TOPIC 1

COST ACCOUNTING

Cost

It’s an amount of expenditure that is incurred or attributable to a specified thing or activities. It’s the volume of economic resources used by the activity.

Costing

It’s ascertaining of cost, that is, it’s a process or technique of ascertaining cost. It’s also classifying, recording and appropriate allocation of expenditure for determination of cost. The relationship of this cost to sale value and the ascertainment of profitability is the main objective of cost accounting.

Accounting

It’s the process of providing information by means of financial statement to enable the use of this information to make an informed decision.

Financial accounting

It’s the process of identifying, measuring, preparing, interpretation and communication of information useful for management decision making in line with the objective of the firm.

Cost accounting

It’s a formal system of accounting for cost of products or service using costing principles, methods and techniques and the practice of cost control and ascertainment of profitability, it’s concerned with measuring economic performance.

Cost units

Cost exists only when we’ve got units to be costed therefore cost unit may be units of production or service e.g. consultation hours, counseling hours etc.

Cost centre

It’s any part of an enterprise to which cost can be charged. It can be an item, a person and hence it involves identifying the cause of this cost and relates it e.g. a salesman cost centre will be charged with salaries and commission expenses.

OBJECTIVES OF COST ACCOUNTING

1. Ascertainment of cost - Different techniques and system of costing are used under different circumstances. Detailed information about cost helps managers to make informed decisions.

2. Cost control - It aims at improving efficiency in the production process by reducing cost or utilizing the resources most efficiently and effectively.

3. Guide on business policies - Cost accounting aims at serving the need to management in conducting a business in utmost efficiency, cost data provide guidelines for various managerial decisions made by the management e.g. which to buy, manufacturing a new product, utilization of plant , idle capacity.
4. Reviewing the economy of production in regard to the methods, types of equipment, design, output layouts etc by comparing information provided with estimates, we can make decisions related to the economies of scale.
5. Provides details of sources of profit/losses revealed in the profit and loss account.
6. It indicates whether certain components made by the company would be economical to buy from outside suppliers or not.
7. Indicates to the management the source of any inefficiencies, wastage, spoilage etc and recommend ways or steps to be taken.

FACTORS TO CONSIDER BEFORE INSTALLING COST ACCOUNT SYSTEM

1. Nature of business, products and methods used in production.
2. Organization structure showing the flow of authority.
3. Methods of purchasing, storage and issue of materials for the existing methods of labour remuneration and incentive plans.
4. Forms of accounting records should be designed so as to involve minimum clerical cost and other expenditures.
5. Size and layout of the factory should be considered.
6. The system should be effective in cost control
7. System should be easy to operate.
8. Installation and operation of the system should be economical.
9. System should be introduced gradually.

LIMITATION OF A FINANCIAL ACCOUNTING THAT LED TO INVENTION OF COST ACCOUNTING

1. Financial accounting gives the information of the entire business and doesn't give data

regarding cost of department product /service or process.

2. Financial accounting is historical, it doesn't compute days to day cost and future cost.
3. Labour cost is not recorded by jobs, process or department therefore incentive plans to employees may not be possible.
4. In financial accounting expenses are not classified into direct cost/indirect cost, fixes /variable cost etc.
5. Cost is not available as a tool in determining the selling price of a product or service.
6. Financial accounting does not control costs.

DIFFERENCES BETWEEN FINANCIAL ACCOUNTING AND COST ACCOUNTING

FINANCIAL ACCOUNGING	COST ACCOUNTING
1. Reports are submitted to shareholders management.	1. Reports are submitted to
2. Preparation of financial statement is a voluntary. statutory requirement.	2. Preparation of cost accounting is
3. Financial accounting statements are periodic	3. Reports are continuous.
4. Statements are subject to audit.	4. Not subject to audit.
5. Information contained is historical future.	5. Information contained is about the
6. Its convectional.	6. Its dynamic.
7. Emphasis on recording financial transactions.	7. Emphasis on cost control.

Profit centre

It's a segment of activity or areas of responsible to which both cost and revenues are analyzed.

Investment centre

It’s a profit centre where managers have a significant degree of control over his investment policy.

Opportunity cost

It’s the sacrifice involved in accepting an alternative under consideration.

Sunk cost

They are costs incurred in the past and are not recoverable under any given condition because the service was delivered or received.

COSTING PRINCIPLES

i. Cost should be related as clearly as possible to its cause.

ii. Cost should not be charged until incurred e.g. a product in the store should not included the cost of selling and distribution since it’s yet to be sold.

iii. Cost statement should give facts and not be based as much as possible on predictions i.e. should not be biased.

iv. Abnormal cost should not be involved in costing the product.

v. Past cost should not be charged to future period, a past cost is one when no more benefit from it is expected.