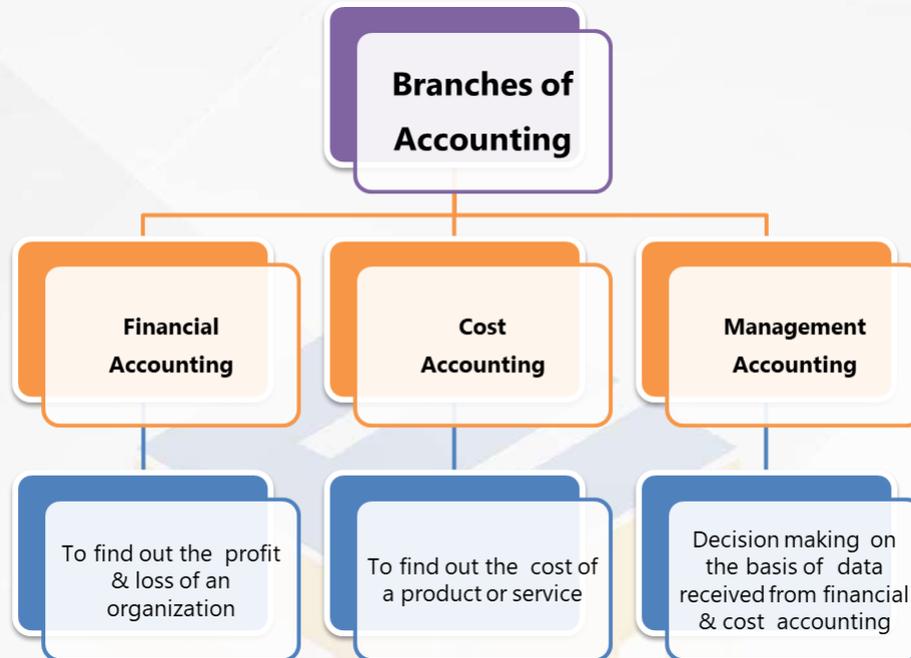


# 1. INTRODUCTION TO COST ACCOUNTING

## Branches of Accounting



## Why cost accounting emerged as a specialized discipline

- Limitations of financial accounting
- Industry become cost consciousness
- Rapid industrial development
- Growing competition
- To control price rise
- Cost control
- To comply with legislations

## Cost, Costing, Cost accounting & Cost accountability

- **Cost**  
 Cost is the total expenditure incurred on production of goods or rendering services it can be  
 Actual i.e. Real cost e.g. Materials cost, wages, salary etc.  
 Notional i.e. imaginary cost / opportunity cost income forgone to taking another option e.g. notional rent
- **Costing**  
 Costing is defined as the technique and process of ascertaining costs.  
 Just calculation of cost
- **Cost accounting**  
 It is the process of accounting for cost Which begins with recording of income and expenditure and ends with the preparation of periodical statements & reports for ascertainment & controlling costs.  
 Calculation of cost & keeping control on cost
- **Cost accountability**  
 Cost accountability is defined as 'the application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control and the ascertainment of profitability'.  
 Application of cost accounting principles, methods & techniques for cost ascertainment, control & ascertain profitability

### Objectives of Cost Accounting



## Scope of Cost Accountancy



## Advantages of Cost Accounting System

- It reveals unprofitable activities, losses or inefficiencies in any form such as wastage of manpower, material, & resources
- It locates the exact causes for decrease or increase in the profit or loss
- It identifies the unprofitable products so that these may be eliminated
- It provides data and information to the management for decision making
- Useful for price fixation purposes
- Optimum level of efficiency can be set using Standard Costing & Budgetary Control methods
- Cost comparison helps in cost control
- Provides ready figures for use by the Government, wage tribunals and boards, and labour and trade unions
- When a concern is not working to full capacity due to various reasons the cost of idle capacity can be readily worked out
- Cost audit in the organization prevents manipulation and fraud and assists in furnishing correct and reliable cost data to the management

