

Introduction of Cost Accounting

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Introduction

- Business needs continuous information regarding cost of business activities to plan accurately for the future , to control business result , and to make a proper appraisal of the performance of persons working in an organization.
- The fulfillment of these goals requires details about the costs incurred and benefits obtained which are provide by cost accounting and management account.
- cost accounting started to be considered more as a technique for cost control a s 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.

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. **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.

Definition of Cost Accounting

- Cost accounting as a tool of management , provides management with detailed records of the cost relating to products operations or functions. It estimated future costs for planning purpose or actual costs for evaluating performance
- The establishment of budgets, standard costs and actual costs of operations, processes, activities or products & the analysis of variances, probability or the social use of funds.
- Cost accounting is a managerial accounting process that involves recording, analyzing, and reporting a company's costs. Cost accounting is an internal process used only by a company to identify ways to reduce spending.
- Cost accounting is helpful because it can identify where a company is spending its money, how much it earns, and where money is being wasted or lost.
- "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**

Nature of cost accounting

Cost accounting is a practice of cost control which is as follows:-

- (a) Cost accounting is a branch of systematic knowledge that is a discipline by itself. It consist its own principles, concepts and conventions which may vary from industry to industry.
- (b) Cost accounting is a science and arts both. It is science because it is a body of systematic knowledge relating to a wide variety of subject and an art because without the efficiency and experience of cost auditor it is not possible to use costing techniques efficiently

