖ Adequate wage procedure
- ❖ Departmentalization of expenses
- ❖ Reconciliation of cost accounts and financial accounts
- ❖ Assuring accuracy of data

Methods of Costing

Methods to be used for ascertainment of cost differs from industry to industry by its nature, production process followed, methods of measuring unit/ department output and finished product. In simple word costing may not be remain same for all the types of industry like

Specific order costing

This is basic method of costing applicable to the industry where the work is executed on the order/ job order/ batches/ contracts, each work is authorized by specific order or contract.

Operation costing.

This is the basic costing methods applicable where the standardized goods and services result from the sequence of repetitive and more or less continuous operation or the process to which cost are charged before being averaged over units produced during the period

Job Costing

Under this method costs are collected and accumulated for each job / work order/ project. A job card is prepared for each job for cost accumulation.

Contract Costing

When the job is being big and spread over longer span then method of contract costing can be used. Separate account is kept for each individual contract. This method more suitable for infrastructure contracts, builders, civil & mechanical engineering contract.

Batch costing

This is extension of job costing. A batch may represent number of small order passed through the factory unit batches. Each batch treated as unit cost or separately costed. This is used for biscuit manufacturing unit, garment industry and Spare parts units

Process costing

This kind of costing is well suitable for the industry where the production is continuous, manufacturing is carried out by distinct and well defines process. Finished good of one Department is input/ raw material for next unit or department.

Suitable for Textile industry, Cement industry, Car manufacturing industry.

One operation (unit or output) costing

This method of costing is useful for the mining industry, Quarries and oil drilling industries, where the manufacture unit continuous and units are identical. In all these industries there is natural standard of unit cost.

Service or operating cost

This suitable for the industry which provides service as distinct for those which manufacture goods. This cost can be applied to transport industry, power supply industry, municipal hospital industry.

Farm Costing

This is applicable Agriculture, animal husbandry, horticulture, where it helps calculation of total cost and unit cost covering various activities of farming.

Types of costing

Uniform costing

It is the use of same costing principles and practices used by several undertakings common and comparison purpose

Marginal costing

It is ascertainment of marginal cost by differentiating fixed and variable cost. It is used to ascertain effect of change in volume or type of output on profit

Standard costing

A comparison is made of actual cost with the prearranged standard cost and cost of any deviation. This permits management to investigate reason for deviation and suitable corrective action.

Historical costing

This is ascertainment of cost after they have been incurred. It aims at ascertain cost incurred on the work done in past, this has limited utility though the comparison of cost over the different period may yield good result.

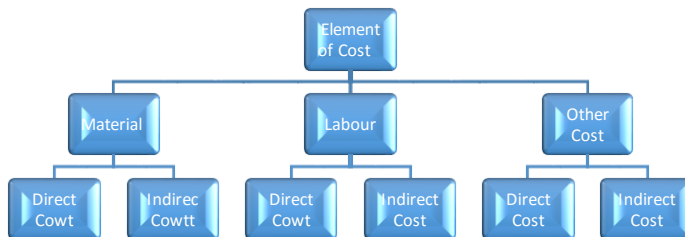
Direct costing

It is the practice of charging all the direct cost variable cost and some fixed cost relating to the operations, process or products leaving all other cost to be written of against profit in which they arise.

Absorption costing

It is the practice of charging all the costs ie both variable and fixed to the operations, process or products. This differs from marginal costing where fixed cost are excluded

To provide proper data to analyze and classify to come up with right decision by the management. To facilitate management with detailed information on cost total cost analyzed by element wise by classifying expense by nature.



Indirect cost which cannot be directly relates to any product / Services / Department unit level output. All the indirect cost referred above can be further classified into

- Production Overheads
- Administrative Overheads
- Selling Overheads
- Distribution Overheads

Direct expenses can be referred as cost which holds correlate relationship with the units produced, ie direct cost

of manufacturing 10 units is Rs.1000, by the same time manufacturing of 100 units will be 10000,

But indirect cost which will not have any correlation with number of units produced. Number units produced may be 100units or 1000 units the rent cost will remain same.

By understanding cost still further we can group the cost into 4 more groups

1. Prime Cost
 - a. Can be referred as Direct Cost, which covers Direct Material+ Direct Labor+ Direct Manufacturing expenses
2. Works or Factor Cost
 - a. Prime cost + Factory overheads
3. Cost of Production
 - a. Works cost + Administrative cost
4. Total Cost or Cost of Sale
 - a. Cost of Production+ selling and distribution overheads

For Ex.

Direct Material 10000, Direct Labour 7000, Factory exeses 3000, Administrative expenses 1600, selling expenses 1400 and sales 30,000

Now

- | | | |
|---|----------------------------------|-----------------------|
| 1) Prime cost from above is | $10000+7000$ | 17,000 |
| a. Direct Material + Direct Labour | | |
| 2) Works or Factory Cost | $17000+3000$ | 20,000 |
| a. Prime cost + Factory Cost | | |
| 3) Cost of Production | $20000+1600$ | 21,600 |
| a. Works or factory cost+ administrative cost | | |
| 4) Total cost or Total sales | $21600+1400$ | 23,000 |
| 5) Profit | $\text{Sales}-\text{Total cost}$ | $30,000-23,000=7,000$ |

Direct Material

Material which can be identified to the final product and can be conveniently measured and directly charged to product. The material quantity or cost which can be measured against each unit of production.

