STUDY MATERIAL

SUBJECT : COST ACCOUNTING
UNIT : I
SEMESTER : VI
CLASS : III B.Com CA
Course Code : 19BBC6C10

UNIT- I:

Cost Accounting – Meaning and definition –Objectives- Difference between financial and cost accounting – Relationship with Management accounting – Nature and significance of cost accounting — Characteristics of ideal costing system – Methods of costing – Elements of costing – cost concept, fixed cost and variable costs – Preparation of cost sheet – Tender and quotations.

Cost: It means the total of all expenditures incurred on the production of an article.

Costing: It is the techniques and process of ascertaining costs. It enables the management to know the total cost and each elements of cost of a product. It has been defined by Weldon as, "the classifying, recording and appropriate allocation of expenditure for the determination of the costs of products or services, and the presentation of suitably arranged data for purposes of control and guidance of management.

Cost accounting: It is the accounting system set up for recording costs. It begins with the recording of income and expenditure and ends with the preparation of statements and reports of costs.

Object of costing:

The important objects of costing are:-

1. To ascertain the costs.
2. To control the costs by setting standards.
3. To provide the basic for the formulation on policies by the management.

Advantages of costing

The advantages of costing may differ according to the type and efficiency of the costing system adopted. Some of the important advantages of a good system of costing are as follows:

1. It helps the management to eliminate the less or unprofitable activities by disclosing them.
2. It reveals the exact cause of losses or inefficiencies and then, helps to improve the efficiency.
3. It provides information upon which estimates tender are made.
4 It guides future production policies.
5. It enables the periodical determination of profits or losses without stock taking
6 It helps in controlling costs by providing information for comparison of costs and the application of standard costing and budgetary control.
7. It provides an efficient check on stores, labour and machine.
8. It guides the management in fixing the prices properly and to take decision regarding various matters like the profitability (1) purchase or production of a

component, (ii) acceptance of an order below cost, (iii) proposed capital expenditure, (iv) use of different machine and methods of manufacture.

Necessity of importance of costing:

A good costing system is an invaluable aid to the management". This statement is true because the costing system helps the management in carrying out its functions by the following ways:

1. **Classification and subdivision of costs:** The costs are collected and collected and classified into various elements which helps the management to ascertain the profitability of each activity and to control them.
2. **Control of materials, labour and overhead costs:** The cost accounting helps the management to excise control over the materials, labour and overhead costs by the application of various techniques.
3. **Business policies:** It guides the management in taking decisions regarding various matters connected with the production and sale of goods.
4. **Budgeting:** It us a co-ordinate plans of action. it helps to correct inefficiencies before they enter into the business.
5. **Standard costing**: It provides the basis for the measurement of efficiency and future planning.
6. **Price determination:** It provides the reliable cost data to get maximum output at minimum cost.
7. **Maximum use of resources:** It provides the reliable cost data to get maximum output at minimum cost
8. **Expansion programmers:** The expansion policies can be decided only on the basis of cost data.
9. **Instrument of control:** The costing is an instrument for planning and controlling the activities of an undertaking to achieve the desired results.

Other factors: It also informs the management about the optimum profitability, seasonal variations, idle time and capacity etc.

Thus, it is clear from the above that the system of cost accounting in an organization helps the management in the formulation of policies, their execution and comparison of actual with the estimated. Such comparison helps to appraise the policies and to effect changes if necessary. So, it is rightly remarked that costing is an invaluable said to the management.

Objectives of cost accounting:

1. **Unnecessary:** Without the help of costing industries prepared in the past. So, it is argued that the introduction of costing is unnecessary and waste.
2. **Inapplicability:** There is no separate system of costing applicable to all types of industries. Hence, it cannot suit the requirements of many industries and inapplicable to such industries.
3. **Defective:** It has been proved as a defective system in many cases sine it fails to produce the desired results.
4. **Expensive:** It is quite an expensive system. Therefore, big industries alone can adopt it with advantages.

