COST ACCOUNTING

UNIT -1 Meaning, objects, scope of Cost Accounting and its relation with Financial Accounting, Methods/Systems of Cost Accounting

MEANING:

Cost Accounting is the classifying, recording and appropriate allocation of expenditure for the determination of the costs of products and services and for the presentation of suitably arranged data for the purpose of control and guidance of management. It deals with the cost of production, selling and distribution.

Cost Accounting is not restricted to past. It is concerned with the ascertainment of past, present and future cost of products manufactured or services supplied. It is a system of determining the cost of products or services.

According to **R.N. Carter,** “Cost Accounting is defined as a system of recording in accounts the material used and labour employed in the manufacture of certain commodity or on a particular job.”

- It is a process of accounting for costs.
- It is concerned with cost ascertainment and cost control
- It records income and expenditure relating to production for goods and services
- It establishes budgets and standards so that actual costs may be compared to find out deviations or variances.
- Provides statistical data on the basis of which future estimates are prepared and quotations are submitted.
- It involves the preparation of right information to the right person at the right time so that it may be helpful to the management for planning, control and decision-making.
- It is a special part of Financial Accounting.
- Under this adequate control is imposed on elements of cost (material. Labour and expenses).
- Under this cost of incomplete work is also ascertained.
- it is both science and arts.

SCOPE OF COST ACCOUNTING:

1. **Costing:** determining of finding out the cost of product or service by any technique or methods.
2. **Cost Accounting:** it is the process of accounting for cost which begins with recording of expenditure and ends with the preparation of statistical data. It is a means by which cost of products or services are ascertained and controlled.
3. **Cost Control:** it is the guidance and regulation by executive action of the costs of operating an undertaking. The cost can be controlled by standard costing, budgetary control, proper presentation and reporting of cost date and cost audit.

4. **Budgeting:** it is a quantitative expression of a plan of action prepared in advance of the period to which it relates.
5. **Cost Audit:** according to **ICMA London** "the verification of cost accounts and a check on the adherence to cost accounting plan."

OBJECTS OF COST ACCOUNTING:

1. Ascertainment of Costs,
2. Cost Control,
3. Determining Selling Price,
4. Guide to business policy,
5. Frequent preparation of accounts and other reports, etc.

DIFFERENCE BETWEEN FINANCIAL ACCOUNTING AND COST ACCOUNTING:

Points of similarities-

- **(i)** The principle of double entry system is applicable in both the systems of accounts.
- **(ii)** The invoices and vouchers constitute the common basis for recording transactions under both the system of accounts.
- **(iii)** Both throw light on the result of the business.
- **(iv)** Both help the businessman to know the causes for losses of the business.
- **(v)** Both facilitate in comparison of the current period.
- **(vi)** Both help in determining future business policy.
- **(vii)** Under both the accounts profits and losses are ascertained.
- **(viii)** Under both the accounts direct and indirect expenses, raw materials, labours and other expenses are recorded.
- **(ix)** Under both the accounts errors can be removed with the help of comparison.
- **(x)** In both only monetary transactions are recorded.
- **(xi)** Under both the accounts selling price of goods produced can be ascertained.

Points of dissimilarities-

BASIS OF DIFFERENCE	FINANCIAL ACCOUNTING	COST ACCOUNTING
Purpose	External reporting; mainly to owners, creditors, tax authorities, etc.	Internal reporting; to the management
Obligation to maintain accounts	To be maintained compulsorily.	To be maintained voluntarily
Recording	It classifies, records and analyses the transactions according to the nature of expenses.	It records the expenditure according to the purpose for which the costs are incurred.
Control	Does not make use of any control techniques.	Makes use of some important control techniques, e.g., marginal costing, budgetary costing, standard

		costing, etc. to control cost.
Analysis of profit	Discloses profits for the entire business as a whole.	It shows profitability or otherwise of each product, process or operation so as to reveal the areas of profitability.
Duration of reporting	Generally, once in a year	Furnishes cost data at frequent intervals (daily, weekly, monthly, etc.)
Valuation of stock	Stock is valued at cost or market price whichever is less	Stock is valued at cost price.
Reporting of costs	Costs are reported in aggregate	Costs are broken down on a unit basis
Nature of information	Only monetary transactions are recorded	Monetary or non-monetary both transactions are recorded.
Fixation of selling price	These are not maintained with the object of fixing selling prices.	It provided sufficient data for fixation of selling price.