Book printing can be measured number of sheets to print

Readymade shirt manufacturing can be measured against cloth used

- ❖ All raw material like jute to manufacture gunny bags
- ❖ Materials purchased for specific jobs, process etc
Glue for book binding
- ❖ Parts or components purchased or produced like
Tyres for car,
- ❖ Primary packing materials like Cartons, wrappings, cardboard boxes used to protect the finished product from climatic condition or easy handling

From the above we can clearly identify the Direct material, the materials which is not coming under above category as Indirect material

Direct Labor

Direct labour is all labour utilized /efforts spent to arrive final product, In other words, labour cost which can be conveniently identified / correlated with products produced. Labour cost incurred to convert the Raw material into Finished product also can be referred as Direct Labour cost

- ❖ Labour engaged in actual production
- ❖ Labour engaged in aiding the manufacturing by the way of supervision, maintenance, tools setting and transportation of materials
- ❖ Inspection of quality, analysis etc

Direct Expenses

All the expenses incurred/ all the expenses has direct correlation with number of units produced or expenses which can be conveniently chargeable against the products produced. All the expenses which can be identified to a particular cost centre and directly charged to the centre or known as direct expenses

Overheads

Overheads can be referred as aggregate of indirect cost of material , Labour and other expenses which cannot be rationally apportioned to number of units produced. Simple word Overheads are the expenses other than direct cost.

Production or manufacturing overheads

Overheads always refers to indirect cost incurred. All the indirect cost incurred of operation and manufacturing division will be considered as production overheads. All the indirect expense incurred from the very beginning of manufacturing to till end of getting ready of finished product ready to be dispatched to customer/ moving to finished goods warehouse. Indirect cost includes depreciation of plant and machinery, rent, electricity, building, coal and fuel, Office expenses, labour welfare expenses, canteen, medical facility etc.

Administrative overheads

All indirect expenses incurred of management cost, starting from formulation of strategy, plan, Organizing , controlling, tracking and managing other managing other managing activities of organization.

Selling overheads

This is an indirect cost of creating demand/ getting order, advertisement expenses, managing sales and distribution department, tracking each elements relates to sales and distribution. Even this includes all incidental expenses like rent, electricity, stationary expenses and salary & commission and advertisement cost etc.

Distribution overheads

All the expenses incurred in the process of making final finished product available to the end customer with

necessary safety packing's. All the official / management expenses to relating to sales and distribution is covered.

Research and development expenses

Expenses incurred on studying our product with customer satisfaction understanding additional facilities, understand better features of competitor products and understand sharpness of our advertising themes, innovation to reduce the basic cost of manufacturing and formulating strategy plan to implement all successful/ approved outcome of research department

Expenses excluded from cost

While listing out the expenses and its nature how the cost has to be arrived, we need to understand the few cost which cannot be considered while performing cost accounting. All the capital expenses, capital loss, profit distribution or apportion of profit, dividend paid, tax paid, abnormal wastage of material, abnormal cost due to fire / natural calamities, Preliminary expenses, underwriting charges, cash discount etc.

Valuation of stock

Stock has to be valued based on the stage where it is, this needs special care

Stock of Raw material

Value of raw material can be calculated as below

	Opening stock	xxxx
Add	purchase	xxxxx
Less	Closing raw material cost	xxxxxx

Result is cost of raw material consumed

Stock of work in progress

Raw material which was started using in production, but not yet reached as finished product can be named as stock in progress.

	Inventory cost	xxxxx
Add	Factory overhead incurred	xxxxx
Add	work in progress beginning	xxxxx (opening WIP)
Less	work in progress closing	xxxx
	Result factory overhead	xxxxx

Stock of finished goods

	Cost of production	xxxx
Add	opening finished goods value	xxxx
Less	Closing finished goods value	xxxx
	Result is cost of finished goods sold	xxxx

Material cost

Material cost plays vital role in cost accounting. Valuation of material cost, Purchase and stores control, Methods raw material valuation and issues and finally material losses and miscellaneous items in material. According to the Indian association of materials management cost of raw material used by Indian industry takes major part from 40% to 65%, cost of material used may vary based on the industry nature.

Material control system which ensures right quality, right quantity of raw material made available at right time and right place. As we know major cost of finished goods is material, if any mismanagement of material may lead to huge waste of working capital of industry. Keeping excess raw material will impact negatively working capital, keeping less quantity of raw material than expected may impact poor utilization of other factors of production like less utilization of labour, plant and machinery, internal transportation other elements.

Stock control has two faces like quantity and financial part. Store keeper/ Production manager will hold their eye on quantity available to avoid no stock situation. Other side Financial management will concentrate to contain the cost of raw material

Material control should very effective then on the cost of material can be controlled to ensure following

- Availability of material

- No excess investment in material
- Reasonable price
- Minimum wastage
- Risk of spolage and obsolescence
- Information about availability of material

Techniques of material control

Following are material control techniques can be used based on the nature if raw material and industry.

- Level setting
- Economic order quantity
- Just in time inventory system
- ABC analysis
- VED Analysis
- Perpetual inventory system
- Inventory Turn over ratio
- FNSD analysis
- Material cost report

Level Setting

This method deals with setting of the levels based on their industry history requirement.

ReOrder level is set considering Span needed from order placement to Receipt material at storage. Ex if order is placed how long it will take to receive the material X daily consumption quantity with buffer quantity.

Minimum stock quantity

This represents minimum quantity of material has to be maintained at all days. This quantity is fixed to avoid Production heldup for want of raw material

Minimum quantity is calculated by multiplying lead time to receive material (stock indenting to receive material)* daily consumption of material

Maximum Level

This level represents maximum quantify of item which can be maintained at any time. Anytime stock level should not exceed the quantity.

ABC analysis

This is the scientific method of Material cost analysis. Few materials less quantity forms part of higher percentage in value and Higher quantity of material forms part of lower cost. ABC analysis runs between two parameters. ABC analysis measures cost significance of each item of material. It concentrates on importance of item.