

Introduction to Costing

The three main branches of accounting are :

- (1) Financial Accounting ;
- (2) Cost Accounting; and
- (3) Management Accounting

Cost: It is the amount of expenditure incurred for or attributed to a given thing. Cost is commonly defined as 'sacrificed resource' for a particular thing.

Costing: Costing can be defined as the technique and process of ascertaining cost. Costing is the classifying, recording and appropriate allocation of expenditure for the determination of costs of products or services.

Cost accounting: The Chartered Institute of Management Accountants in England (CIMA) has defined Cost Accounting as, "the process of accounting for cost from the point at which expenditure is incurred or committed to establishment of its ultimate relationship with cost centres and cost units. In its widest usage, it embraces the preparations of statistical data, the application of cost control methods and the ascertainment of the profitability of activities carried or planned"

Cost Accounting has the following objectives:

- (i) Ascertainment of cost and determining the selling price.
- (ii) Cost control i.e. keeping costs under check;
- (iii) Ascertaining profitability and profits earned on each activity including ascertaining causes that lead to a particular figure; and
- (iv) Collection and presentation of such information or statements as are required by management in its task of planning and making decisions.

The decisions to be made may be of various types, some examples of which are:

- (a) fixing prices under normal and special circumstances;
- (b) determining priorities for products;
- (c) deciding whether a component will be bought from the market or made within the factory itself; and
- (d) deciding on the best processes of manufacture etc.

The scope of cost accounting refers to the various areas of study under the purview of cost accounting as follows :

- (i) Cost classification : This refers to the grouping of homogenous items of cost into a common group. Cost classification is a process of arranging the items of cost into certain categories on the basis of defined criteria. Three common bases of cost classification are : (a) element-wise classification; (b) function-wise classification; (c) behaviour-wise classification.
- (ii) Cost recording : This refers to the posting of cost transactions into the various ledgers maintained under a cost accounting system. This involves recording of cost data according to a pre-arranged classification.
- (iii) Cost allocation : This refers to allotment of costs to various departments or products on a pre-determined basis. Cost allocation is that part of cost attribution which charges specific costs to a cost centre or cost unit.
- (iv) Cost determination : This refers to the determination of cost of products (or services), departments and other segments of operation of a manufacturing concern. Cost is ascertained in two ways, namely, (a) Statement method (popularly known as cost sheet or cost statement); (b) Account method (i.e., Production account is prepared under the double entry principle).
- (v) Cost comparison : This involves comparison of the cost of alternative products, activities and areas of operation in the field of production.
- (vi) Cost control : Cost control is a device for regulating the cost of output (or operation) by careful use of the techniques of cost accounting. Cost control is exercised through a variety of techniques (such as standard costing, budgetary control, inventory control, quality control). Cost control helps in utilisation of resources in the best possible manner.
- (vii) Cost reporting : This refers to furnishing of relevant cost information to the management on a regular basis so as to meet the requirements of management. It is a formal system designed to ensure timely supply of pertinent cost information to the management for their policy-making and operating decisions.

- (viii) Cost reduction : Cost reduction represents achievement of real and permanent reduction in the unit cost of goods manufactured and services rendered. Cost reduction may be brought about by the elimination of wasteful and non-essential elements in design of products. The final aim of cost accounting is the reduction of real costs of goods (or services) on a permanent basis through maintaining (or improving) quality and utility.

Cost Accountancy: Cost accountancy is a subject which is related to the accounting of goods produced or services rendered. It involves the application of costing and cost accounting principles, methods and techniques to the practice of cost control and the ascertainment of profitability. It also covers the presentation of information derived therefrom for the purpose of managerial decision-making

Cost object is any item for which costs are being separately measured. It is a key concept used in managing the costs of a business.

Cost Unit is a quantitative unit of product (or service) in relation to which costs are ascertained (or expressed). A Cost unit differs from industry to industry. The unit selected should be one which is the most natural to the business and is acceptable to all concerned. Examples : (i) Cost per kg. of sugar, (ii) Cost per 1,000 bricks, (iii) Cost per tonne of cement, etc.

Cost centre is the smallest segment of activity (or area of responsibility) for which costs are ascertained. Such a sub-division helps in the collection of costs and absorption of costs to cost units. Cost Centre may be a location, person or item of equipment (or group of these) in respect of which cost may be ascertained and used for the purpose of cost control. So, a cost centre may be a depot (or warehouse), an individual, a machine in the factory.

Classification of Cost

Fixed, Variable and Semi-Variable Costs

The cost which varies directly in proportion with every increase or decrease in the volume of output or production is known as **variable cost**. Some of its examples are as follows:

- Wages of laborers
- Cost of direct material
- Power

The cost which does not vary but remains constant within a given period of time and a range of activity in spite of the fluctuations in production is known as **fixed cost**. Some of its examples are as follows:

- Rent of building
- Insurance charges
- Management salary

The cost which does not vary proportionately but simultaneously does not remain stationary at all times is known as **semi-variable cost**. It can also be named as semi-fixed cost. Some of its examples are as follows:

- Depreciation
- Repairs