METHODS OF COST ACCOUNTING:

1. **Single costing, unit costing or output costing:** it is adopted in concerns where production is continuous and where only one product or a few types of similar products, which vary only in size, shape and quality and whose product can be measured by a common unit (per quintal, per bag, per ton, per barrel, per kilogram, etc.), are produced.
2. **Job costing:** it is adopted in concerns where the work done is analyzed into different jobs, each jobs being considered as separate unit of cost.
3. **Contract costing or terminal costing:** it is adopted where a job is very big and takes a long time to complete.
4. **Batch costing:** it is adopted in concerns where small components of the same kind are required to be manufactured in large quantities.
5. **Process costing:** it is adopted in concerns where a continuous process of production is carried and the product is homogeneous. In these industries the cost of each process is determined for a given period of time. It is standardized and quite stable; therefore, control is comparatively easier.
6. **Operation costing:** it is a more detailed application of process costing. In this, cost of distinct operation of a process, instead of cost of process as a whole is ascertained.
7. **Operating costing:** it is used in service rendering undertakings.
8. **Uniform costing:** when various undertakings, under the same or under different managements in the same industry, use the same principles or practices of costing, they are said to be using uniform costing. It facilitates inter-firm comparison.
9. **Multiple or composite costing:** this system is applicable to undertakings where a variety of articles are produced, each article differing from other as to prices, material used, process of manufacture, etc. or where varieties of raw materials pass through different processes. Since

more than one method of costing is applied, the method of costing used here is multiple or composite costing.

10. **Departmental costing:** it is applicable where the cost of a department or a cost center is required to be ascertained.
11. **Cost plus method:** where a businessman feels hesitant to quote for a work which is absolutely new to him and new to other persons or contractors and he is unable to estimate the cost of the work offered to him, it is decided with the contractor that he would be paid the total cost of work plus his profit at a certain percent on the total cost.
12. **Target costing method:** in big business houses the cost price of the work is ascertained by experts and experienced persons well in advance or even before the commencement of the work.
13. **Farm costing:** this method of costing helps in calculation of total cost and per unit cost of various activities covered under farming.

TECHNIQUES OF COSTING: it refers to the specialized techniques or procedures adopted for ascertaining cost of products for certain special purposes.

1. **Absorption costing:** this is a traditional technique. This technique is useful in submitting tender or quotations and in preparing job estimates. It is the practice of charging all costs, both variable and fixed to operations, processes or products. This differs from marginal costing where fixed costs are excluded.
2. **Marginal costing:** it is technique of bifurcating the total cost into two classes; (i) variable or marginal costs and (ii) fixed costs, and charging only the variable cost to the product for the purpose of ascertaining its marginal or variable costs and the effect of the changes in volume on profit. It is useful in taking managerial decisions on such matters as the expansion of output, reduction of prices in times of competition and depression, product-mix, etc.
3. **Direct costing:** the technique of charging all direct costs to operations, processes or products and leaving the indirect costs to be written off against the profits to the period in which they are incurred is known as direct costing.
4. **Differential costing:** it is used by the management to decide about the alternative course of action. Under this technique a comparison is made between the cost differential and income differential between two or more courses of action and decision in favour of a more profitable course of action is taken.
5. **Standard costing:** it is the establishment of standard costs and applying them to measure the variances and analyzing the causes if variations with a view to overcome the variances and to maintain maximum efficiency in production.
6. **Uniform costing:** it refers to the adoption of the same costing principles and procedures by all concerns engaged in the same line of activity or industry. It facilitates inter-firm comparison of costs.
7. **Historical costing:** it is ascertainment of costs after they have been incurred. It has a limited utility, though comparisons of costs over different periods yield good result.