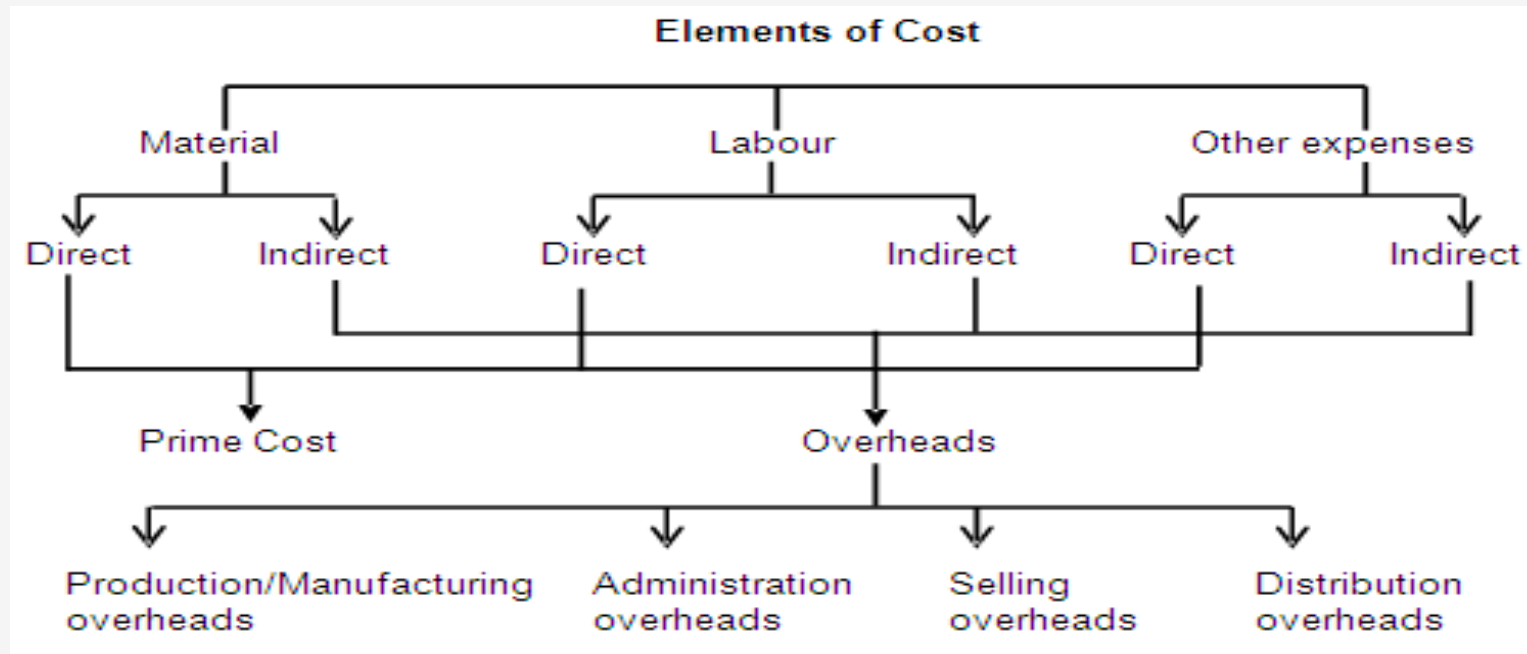
Objectives of Cost Accounting

- To assertion and control cost.
- Determining selling price.
- Facilitating preparation of financial and other statements
- To reduce cost.
- To provide base for operating policy.

Importance of cost accounting

- (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.
- (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

Elements of cost Accounting



Classification of Cost



Advantages of cost Account

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.
- (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.

Limitations of Cost Accounting

These are the following reasons for which cost accounting is criticized by the different sections of society:

- a) Not Reliable: Cost Accounting is based on estimates and so it is not reliable.
- b) Failure of the System:** Cost Accounting system has failed to produce desired results in many concerns. Thus it could be said that this system is at fault.
- c) Unnecessary:** it is not necessary in Business concern as it involves duplication of work.
- d) Inapplicability:** Modern methods of cost accounting are not applicable to every type of industries.
- e) Expenses:** It is expensive because double set of account books has to be maintained and its introduction involves considerable amount of expenditure

Methods of cost accounting

Depending upon the nature of the business and the types of its products, numbers of methods of cost ascertainment are used in practice. The methods of costing are as follows: 6

- a) Job Costing:** In this system the cost of each job is ascertained separately which is suitable in all cases where work is undertaken on receiving a customer's order. Like a printing press, motor work shop etc.
- b) Batch Costing:** It is considered as the extension of job costing. It represents a number of small orders passed through the factory in batch. Each batch here is treated as a separate unit of cost.
- c) Contract Costing:** It is suitable for the firms which are engaged in the work of construction of bridges, roads, buildings etc.
- d) Single or Output Costing:** It is used in the business where a standard production is turned out and it is desired to find the cost of a basic unit of production.
- e) Process Costing:** It is a method of costing used to ascertain the cost of a product which may pass through various processes before completion.
- f) Operating Costing:** The cost of providing a service is known as operating cost and the methods to ascertain the cost of such services is known as operating costing.
- g) Multiple Costing:** In multiple costing, a combination of two or more methods of costing is used in conjunction to determine the cost of final product. This method is used by the industries where different components are separately manufactured and subsequently assembled into the finished product. For e.g.: Motor car, Television, Ships etc.

Techniques of Cost accounting

For ascertaining cost, following techniques of costing are usually used:-

- a) Uniform Costing:** The practice in which common methods of costing for different undertakings in the same industry are used is known as uniform costing.
- b) Historical Costing:** In this technique, ascertainment of cost is done after they have been incurred but the utility of this technique is limited.
- c) Direct Costing:** The practice of charging all direct costs to operations, processes or products leaving all indirect costs to be written off against profit's in which they arise are called as direct costing.
- d) Absorption Costing:** In this all costs, both variable and fixed are charged to production, operations or processes.
- e) Marginal Costing:** The method of ascertaining marginal cost by differentiating between fixed and variable costs. This technique is used to ascertain effect of changes in volume or type of output over the profits
- f) Standard Costing:** The preparation of standard costs and applying them to measure the variations from actual cost and analyzing the causes of variations with a view to maintain maximum efficiency in production is known as standard costing.
- g) Activity Based Costing:** ABC is a system that focuses on activities as fundamental cost objects and utilizes the cost of these activities as building blocks or compiling the costs of other cost objects

THANK YOU