Cost accounting

Cost Accounting is a method of accounting wherein all the costs involved in performing any process, project or product are noted and analyzed. Such analysis helps the management in taking strategic decisions.  
Cost accounting uses various techniques to make an organization cost effective.

Traditional accounting VS Cost accounting

* In traditional accounting, the profit and loss is derived by deducting expenses from income whereas in cost accounting the motive is to be cost effective by reducing costs of process, production or project.
* Financial accounting views an organization in entirety whereas cost accounting segregates the organization into various processes, projects or production units.
* Financial accounting is used to present the position of the organization to its stakeholders whereas cost accounting is used for internal review of costs.
* Financial accounting is uniform across various businesses, however, cost accounting methods vary based on the type of business.

**Elements of cost in general**

For a standard manufacturing unit the various costs involved can be segregated into the following :

* Material
* Labour
* Other expenses

These can be further segregated into the following:

* Direct
* Indirect

**Illustration**

Say a toy manufacturing unit procures plastic as a raw material. The cost of plastic is direct material cost. The costs incurred in the packing and transportation of the same is the indirect material cost.  Similarly, the labour cost for the production of toys is the direct labour cost whereas the salary of the production supervisor will be indirect labour cost.

**Different types of costs**

For analyzing the various costs it is imperative to first understand the types of costs.

**Fixed Costs**

The costs that remain constant despite changes in production,  process or projects are referred to as fixed costs. For example, in a manufacturing unit the salaries of the office staff will remain fixed irrespective of the production.

**Variable costs**

These costs vary with the production,  process or project changes. For example, in an organization manufacturing toy the material and labour cost will be dependent on the production.

**Opportunity cost**

The cost incurred in selecting one option over another is called opportunity cost. For example in a toy manufacturing unit with limited labour hours and material, the decision to produce one particular toy say ‘Dancing Monkey’ will result in non-production of an other toy say ‘Spinning top’. So while considering the profitability of toy ‘Dancing Monkey’ the organization has to consider the profit of ‘Spinning top’ that it forgoes.

**Sunk cost**

Certain costs are incurred and cannot be recovered these are sunk costs.  Continuing with our example of toy manufacturing unit, sunk costs would refer to machinery cost that has been incurred.

## ****Techniques in Cost Accounting****

The techniques of costing facilitate managerial decision making. The different types are

**Marginal Costing**

As per this technique, the management may decide the number of units to be produced.  Suppose a toy unit is already producing 100 units of ‘Dancing Monkey’ toy, this technique will help the management understand that if the production is increased to 150, will it be profitable.  In this technique, only the variable costs for additional units produced will be considered. Fixed costs are not taken into consideration as they do not vary with changes in production.

**Standard Costing**

In this technique of costing the costs incurred are compared to the predetermined cost of the product,  process or project. The variances are analyzed to bring about cost-effectiveness.

**Direct Costing**

In this technique all the direct costs incurred for a particular product,  process or project are charged to it and the indirect costs are written off to profit and loss.

**Historical Costing**

It is comparison of all costs incurred after the process is performed.

**Uniform Costing**

In this technique same costing practices are followed across certain units to facilitate comparison.

**Absorption costing**

This is a method of full costing.  In this all costs are charged to the product,  process or project.

**Which are the various methods of Costing?**

Since each business is so varied from the other, the method of costing cannot be uniform.  The different methods of costing used by different businesses are summarized here under :

|  |  |
| --- | --- |
| **Method** | **Type of Business** |
| Job Costing – The costs incurred for a particular job can be easily identified | Advertising |
| Contract costing – Similar to job costing but the duration of assignment is longer. | Construction |
| Unit costing – The costs are incurred for a fixed quatiny. | Mining |
| Batch costing – The costs incurred for a fixed number of units forming a batch | Manufacturing of spare parts |
| Process costing – The processes involved are easily distinguished. | Textile units |
| Operating costing – The costs are incurred for services rendered. | Hospitals |