

# COST ACCOUNTING INTRODUCTION

In the initial stages cost accounting was merely considered to be a technique for ascertainment of cost of products or services on the basis of historical data. In course of time due to competitive nature of the market, it was realized that ascertainment of cost is not as important as controlling costs. Hence, cost accounting started to be considered more as a technique for cost control as compared to cost ascertainment.

Due to technological development in all fields, now cost reduction has also come within the ambit of cost accounting. Cost accounting is thus concerned with recording, classifying and summarizing costs for determination of costs of products or services, planning, controlling and reducing such costs and furnishing of information to management for decision making.

# DEFINITION OF COST ACCOUNTING

- “Cost accounting is a quantitative method that accumulates, classifies, summarizes and interprets information for three major purposes: (in) Operational planning and control ;( ii) Special decision; and (iii) Product decision.” -**Charles T. Horngren**
-

# DEFINITION OF CA

- “Cost accounting is the process of accounting for costs from the point at which the expenditure is incurred of committed to the establishment of its ultimate relationship with cost units. In its widest sense, it embraces the preparation of statistical data, the application of cost control methods and the ascertainment of the profitability of the activities carried out or planned is defined as the application of accounting and costing
- principles, methods and techniques in the ascertainment of costs and the analysis of saving and/or excess as compared with previous experience or with standards.” – **Institute of Cost and Management Accountants of London**

# BRANCHES OF ACCOUNTING

- 
- There are seven branches of accounting:-
- **a) Financial Accounting:** This is called original accounting, which is mainly confined to the preparation of financial statement for the various concern parties and financial institutions.
- **b) Cost Accounting:** The process of accounting for cost which begins with the recording of income and expenditure or the bases on which they are calculated and ends with the preparation of periodicals statements and reports for ascertaining and controlling cost.
- **c) Management Accounting:** Management accounting is a distinctive form of resource management which facilitates management's 'decision making' by producing information for managers within organization.
- **d) Inflation Accounting:** This accounting system do not consider the cost constant at every time because the price of a commodity change with time to inflation and decline purchasing power of money.

# BRANCHES OF ACCOUNTING

- **e) Social Accounting:** This deals with the application of double entry system of book keeping to socio-economic analysis at the preparation, estimation and interpretation of nation and international income and balance sheet.
- **f) Value -Added Accounting:** In this system income is measured by the value added by a firm in a particular period. It is the difference between the value of the product and the cost of raw material,
  - stores and any brought out component used for production.
- **g) Human Resource Accounting:** Human Resource accounting is the measurement of the cost and value of people for the organization or it is the process of identifying and measuring data about
  - human resources and communicating this information to interested parties.
  - 
  -

# Advantages OF Cost Accounting

- A good system of costing is the technique of controlling the expenditure and helps bringing economy in production, so it serves the needs of a large section of people in the following ways.
- **(a) Benefits to the Management:** The information revealed by cost accounting aims at mainly assisting the management in decision making and optimizing profits. Besides this there are certain advantages of cost accounting to the management i.e. it helps in price fixation, in revealing profitable and unprofitable activities, idle capacity, in controlling cost and also helps in inventory control.
- **(b) Benefits to the Employees:** Cost accounting introduces wage scheme, bonus to the efficient & sincere employees which in turn increasing productivity, profitability and lowering cost.

# Advantages continued...

- **(c) Benefits to Creditors:** The better management of finance through cost accounting leads to timely debt servicing by company in the form of repayment of loan and payment of interest. To stay and grow in competition and for judging soundness of present and perspective borrower and cost
- reports give better picture of efficiency profit prospectus and capacity.
- **(d) Benefits to the Government:** Cost accounting enables the Govt. to prepare plans for economic development of the country, to make policies regarding taxation, excise duty, export, price, ceiling,
- granting subsidy etc.
- **(e) Benefits to Consumers/Public:** Cost accounting helps consumers in getting goods of better quality at reasonable price.



# Importance of CA

- Cost accounting gives information and reports to the management in the following ways:-
- **(a) Control of Material Cost** –Cost of material is a major portion of the total cost of a product. It can be controlled by regular supply of material and spares for production, maintaining optimum level of funds in stocks of materials and stores.
- 
- **(b) Control of Labour Cost:** If workers complete their work within the specified time cost of labour can be controlled.