## Limitations of Cost Accounting system

**Difficulty in classification of cost**

**Expensive, It require considerable amount of additional work**

**Need for preparation of reconciliation for verification of accuracy**

**Not universally applicable , Lack of uniform procedures & formats**

**Large number of conventions , estimates & flexile factors are used**

**Results can be taken as mere estimates , Inefficiency**

## Prerequisites for Installation of Cost System

1. The nature, method and stages of production, the number of varieties and the quantity of each product and such other technical aspects should be examined.
2. The size, layout and organization of the factory should be studied.
3. The methods of purchase, receipt, storage & issue of materials should be examined.
4. The wage payment methods should be studied.
5. The requirements of the management and the policy adopted by them towards cost control should be kept in view.
6. The cost of the system to be installed should be economic.
7. The system should be simple, easy to operate, minimum clerical work & expenses.
8. The system should be so designed that cost control can be effectively exercised.
9. The system should incorporate suitable procedure for reporting to the various levels of management..

## Requisites of a good Cost Accounting System

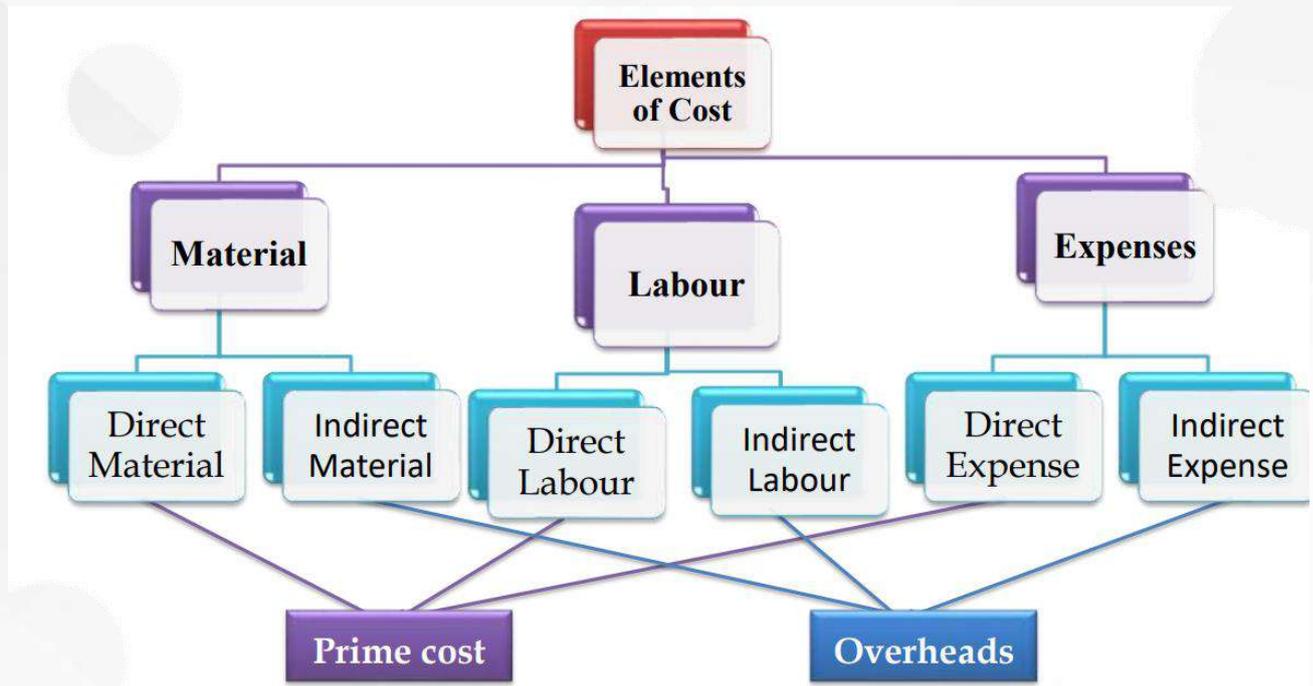
- The cost accounting system should be simple and practical. It should be able to meet the requirements of the organisation.

