

Introduction to Cost accounting

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COSTING

- The procedure to measure the cost.
- Finding the cost of a product or service by any method or technique.
- ICMA defines costing as “ the techniques and process of ascertaining the cost”.
- The techniques of cost → principles and rules or ascertaining cost.

COST ACCOUNTING

Meaning

Cost accounting is the process of *ascertaining cost of production*. It is concerned with *ascertainment* and *reporting* of cost data to help the managers in decision making and controlling cost.

Definition

ICMA defined cost accounting as “ the process of accounting for cost from the point at which expenditure is incurred or committed to the establishment of its ultimate relationship with cost centres and cost units.”

Cost Accountancy

ICMA, England defined cost accountancy as “ the *application of costing and cost accounting principles, methods and techniques* to the science, art and practice of *cost control and ascertainment of profitability*. It includes the presentation of information derived there from for the purpose of material *decision making*”

Scope of cost accounting

1. Cost ascertainment:

It refers to ascertaining the cost of a product, service or job. It is done through collection of cost, analysis of cost and linking o various expenses to the product, service or job.

2. Ascertainment of profitability:

Ascertain profitability of each product, job or service. It determines the potential of a product, service or job to make profit and it also ascertains the actual profit made by them.

3. Cost presentation/ reporting:

It refers to presenting or reporting of cost data to various managerial personnel to help them in decision making.

4. Cost comparison:

It helps to compare the cost of production of different products or services as well as different periods of time. It helps in decision making. It involves both inter-firm and intra-firm comparison.

5. Cost control:

It ensures that actual cost of production does not exceed the predetermined standards. It is the process of guiding and regulating costs. It is exercised through the techniques of standard costing and budgetary control

6. Cost reduction:

It is the continuous effort to reduce the cost of production of goods and services without affecting their quality.

7. Cost audit:

Verification of the correctness of the cost accounts. It ensures the cost accounts are kept correctly in accordance with the principles of costing . It helps to detect errors and prevent frauds.

Objectives

- To *ascertain the cost of production* of goods manufactured.
- To provide cost data for *fixation of selling price*.
- To provide *analysis of cost* by processes, operations or departments.
- To disclose *wastage of resources* and suggest measures to reduce the wastages.
- To *ascertain profit or loss* of each product, process or departments.
- To *ascertain the profitability* of each activity.
- To exercise *control* over different elements of cost
- To help management in *decision making*.
- To help management in the *formulation and implementation of incentive wage schemes*.
- To assist in the preparation of *interim financial statements*.

Functions

- It helps to *ascertain the accurate cost* of each job, process or product.
- It helps the management in *formulation of policies and decision making*.
- It helps in the *optimum utilisation of resources*.
- It helps in *fixing the price* of goods and services.
- It provides useful data for the *preparation of financial statements*.
- It helps in *cost control* through techniques such as standard costing and budgetary control.
- It helps to make *inter firm and intra firm comparison*.
- It helps in the *implementation of incentive wage system*.
- It provides cost data to *government departments and trade unions*.

Advantages of cost accounting

Advantages to management

- CA provides detailed cost information in the classified manner.
- CA reveals profit / loss of each product, service or job separately.
- It helps management to measure , maintain and improve its performance.
- It helps the management to know the exact cause of profit/loss.
- It supplies accurate cost information and thereby helps the management in fixing selling prices.
- It helps in decision making. Cost report enables to choose the best alternative.
- It helps to identify profitable and unprofitable activities and to take steps to eliminate or reduce the unprofitable ones.

Advantages to employees

- CA reduces all sorts of wastages and inefficiencies and thereby improves the productivity of workers.
- It introduces a sound wage policy in an organisation.
- It introduces incentive wage schemes and bonus plans. It recognizes and rewards the efficiency of workers.
- It leads to lower cost and higher profits. Workers are paid higher bonus on the basis of profit.
- It leads to prosperity and stability of business which offers job security to the workers.