DIFFERENCE BETWEEN

	Financial Accounting	Cost Accounting
1	It provides general information about the profit or loss and financial position of a business	It provide information to the managem for planning execution and control of a
2	These accounts are required by law	These accounts are kept voluntarily
3	classifies and records the expenditure accounting to their nature	It classifies and records the to their pu
4	It does not provide any type of control	It provides a detailed system of contro
5	It gives reports usually at the end of the yr	It gives reports as and when required.
6	It records the total costs	It records the unit costs also.
7	It relates to trading transaction of a business.	It relates to manufacturing transaction
8	It is mostly based on estimates	It is based on actual facts and figures.
9	It show all the expenses	It shows only the production expenses
10	It reveals the profit or loss of the entire business	It reveals the profit or loss of a particu
11	In Brief, it is the accounting system for the whole	It is only a part of the financial busines

Installation of cost accounting

The following steps should be taken at the time of introducing a costing system in an organization.

1. The nature of business and the process of operations carried on should studied.
2. The costing system should be designed in such a manner to suit the specific requirements of the business.
3. The degree of accuracy desired and frequency and regularity of supplying cost data to the management should also be determined before designing the costing system.
4. The system of costing should be simple and easily understood by the operators.
5. Before it is put into effect, its benefits should be clearly explained to all the people connected with it to obtain their co-operation.
6. It should be introduced gradually and smoothly without much disturbance to the existing organization.
7. The relative profitability of the amount to be spent and the benefits to be obtained from the introduction of a costing system should also be considered.
8. The cost department should function independently. It should have easy access to the other departments which helps it to understand their problem and to take corrective action.

Problem in installing a costing system and suggestion to overcome them

1. **Lack of support from top management:** In most of the cases, this system has been introduced without the full co-operation of the management. As a result, it has not been implemented successfully. In order to overcome this difficulty, the cost accountant must obtain the full support of the management before its introduction.
2. **Resistance from the existing staff:** The existing staff may feel that the introduction of a new system may effect their importance and hence, they cannot

support it. In such cases, the new opportunities that they will get from its introduction should be well explained to them.

3. **Shortage of trained staff:** There may be shortage of staff trained in cost accounting at the time of to introduction. Such shortage can be avoided by giving proper training to the existing staff.
4. **Heavy cost of operation:** The cost of operating this system is heavy unless it is designed accounting to the specific needs of a concerns.
5. **Proper supervision**: After installation os a costing system, there must be proper supervision. The cost accountant should also take as much effect as possible to make the system successful and to achieve the desired results.

Method of costing

1. **Job Costing:** This system is adopted in industries where each job has a separate identity and are produced against specific orders. The costs are collected for each job separately under this system. it is also know as lot costing, Specific or production order.
2. **Construct Costing:** It is similar to job costing but requires a long period for completion. It is applied in industries engaged in construction works. Under this system, a separate account is opened for each contract and each contract is considered as a separate cost unit.
3. **Batch costing:** This method is adopted in industries where the goods are produced for stock and for sale to the customers in general. Under this method, the costs are computed for a batch or lot instead of a job in job costing. The unit cost is calculated by dividing the total cost of a batch by the number of units produced in that batch. it is suitable for industries producing components and spare parts for assembling finished products.
4. **Process costing:** The system adopted to ascertain the cost of each process of production is known as process costing. It is suitable for industries where a product passes through different processes for completion. In other words, it is a system adopted in industries where the finished product of one process is the raw materials of the next process. This system is suitable for industries like cotton textile, paper, sugar, chemical and mining.
5. **Unit or output or Single costing:** This method is suitable for industries where manufacturing is continuous and the units are identical. It is applied in industries like mines, quarries, oil drilling, breviaries, brick works etc. The unit cost is determined by dividing the total cost by the number of units produced.
6. **Operating costing:** This system is employed in undertakings performing service rather than producing goods like transport and power supply companies, hospitals, hotels etc. This method is used to ascertain the cost of performing the service.
7. **Multiple costing or composite costing:** This method is the combination of two or more costing methods. This is suitable for industries where a number of component parts are separately produced and subsequently assembled into a a final product e.g., industries manufacturing cycles, automobiles, radius, typewriters etc.

Type of costing:

1. **Uniform Costing:** When the same costing principle and practices are used by several concerns for the common control or comparison of costs, it is know as uniform costing.
2. **Marginal costing:** it means the ascertainment of marginal cost by differentiating between fixed and variable costs and of the effect on profit due to changes in volume or type of output.
3. **Standard costing:** It is the preparation of standard costs and applying them to measure the carnations from standards. it analyses the causes of variations with a view to maintain maximum efficiency in production.
4. **Historical Costing:** Under this costing the costs are not predetermined but are ascertained after their occurrence. Therefore, hte costs are not available in time to correct inefficiencies and to control costs.
6. **Direct costing:** The practice of charging all direct costs to the products in know as direct costing. Under this system, the indirect costs are written off against the profit of the period.

