



AKSHEEYA COLLEGE OF ARTS AND SCIENCE

**DEPARTMENT OF
COMMERCE**

Class: III B.Com B sec

Subject : Elements of Cost Accounting

UNIT-1 INTRODUCTION TO

COST ACCOUNTING

Important terms

- **Cost**
- **Costing**
- **Cost Accounting**
- **Cost Accountancy**
- **Financial Accounting**
- **Management Accounting**
- **Cost control**
- **Cost reduction**
- **Cost centre**
- **Cost unit**
- **Profit centre**
- **Cost Audit**

COST

Cost is the value of economic resources a used as a result of producing or doing the thing cost.

ICMA - Institute of Cost and Management Accountants London, Cost defines

- a) Actual expenditure incurred on a given thing**
- b) Notional expenditure attributable to a given thing**

COSTING

Costing as the ascertainment of costs.

It is the techniques and processes of ascertaining costs and studies the principles and ruled concerning the determination of cost of products and services.

Cost Accounting:

Meaning

It is the method of accounting for cost. The process of recording and accounting for all the elements of cost is called "cost accounting"

Definition

ICMA has defined cost accounting as follows:

“The process of accounting for cost from the point at which expenditure is incurred or committed to the establishment of its ultimate relationship with cost centers and cost units. In its widest usage it embraces the preparation of statistical data, the application of cost control methods and the ascertainment of the profitability of activities carried out or planned”.

Need for cost accounting

Intense competition in the market place has made the management of business and industrial units turn to the accounting department for accurate and relevant information regarding the cost of products or service. Such cost data is useful in

- (a) Fixation of selling prices
- (b) Control of cost and
- (c) Decision-making from alternative choices.

Scope and Objectives of Cost Accounting

- The term 'scope' here refers to field of activity. Cost accounting is concerned with ascertainment and control of costs.
- The information provided to the management is helpful for cost control and cost reduction through functions planning, decisions making and control.
- In the initial stages of evolution, cost accounting confined itself to cost ascertainment and presentation of the same with the main objective of finding the product cost.
- Development of business activity and introduction of large scale production, the scope of cost accounting was broadened and providing information for cost control and cost reduction has assumed equal significance along with finding out cost of production.
- In addition to enlargement of scope, the area of application of cost accounting has also widened. Initially cost accounting was applied in manufacturing activities only. Now, it is applied in service organizations, government organizations, local authorities, farms extractive industries, etc.

Objectives or Purposes or Functions or Aims of Cost Accounting:

1. Cost finding or Cost Ascertainment
2. Control of cost
3. Cost Reduction
4. Fixation of selling price
5. Providing information for framing business policy

Distinguish between Financial Accounting and Cost Accounting

Comparison Points	Cost Accounting	Financial Accounting
Meaning	Cost Accounting is an accounting system via which an organization keeps track of different costs	Financial Accounting is an accounting system that collects records of company financial information to demonstrate the

	incurred in production operations in the company.	company's accurate financial position at a specific date.
Type of cost is used for recording.	Historical as well as pre-determined cost.	Only historical cost.
Mandatory	No, it is not mandatory, except for manufacturing firms.	Financial Accounting is mandatory for all firms.
Information type	Cost accounting records the labor, material and overhead information used in the production process.	In Financial accounting, the information in monetary terms is recorded.
Users	Cost accounting information is only used by the organization's internal management such as directors, employees, supervisors, managers etc.	Financial accounting information is used by internal and external parties such as customers, creditors, shareholders, etc.
Valuation of Stock	At cost	Net Realized value or cost, whichever is less.
Forecasting	In cost accounting. With the help of budgeting techniques forecasting, is possible.	In Financial accounting, forecasting is not possible.
Purpose	The purpose of cost accounting is controlling and reducing costs.	The purpose of financial accounting is to keep the entire record of the financial transactions.
Profit Analysis	In cost accounting, normally, the profit is analyzed for a specific job, batch, product, process, etc.	In Financial accounting, expenditure, profit and income are analyzed simultaneously for a specific period of the entire unit.