- The data and information used by the cost accounting system should be authentic and accurate enough to present accurate reporting in order to facilitate the management for taking right decisions.
- There is a need for uniformity and consistency in classifying, treating and reporting cost data and information so that it can facilitate comparability of the results of the system.
- With a view to ensuring clarity of the results there should be integration of the cost accounting system with financial accounting, operation research, statistics, taxation etc.
- The cost accounting system should have enough flexibility in order to accommodate necessary amendments and modifications for the purpose of incorporating changes in technical, regulatory and other requirements.
- The management should be satisfied with the implementation of cost accounting system that facilitates the management in taking strategic business decisions.

### Differences between Financial and Cost Accounting

Financial Accounting	Cost Accounting
It provides the information about the P&L account & balance sheet to owners & other outside partners	It provides information's to the management for decision making
Emphasis on recording aspect without attaching any importance to control	It provide detailed system of control for materials , labour & overheads costs with the help of standard costing & budgetary control
It report operating result & financial position usually at the end of the year	It gives information's through cost reports to the management as and when desired
Whole business	Product wise
Use actual figures and facts only..	Use of facts ,figures ,estimates & standards.
Does not consider efficiency of workers , plant & machinery	consider efficiency of workers , plant & machinery
Classify expenses on the basis of nature	Classify expenses according to the purpose
Standard formats are available	No standard formats
Stocks valued at lower of Cost or Market price	Stocks are valued at Cost only
Mandatory	Voluntary