ELEMENTS OF COSTS

Direct materials: All those materials which can be easily identified as chargeable to a particular product, job or process, are know as direct materials. Examples: Timber used in furniture's, paper used in note books etc.

Direct Labour: All those laborers who can be easily identified as attributable to a particular job, production process are know as direct labour. The wages given to them are known as direct wages. Example: Workers directly engaged on production.

Direct or chargeable expenses: All those expenses which are incurred specifically for a particular job, product or process are know as direct expenses. Examples : Expenses on drawings, models, design, excise duty, royalty etc.

Overhead: Indirect materials, indirect labour and indirect expenses are collectively know a "Overhead"

The students are advised to render the chapter "Overhead" for details.

Concept of cost

Cost unit: It is a unit product or service or time in terms of which costs may be computed, e.g., per tonne in case of coal, per meter in case of cloth etc.

Cost centre: It is a part of an undertaking for which costs may be ascertained. So, it bay be location like a department or an area or an item of equipment like lathe or a person like salesman, foreman

CLASSIFICATION OF COSTS

1) According to variability:

1. Fixed costs or period costs are those costs which remains constant irrespective of the volume of output e.g., factory rent, insurance etc.
2. Variable costs or product costs are those costs which will vary in direct proportion to the output, e.g., direct materials, direct labour, power etc.

3. Semi-variable costs are those costs which are partly fixed and partly variable, e.g., telephone charges.

2) Accounting to controllability:

1) Controllable costs are those costs which are not within the control of management ex., rent of building

3) According to normality

i) Normal cost: It is normally incurred at a given level of output and it forms part of the of cost production.

ii) Abnormal cost: It is not normally incurred at a given level of output and therefore, it is charges to costing profit and loss account.

4) According to managerial decision:

i) Marginal cost: It is the total variable cost comprising of prime cost and variable overheads.

ii) Out of pocket cost: It is a cost which gives rise to cash expenditure.

iii) Differentials cost: It is the change in costs due to change in the level of activity or method of production.

iv) Sunk costs: It is a cost which cannot be recovered due to the permanent closure of a plant.

v) Shut down costs: It is the cost incurred on the plants kept idle due to the temporary suspension of activities.

vi) Imputed costs or notional cost: It is the cost in respect of which no actual expenditure is incurred e.g., rent of won building, interest on capital etc. Therefore, it appears only in the cost accounts.

vii) Replacement cost: It is the cost at which an asses can be replaced.

viii) Opportunity cost: It is the cost which may be earned from the alternative use of a productive capacity.

ix) Avoidable cost: It is the cost which can be eliminated on the discontinuation of a product or department, e.g., salary of clerks in that department.

x) Unavoidable cost: It is the cannot be eliminated on the discontinuation of a product or department, e.g., salary factory manager.

Expenses and incomes excluded from cost accounts :

The total cost of a product should include only those items of expenses which are a charge against profits. The other items of expenses which are relating to capital assets, capital losses, distribution of profits and items of pure financial nature should not form part of the cost.

The following items of expenses and revenuers are to be excluded from the cost accounts:

Expenses:

1. Abnormal waste of materialism idle time, bad debts and other abnormal expenses.
2. Interest on capital and borrowings.
3. Loss on sale of capital assets.
4. Discount and commission on issue of shares and debentures.
5. Preliminary expenses.

6. Fines and penalties.
7. Dividend paid.
8. Income –tax and super taxes.
9. Goodwill written off.
10. Charitable donations.

Revenues:

1. Profits from the sale of fixed assets.
2. Transfer fee received.
3. Rent received.
4. Dividends received.
5. Interest on back deposits.

Cost sheet/Statement of cost/production statement

It is a statement showing the total cost of a product or job in detail. It also shows the various elements of cost and cost per unit.

Advantages of cost sheet

1. It helps in fixing up the selling price
2. It is useful for determining the estimated prices for tenders or quotations.
3. It enables the manufacturer to control and minimize the cost.
4. It is useful for the formulation of production policies.

