

# Unit 1 : Introduction to Cost Accounting

What is cost ??

Cost is a measurement , in monetary terms of the amount of resources used for purpose of production of goods or rendering services. Manufacturing of goods or rendering services involves consumption of resources. Cost is measured by the sacrifice made in terms of resources or price paid to acquire goods and services.

What is costing ??

Costing means the techniques and process of ascertainment of costs

What is Cost Accounting ??

- Its a process of accounting of cost
- Which begins with recording of Income & Expenditure and ends with periodical statements.
- Cost Accounting also involves application of costing principles, methods, & techniques.

**What is the Scope of Cost accounting ??**

- a) Cost Ascertainment : The basic feature of any method of cost accounting is to ascertain the cost of each unit, job, process or department. It deals with not only the actual costs incurred but also the predetermined costs.

The timely and reliable cost information about the cost of output is to be ascertained appropriately by using various methods of costing viz. job costing and process costing.

Such analytical information about the cost of products is provided to the management which becomes the actual basis of the various managerial decisions such as pricing, planning and control.

### - (b) Cost Control : .

The basic feature of any technique of cost accounting is to utilise the detailed cost information to controlling the costs at different stages by using different techniques of cost control to keep the costs at the minimum possible extent to survive in the competitive market.

Cost accounting ultimately aims at improving the overall profitability by controlling the cost more strictly by using various techniques like standard costing, budgetary control, marginal costing etc.

### - (c) Cost Presentation :

The data collected and re-classified systematically is presented scientifically by the cost accounting department in the form of cost statements and cost reports to the different levels of management as and when it is required. The analytical cost reports are basically used by the management internally at various levels for performance appraisal planning, control and decision-making functions

### Functions of Cost Accounting :

- (a) To ascertain cost of product or services rendered.
- (b) To analyse the data and provide suitable information to assist management in decision-making
- (c) To provide information for planning and control through the techniques of standard costing and budgetary control
- (d) To indicate to the management any inefficiencies and waste.
- (e) To provide data for periodical Profit and Loss Accounts and Balance
- (f) To reveal sources of economies in production.
- (g) To assist the management in fixation of selling price.
- (h) To present comparative cost data for different periods.
- (i) To provide the basis for production planning.

(j) To provide information to enable management to take decisions.

## Advantages and Limitations of Cost Accounting :

Advantages of Cost Accounting :

Advantages to the Management:

- (a) It can decide production at optimum level, and utilise the plant capacity to the maximum extent.
- (b) It helps to fix and revise the product prices in a scientific manner.
- (c) It facilitates cost control and cost reduction.
- (d) It reveals idle capacity,
- (e) It helps to check the accuracy of financial accounts.
- (f) It helps in proper valuation of inventory which is necessary to ascertain the profit correctly

Advantages to the Owners :

- (a) It helps owners to earn higher profits and improvement in net worth.
- (b) Higher profits enable the management to pay higher dividend to the shareholders.

Advantages to the Workers :

- (a) It helps management to fix proper remuneration to workers.
- (b) It helps management to evaluate worker's efficiency in a scientific

Advantages to the Government :

- (a) Government can get higher revenue due to increasing taxes on production, sales and income.
- (b) It helps Government to make sound business and economic policies.

## Limitations or Demerits of Cost Accounting

### (a) Expensive :

Highly paid cost accountants and the organisation of costing system involve additional expenditure. However, before installing it, care must be taken to ensure that the benefits derived out of it are more than the investment made on this system of accounting

### (b) More Complex :

Cost accounting system involves number of steps in ascertaining cost such as collection and classification of expenses, allocation and apportionment of expenses etc.

### (c) Limited Applicability :

All business enterprises cannot make use of a single method and technique of costing.

( It all depends upon the nature of the business and type of product manufactured by it.)

### (d) Not Applicable to Small Concerns :

A cost accounting system is applicable only to a large sized business and not suitable for small sized business as it is more expensive.

## Objectives of Cost Accounting:

### (a) Ascertainment of Cost:

This is the primary objective of Cost Accounting.

For the purpose of ascertaining the cost of a product, process or operation, it is necessary to record the expenses incurred, classify them properly and then allocate or apportion it amongst the respective products, processes or departments for calculating total cost of each of these.

### (b) Control of Cost :

Cost control aims at improving efficiency by controlling and reducing cost.

Cost control is becoming more and more important tool because of growing competition

(c) Determination of Selling Price : Cost accounting provides information on the basis of which selling prices of products or services may be fixed. Total cost of production constitutes the basis on which selling price is fixed by adding a margin of profit. Cost accounting furnishes both the total cost of production as well as cost incurred at each and every stage of production.

(d) To provide a Basis for Operating Policy:

Cost data to a great extent helps the management in formulating the policies of a business and in decision-making. Hence, availability of cost data is a must for all levels of management.

Some of the decisions which are based on cost data are :

- i) make or buy decision.
- ii) manufacturing by mechanism s
- iii) whether to close or continue operations
- iv) selling below cost decision.
- v) introduction of new products etc.