# IMPORTANCE CONTINUED..

- **(c) Control of Overheads:** By keeping a strict check over various overheads such as factory, administrative and selling & distribution, this can be controlled.
- **(d) Measuring Efficiency:** Cost accounting provides information regarding standards and actual performance of the concern activity for measuring efficiency.
- **(e) Budgeting:** The preparation of the budget is the function of costing department and budgeting is done to ensure that the practicable course of action can be chalked out and the actual perform corresponds with the estimated or budgeted performance.
- **(f) Price Determination:** On behalf of cost accounting information, management is enable to fix remunerative selling price for various items of products and services in different circumstances.
- **(g) Expansion:** The management may be able to formulate its approach to expansion on the basis of estimates of production of various levels.
-

# INSTALLATION OF COST ACCOUNTING

- It is essential to undertake a preliminary investigation installing a suitable system of cost accounting to know the feasibility of installing cost accounting system to such business.
- **(a) Essential Conditions:** The following conditions are essential for successful functioning of the costing system:-
  - (i.) Material control system should be very efficient.
  - (ii.) The role of cost accounting must be clear.
  - (iii.) The methods of wage payment must be sound and well designed.
  - (iv.) The cost report should be printed forms to facilitate quick compilation.
  - (v.) The cost and financial accounts must be integrated so as to facilitate reconciliation of profit.

# INSTALLATION OF COST ACCOUNTING

- **(b) Essential Factors for Installing a Cost Accounting System:** The following essential factors are to be considered before installing a cost accounting system :-
- **(i) Nature of Industry** –There is no technique or method of costing that can be applied universally. The nature of business should be considered while applying the costing techniques.

# INSTALLATION OF COST ACCOUNTING

- **(ii) Background of Business Unit** –The back ground of business unit includes its existence, position, rate of growth, policy and philosophy of management. It serves as a basis for designing the cost accounts in respect of necessity, simplicity and investment involved in installing cost account.
- **(iii) Selling & Distribution Method** –The warehousing facility, external transport, market research and other promotion measures, terms of sale and promotion of orders from customers are to be considered with regard to distribution process.
- **(iv) Flexibility and Uniformity** – The cost accounting system to be install must be flexible and uniform in operation and must be capable of adoption to changing conditions and facilitates inter firm comparison among various firms belonging to the same industry

# INSTALLATION OF COST ACCOUNTING

- **(v) Product Range** – Range of product must be analyzed in terms of size, models, fashions, area of market and competitors to determine the method of costing to be selected.
- **(vi) Organizational Factors** – Size and type of organization, levels of management, extent of delegation and responsibility, extent of departmentalization, availability of modern office equipments and number of managerial and supervisory staff are to be considered while installing cost accounting.
- **(vii) Area of Control**-It must be given top most priority for exercising control over materials when material control occupies significant are of control.
- **(viii) Reporting and Use of Electronic Data Processing-** The reports of cost data must be frequent and promptitude, while installing cost accounting system. In modern ere use of electronic data processing equipments and computers has become a common practice.
-

# PROCEDURE FOR INSTALLATION

- 
- **(i.) Nature of Business:** Nature of the business of organization like capacity of plant, nature of material and labour, and various processes etc. should be considered before installation of costing system.
- **(ii.) Determination of Cost Centers:** Nature and no. of cost centers required should be decided to control cost.
- **(iii.) Determination of Process:** Suitable system or process should be adopted according to the size of business and nature of product.
- **(iv.) Nature and Quality of Product:** Quality of product, time consumed, and process used etc. should be considered while installing a costing system.
- **(v.) Determination of Extent and Way to Control:** Extent and way to over material, labour and over head should be determination.

# PROCEDURE FOR INSTALLATION

- **(vi.) Arrangement for Flow of Cost Data:** Proper arrangement should be made for the information related to cost.
- **(vii.) Forms:** Standardized forms should be used by all foreman and workers.
- **(viii.) Records to be Maintained:** Complete and accurate records should be maintained to carefully work out.