Advantages to creditors

- CA records, enable the creditors to ascertain the solvency and creditworthiness of the business.
- It helps to assess the profitability and future prospects of the business.
- It helps to verify whether the loans given are productively employed or not.
- It leads to business prosperity and stability which in turn provides higher safety to the funds of creditors.

Advantages to government

- CA data helps the govt. in formulating policies such as pricing policies, taxation policies, foreign trade policies, wage policies etc.
- CA data is helpful in the preparation of budgets and national economic policies.
- It helps the govt. departments to assess excise duty, sales tax, income tax etc.
- It helps in settling labour disputes regarding wages, bonus etc.
- It helps to effectively manage and improve the performance of public sector undertakings.

Advantages to the general public (society)

- It reduces wastages and thereby lowers cost of production. It enables companies to sell quality goods at lower price to the people.
- It provides a feeling to the consumers that the prices charged are reasonable.
- It facilitates introduction of better methods of production which helps to provide improved products to the people.
- It improves the profitability of industries which results in increased employment opportunities.
- It helps to curb inflation through continuous efforts on cost control and cost reduction.

Limitations of cost accounting

- It lacks uniform procedures and policies for cost ascertainment. Different cost accountants may follow different procedures.
- It involves lot of estimations and predictions. So, the cost ascertained may not be the true cost.
- Cost data is not suitable for all purposes.
- It is only a helping tool for managerial decision making. Its effectiveness depends on the decisions made on the basis of it.
- It has limited applications. It is suitable to manufacturing and service rendering companies only.
- It is suitable for big concerns only as it requires several steps and formalities.
- It is only a supplementary accounting system. It cannot replace the financial accounting system.

Financial Accounting V/S Cost Accounting

Financial accounting

1. It is followed in all types of concerns.
2. Records all types of transactions of a concern.
3. It records only past transactions. (historical)
4. Records total expenditure of the concern.
5. Discloses profit or loss of the business as a whole.
6. Records expenditure in a subjective manner. i.e., according to their nature.
7. Records only monetary transactions.

Cost accounting

- Followed only in manufacturing and service rendering concerns.
- Records only the transactions relating to manufacture and sale of goods and services.
- It records estimates for the future. (forward looking)
- Records expenditure for each product, process or department.
- Discloses profit or loss of each product, process or department.
- Records expenditure in an objective manner. i.e., according to the purpose for which they are incurred.
- Records monetary as well as non-monetary transactions.

Financial accounting

Cost accounting

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| 8. | The purpose is to ascertain profit or loss and the financial position of the business. | The purpose is to provide cost information to the management or planning, control and decision making. |
| 9. | It is of little use in cost control. | It uses several techniques to control the cost of production. |
| 10. | It does not help in the fixation of selling price. | It provides sufficient cost data to fix selling price. |
| 11. | Prepared and presented usually at the end of the year. | Provides cost reports as and when required by the management. |
| 12. | Maintained according to the requirements of Companies Act and Income tax Act. | Maintained to suit the requirements of management. |
| 13. | Maintenance of financial accounts is compulsory. | Maintenance is optional. But now, it is mandatory for the manufacturing concerns. |
| 14. | Stock is valued at cost or market price whichever is less. | Stock is always valued at cost. |

Methods of costing

The methods of finding costs are:

1. Job costing.
2. Batch costing.
3. Contract costing
4. Process costing
5. Single / unit costing
6. Operating costing
7. Operation costing
8. Multiple costing

Types of costing

1. Absorption costing/ full costing :

charging all costs to the products or services.

2. Marginal costing/ variable costing :

charging variable costs.

3. Direct costing :

process of charging all direct costs to the products, services.

4. Differential costing:

comparing cost of two alternatives for the purpose of decision making.

5. Uniform costing:

use of same costing principles, practices and methods by several undertakings for a common comparison of costs.

6. Historical costing:

ascertainment of costs after they have been incurred.

7. Standard costing:

comparing actual costs with standard costs, analysing variances and taking remedial actions.

8. Activity based costing:

apportionment of overheads.

9. Life cycle costing:

Evaluation of total cost of the product over its economic life.

10. Target costing:

technique to control cost in competitive environment of a product.