MANAGEMENT ACCOUNTING:

Meaning:

The term Management Accounting consists of two words “Management” and “Accounting”. It is the study of managerial aspects of accounting. Management accounting is the accounting system for making decisions of the business enterprise.

DEFINITION:

Management Accounting is the adaptation and analysis of accounting information, and its diagnosis and explanation in such a way as to assist management” – **T. G. Rose**

“Management Accountancy is the presentation of accounting information in such a way as to assist management in the action of policy and in day-to-day operation of undertakings”.

I.C.M.A- the definition recently incorporated into the terminology.

OBJECTIVES:

The objectives of management accounting are:

- To assist the management in promoting efficiency. Efficiency includes best possible services to the customers, investors and employees.
- To prepare budget covering all functions of a business (i.e. production, sales, research and finance).
- To analysis monetary and non-monetary transactions.
- To compare the actual performance with plan for identifying deviations and their causes.
- To interpret financial statements to enable the management to formulate future policies.
- To submit to the management at frequent intervals operating statements and short term financial statements.
- To arrange for the systematic allocation of responsibilities.
- To provide a suitable organization for discharging the responsibilities.

DISTINCTION BETWEEN MANAGEMENT AND FINANCIAL ACCOUNTING:

Basis for Comparison	Financial Accounting	Management Accounting
Meaning	Financial Accounting is an accounting system that focuses on the preparation of a financial statement of an organization to provide financial information to the interested parties.	The accounting system which provides relevant information to the managers to make policies, plans and strategies for running the business effectively is known as Management Accounting.
Orientation	Historical	Future
Users	Both internal and external users	Only internal users
Nature of statements prepared	General-purpose financial statements	Special purpose financial statements
Rules	Rules of GAAP are followed	No fixed rules for the preparation of reports
Reports	Only financial aspects	Both financial and non-financial aspects
Time Span	Financial statements are prepared for a fixed period, i.e. one year.	Management Reports are prepared whenever needed.
Objective	To create periodical reports	To assist internal management in planning and decision-making process by providing detailed information on various matters.
Publishing and auditing	Required to be published and audited by statutory auditors	It is not meant to be published or audited. It is for internal use only.
Format	Specified	Not Specified

DIFFERENCES BETWEEN COST ACCOUNTING AND MANAGEMENT ACCOUNTING

1. Cost Accounting is concerned with cost ascertainment, determining profitability and control of costs through budgetary control, marginal costing and standard costing.

Management accounting is concerned with providing relevant information to formulate the policies of the organization and improving its profitability.

2. Cost accounting is developed and improvised out of financial accounting.

Management accounting is conceived out of cost accounting.

3. Cost accounting suggests to the management the best of the alternatives by use of different costing techniques.

Management accounting considers cost as well as non cost techniques and information for deciding upon alternatives.

4. Cost Accounting reveals variances to management by using budgets and standard costing techniques.

Management accounting is helpful in suggesting to the management way and means of deletion of unfavorable variances.

ADVANTAGES OF COST ACCOUNTING

I. To the Management

1. Effective decision making
2. Measuring efficiency
3. Cost Reduction
4. Fixation of selling price
5. Effective cost control

II. To the Employees

- I. Stability of tenure
2. Fair wages policy

3. Rewards for higher efficiency through incentive schemes

III. To the Government

1. Granting of subsidies
2. Planning of resources
3. Utilisation of scarce resources

IV. To the Public

1. Removal of wastages
2. Fair price for products
3. Employment opportunities

LIMITATIONS OF COST ACCOUNTING

1. Lack of uniformity
2. Conventions
3. Costly
4. Second hand data
5. Uncertainty
6. Applicability

OBJECTIVES OF COST ACCOUNTING

1. Cost Accounting is costly to operate
2. Cost Accounting is unnecessary
3. Cost Accounting involves many forms and statement
4. Costing may not be applicable in all types of Industries
5. It is based on Estimations

- **Cost Centre:** Cost centre is defined as "A location, person or item or equipment (or group of these) for which costs may be ascertained and used for the purposes of cost control"- ICMA.
- **Cost Unit:** The Chartered Institute of Management Accountants, London, defines a unit of cost as "a unit of product or service in relation to which costs are ascertained".
- **Cost Control:** The ICMA, London defines cost control as "The regulation by executive action of the cost of operating an undertaking particularly where such action is guided by cost accounting".
- **Cost Reduction:** The ICMA defines cost reduction as under, " Cost reduction is to be understood as the achievement of real and permanent reduction in the unit cost of goods manufactured or service rendered without impairing their suitability of the use intended or diminution in the quality of the product".
- **Cost Audit:** ICMA defines cost audit as "the verification of cost accounts and a check on the adherence to the cost accounting plan".