# Essential of a Good Cost Accounting System

- A good cost accounting should possess the following essential features:
- i) It should be simple, practical and capable of meeting the business concern requirements.
- ii) Accurate data should be used by cost accounting system; otherwise it may distort the output of the system.
- iii) To develop a good system of cost accounting necessary co-operation and participation of executives from various departments of the business is needed.
- iv) The cost of installing and operating the system should be result oriented.
- v) It should not sacrifice the utility by introducing unnecessary details.
- vi) For the introduction of the system a carefully phased programmed should be prepared by using network analysis.
- vii) Management should have faith on costing system and works as a helping hand for its development
- and success.
- 
-




# OBJECTIVES OF COST ACCOUNTING

- Cost accounting aims at eliminating the loopholes in the production process and ensures manufacturing of goods at the lowest possible cost.
- **Control and Reduce Cost:** Cost accounting continuously focuses on managing the cost of production per unit to improve profitability without compromising with the quality of the product.
- **Determine Selling Price:** It provides the total cost incurred in the product or service, which is the base for fixing an appropriate selling price.
- **Assist Management in Decision Making:** The reports and cost sheets generated based on cost accounting back the managerial decisions of the organization



# OBJECTIVES OF COST ACCOUNTING

- **Ascertain Closing Inventory:** It determines the closing inventory value at the end of the financial year.
- **Ensure Profit from Each Activity:** Cost accounting reviews the cost and takes corrective actions at each level to ensure profitability from all business activities.
- **Budgeting:** It generates the estimated cost of products or services to assist in budget planning, implementation and control.
- **Setting Performance Standards:** It provides a standard cost of goods or services to sets a level for the future course of action.

- 
- **Business Expansion:** It estimates the cost of production at different stages, based on this analysis, the management can plan for expansion of the business.
  - **Minimizing Wastage:** Cost control and reduction so attained helps in reducing the wastage during the manufacturing process.
  - **Improves Efficiency:** Cost accounting assures cost management, profit appreciation and less wastage which ultimately enhances the overall production and manufacturing process of products.

# SCOPE OF COST ACCOUNTING

- Cost accounting is being widely applied by the production units to modify the process and maximise the profit.
- Following are the various applicabilities of the cost accounting techniques:

# SCOPE OF CA

- **Cost Analysis:** Cost accounting determines the deviation of the actual cost as compared to the planned expense, along with the reason for such variation.
- **Cost Audit:** To verify the cost sheets and ensure the efficient application of cost accounting principles in the industries, cost audits are done.
- **Cost Report:** Cost reports are prepared from the data acquired through cost accounting to be analysed by the management for strategic decision making.
- **Cost Ascertainment:** To determine the price of a product or service, it is essential to know the total cost involved in generating that product or service.
- **Cost Book Keeping:** Similar to financial accounting; journal entries, ledger, balance sheet and profit and loss account is prepared in cost accounting too. Here, the different cost incurred is debited, and income from the product or service is credited.

# SCOPE OF CA

- **Cost System:** It provides for time to time monitoring and evaluation of the cost incurred in the production of goods and services to generate cost reports for the management.
- **Cost Comparison:** It examines the other alternative product line or activities and the cost involved in it, to seek a better opportunity for generating high revenue.
- **Cost Control:** Sometimes, the actual cost of a product or service becomes higher than its standard cost. To eliminate the difference and control the actual cost, cost accounting is required.
- **Cost Computation:** When the company is engaged in the production of bulk units of a particular product or commodity, the actual per-unit cost is derived through cost accounting.
- **Cost Reduction:** It acts as a tool in the hands of management to find out if there is any scope of reducing the standard cost involved in the production of goods and services. Its purpose is to obtain additional gain.

# LIMITATIONS OF CA

- Cost accounting is not sufficient alone to control or reduce the cost of products or services. It is necessary to use the data so generated to take corrective actions which require a lot of **experience and expertise**.
- Moreover, it differs from the financial accounting we practice in day to day life. To get an accurate result, a **reconciliation statement** has to be prepared.
- In the books of accounts, many entries have to be made twice; once in the final accounts and then in the cost accounts, which is a tedious process. Due to the **lengthy process of duplicate entries**, there is a need for additional efforts from the personnel. Thus it increases the **labour charges** for the organisation.
- It is majorly applicable to the industries, factories and manufacturing units where some production function takes place. It is **less useful for service industries**.