(e) Frequent Preparation of Accounts and Other Reports:

Every concern relies upon the reports on cost data to know the level of efficiency regarding purchase, production, sales and operation results. Financial accounts provide information only at the end of the year because value of closing stock is available at the end of the year. Bot cost accounts provide the value of closing stock at frequent intervals by adopting "continuous stock verification system. Using the value of closing stock it is possible to prepare final accounts and to know the operating results of the business.

(f) To provide Data for Cost Reduction :

For survival in the world of competition, it is necessary to keep the prices of products or services as low as possible. It is only possible when cost of production is less. So the management has to make continuous efforts to reduce the cost.

To provide data for cost reduction is one of the important objectives of cost accounting.

It helps the management in finding out new and improved methods to reduce costs.

### Cost Centre :

According to ICMA, London, Cost Centre is defined as, "a location, person or item of equipment (or group of these) for which costs may be ascertained and used for the purpose of control".

Thus, a Cost Centre is a part of the business to which costs can be attributed or charged.

It may be a location (a department, sales area etc.), an item of equipment (a delivery van, lathe machine etc.) or a person (a machine operator, salesman etc.)

The finding out of a proper cost centre and analysis of costs for each cost centre is necessary for cost comparison and cost control.

- To find out the cost of each product or service, expenses should be separated according to each cost centre.
- For each cost centre, one person is held responsible who is supposed to control the cost of that particular cost centre.

### Types of Cost Centre :

#### (a) Production Cost Centre :

It is a cost centre connected with production i.e. machine shop, welding shop, assembly shop etc. The manufacturing and non-

manufacturing costs are charged to product cost centres.

(b) Service Cost Centre:

A Service Cost Centre is one which provides services to the other cost centres. Only non-manufacturing costs are charged to service cost centre.

Examples of service cost centre are canteen, machinery, maintenance department, office service etc.

(c) Personal Cost Centre:

Personal Cost Centre consists of a person or group of persons. Personal Cost Centre follows the organisational structure of a factory

Under this type of cost centre, costs are analysed and accumulated by works manager, sales manager, store-keeper, foreman

(d) Impersonal Cost Centre

It consists of a location or item of equipment. A cost centre relating to location may represent a region of sales, a warehouse, or storeroom. Cost centre relating to an item of equipment should be a machine or group of machine.

(e) Operation Cost Centre:

It is a cost centre which consists of machines/persons carrying out similar operations

(t) Process Cost Centre:

It is a cost centre which consists of a specific process

Factors Affecting Cost Centre: (a) The volume of work to be performed

(b) The extent of cost control that can be exercised.

(c) Responsibilities to be identified.

(d) The use of cost centres to the cost accounting department.

## Cost Unit :

Cost unit is a quantitative unit of product or service or time in relation to which costs are ascertained or expressed.

The unit selected should be the most natural to the business and accepted to all concerned. Therefore, utmost care should be taken while selecting cost units.

Costing means measuring the costs in relation to a unit

Eg. In cement factory , the cost per tonne is found out. In a cloth mill, the cost per meter is ascertained in case of machine, the cost per machine hour is found out etc.

Thus here, tonne, metre and machine hour become the cost units. Hence, we can say that a cost unit is nothing but a unit of measurement of cost.

## Units of Cost in Various Industries :

Each industry has a different cost unit, some of which are given below:

Industry/Product	Cost Unit	Industry/Product	Cost Unit
(a) Automobile	Number	(l) Transport	Tonne km/Passenger km
(b) Bricks	Thousand	(m) Utensils	KG/Tonne
(c) Cotton / Jute	Bale	(n) Cement	Tonne
(d) Chemicals	Litre, Gallon, K.G. Tonne	(o) Cable	Metre or km
(e) Electricity	KWH	(p) Fertilizer	Per tonne
(f) Furniture	Number	(q) TV/Radio/LED Sets	Per Set
(g) Gas	Cubic metre	(r) Building	Per sq.ft./Per sq. mtr.
(h) Hotel / Hospital	Room per day/per bed	(s) Nuts and Bolts	Gross
(i) Mines	Tonne	(t) Sugar & Flour Mills	Quintal
(j) Steel	Tonne	(u) Timber	Cubic foot
(k) Shoes	Pair	(w) Water Supply	Thousand litres / Gallon

<u>FINANCIAL ACCOUNTING (FA)</u>	<u>COST ACCOUNTING (CA)</u>
➤ FA records, reports and analyses financial transaction of a concern.	CA records, reports and analyses cost of each cost Centre of a concern i.e. whether it is Direct cost or Indirect cost.
➤ FA is used even by outside entities. e.g. – investors, creditors, bank etc.	CA is used only by the management of the concern.
➤ FA uses the double entry system for recording financial data.	CA does not use the double entry system for Collecting cost data.
➤ FA results are shown in profit and loss a/c And Balance Sheet.	CA results are shown in costing profit and loss And Cost Sheet.