Cost Manual: ICMA defines cost manual as "A document which sets out the responsibilities of the persons costing in the routine of and the forms and records required for costing and cost accounting"

METHODS OF COSTING:

Job Costing: ICMA defines Job Costing as, "that form of specific order costing, where work is undertaken to Customers specific requirements"

Contract Costing: It is applied in concerns involved in construction work, like lying of roads, bridges and buildings, etc. For each of the contracts a separate account is opened and the total cost incurred is identified with it. The contracts may take a long time for completion. It is also known as terminal costing.

Batch Costing: ICMA defines it as, "that form of specific order costing which applies where similar articles are produced in batches either for sale or for use within an undertaking. In most cases, the costing is similar to job costing".

Process Costing: This method of cost ascertainments used where the input is processed through several distinct processes to be converted into a finished product.

Operating Costing: This method is applicable where there is mass production and several processes are involved with different operations to be carried out to complete the process of production. It is similar to process costing but cost details are maintained for every minute operation and costs are more accurate.

Operation Costing: This method is applicable where there is mass production and several processes are involved with different operations to be carried out to complete the process of production.

Unit or Output Costing: This method is applicable where output is uniform in all respects and production is continuous. Under this method cost per unit is ascertained by dividing the cost by number of units produced.

Multiple Costing: This is a system where two or more methods of costing like job costing unit costing and operation costing are applied to find the cost of production. It is the application of combination of two or more methods to ascertain the cost of the work done.

METHODS OF COSTING

1. Historical Costing
2. Standard Costing
3. Marginal Costing
4. Uniform Costing

Elements of Cost

Unit 2 Cost Sheet

SPECIMEN OF STOCKS OF RAW MATERIALS

PARTICULARS	AMOUNT	AMOUNT
Opening stock of raw materials		XXX
ADD :Purchase of raw materials	XXX	
Carriage inwards	XXX	
Other direct materials used	XXX	
Taxes & Duties on the material purchased	XXX	
		XXX
LESS :Closing Stock of raw materials	XXX	
Sale of unsuitable raw materials	XXX	
Sale of scrap of raw materials	XXX	
		XXX
Cost of raw materials consumed		XXXX

Prime Cost=Direct Material+ Direct Labor + Direct Expenses

SPECIMEN OF COST AND PROFIT

PARTICULARS	AMOUNT	AMOUNT
Opening stock of raw materials		XXX
ADD :Purchase of raw materials	XX	
Carriage inwards	XX	
Other direct materials used	XX	

Taxes & Duties on the material purchased	XX	
		XXX
LESS :Closing Stock of raw materials	XX	
Sale of unsuitable raw materials	XX	
Sale of scrap of raw materials	XX	
		XXX
Cost of raw materials consumed	XX	
Direct Wages	XX	
Direct or chargeable expenses	XX	
		XXX
Prime Cost		XXXX
ADD • Factory Overhead	XX	
ADD: Opening Work in Progress	XX	
LESS: Closing Work in Progress	xx	XXX
Works Cost (or) Factory Cost		XXXX
ADD: Administration Overheads		XXX
Cost of Production		XXXX
ADD: Opening Stock of Finished Goods	XX	
LESS: Closing Stock of Finished Goods	XX	
		XXX
Cost of production of Goods sold		XXXX
ADD: Selling & Distribution Overheads	XX	
		XXX

Cost of Goods sold (or) Cost of Sales		XXXX
ADD :Profit / LESS : Loss		XX
SALES		XXXXX