Specimen of a cost sheet or statement of cost (and profit) for the period ending...............

Particular	**Details**	**Total Cost Rs.**	**Cost per unit Rs.**
Direct material:			
Opening stock of raw materials	XXX		
add purchases			
add Purchases expenses	XXX		
	XXX		
Less purchases	XXX	XXX	XXX
Direct labour		XXX	XXX
Direct expenses		XXX	XXX
Prime cost		XXX	XXX
Add factory overhead or works overhead			
(Factory on cost or works on cost)			
....	XXX		
....	XXX		
....	XXX		
	XXX		
Less Scrap realised	XXX		
		XXX	XXX
		XXX	XXX
Add opening stock of work in progress		XXX	---
		XXX	

Less closing stock of work in progress		XXX	---
Factory cost or works cost		XXX	XXX
Add office and administrative overheads			
....	XXX		
....	XXX		
....	XXX	XXX	XXX
Cost of production		XXX	XXX
Add Opening stock of finished goods		XXX	--
		XXX	XXX
Less Closing stock of finished goods		XXX	---
Cost of goods sold		XXX	XXX
Add Selling and distribution expenses		XXX	XXX
Cost of sales or total cost		XXX	XXX
Profit		XXX	XXX
Sales		XXX	XXX

Notes :

1. Unit cost column is to be provided only when it is requires showing t he cost per unit. Otherwise it is not necessary.
2. Cost per unit is to be calculated for all the figures papering in the total cost column except the opening and closing stock items.
3. Cost per unit of each item.
   Up to cost of production = $\frac{\text{Cost of the concerned item}}{\text{No. of units produced}}$
5. Cost/profit per unit from cost of goods sold to sales =
   $\frac{\text{Cost / amount of the concerned items}}{\text{No. of units sold}}$
6. When the value of closing stock of finished goods is not given, it is to be calculated in the following manner:

$$\frac{\text{Cost of production}}{\text{No. of units produced}} \text{ x No of units in closing stock}$$

7. Meaning of scrap : It is the residue from the materials used in the process of manufacture. The scrap may be realized without further processing. Such realized value of scrap is credited to profit and loss account or job account.

8. Meaning of spoilage: The loss due to defective goods which cannot be rectified economically is known as spoilage. If spoilage is normal, it is treated value of scrap is credited to profit and loss account or job account.

Tender and quotations

Quotation is the fixed price offered to customers in response to render notice. It has legal binding and when a customer accepts, it can’t be changed. Whereas, tender is the response to an invitation of tender which is submitted by a prospective supplier.

STUDY MATERIAL

Invitation of tender is the open request form which is published in printed media (local news newspaper). It can be issued for construction contractor, machinery supplier, information technology, etc. the whole process starting from inviting tender, submitting tender and filling quotation is part of tendering process.

Quotation

Quotation is the formal document or document of promise given by supplier to supply goods & services to buyer at stated price under some specific conditions.

Quotation consists of terms of sales, payment, warranty, price to charge for product/services, time, date, delivery location, validity period. It also helps buyers in knowing the cost of goods/services before purchase. Generally government enterprises float the tenders.

Tender

Tender is the response to an invitation of offer. This invitation provides services/products at quoted price at specific quality (with specific conditions). Generally tenders are floated by government undertakings, corporate players, and financial institutions.

They want goods at large scales in order to meet the production requirements. In most cases, in order to meet the requirement they can't deliver on their own and they have to go to a third party supplier to meet the requirements. For these reasons they invite bids from third party suppliers.

The major differences between a tender and a quotation are as follows −

Tender	Quotation
Supplier bid on goods/services.	Document of estimated cost for supplying goods/services.
Find out the best price.	Offering fixed price.
Response for request for tender.	Response to request for quotation.
Price and quality are the components in Tender.	Price is the component in quotation.
Large scope.	Narrow scope.

Conclusion

Government companies or corporations will go for tenders or quotations to meet their large requirements. They manage their resources in the best way and provide value for their money. Tender is the process of asking suppliers to bid on products/services required by a company whereas quotation is the response to bidders, where they quote their price for goods/services. Quotation is also termed as an estimation given by professionals for jobs. Tender is more formal than quotations.