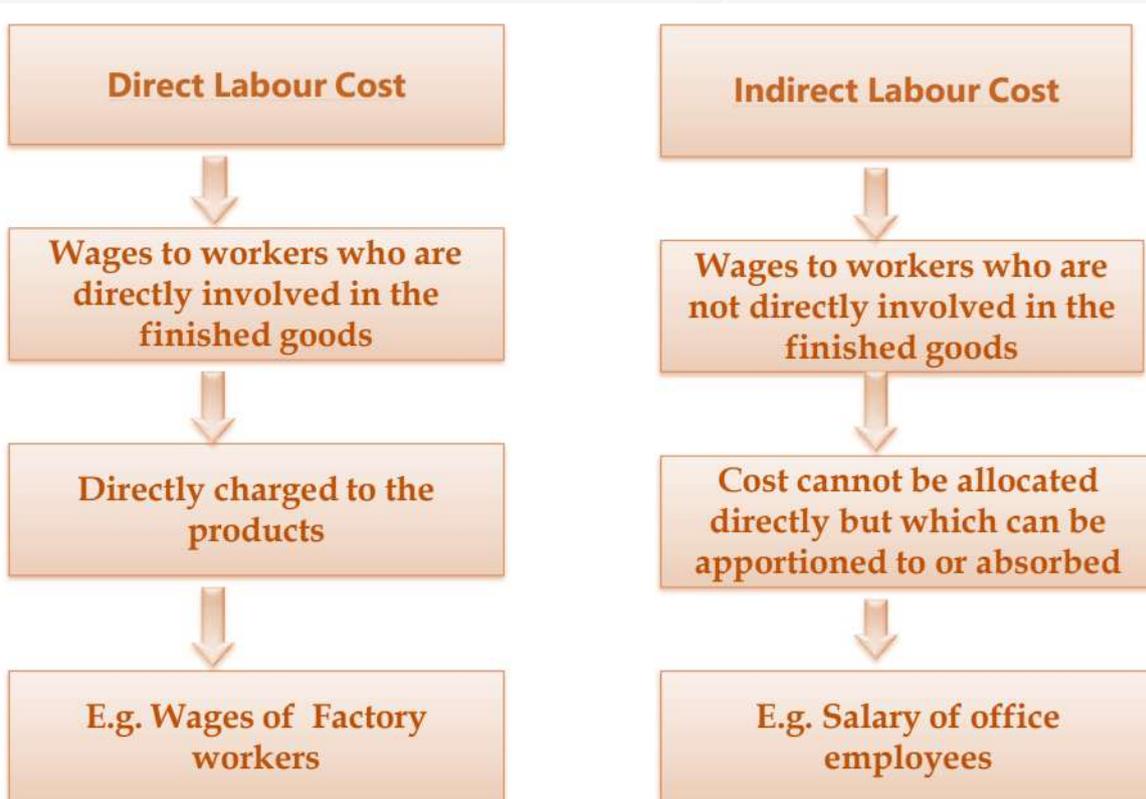
## Elements of Cost



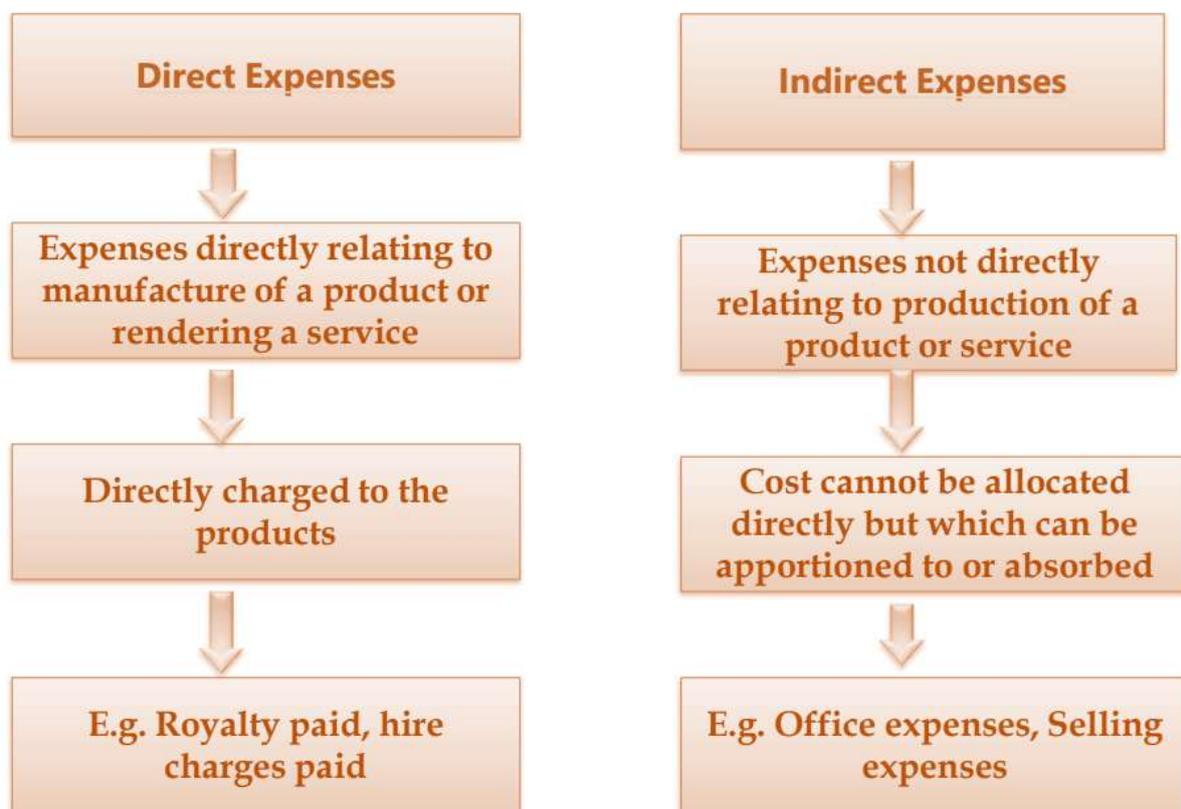
## Material Cost



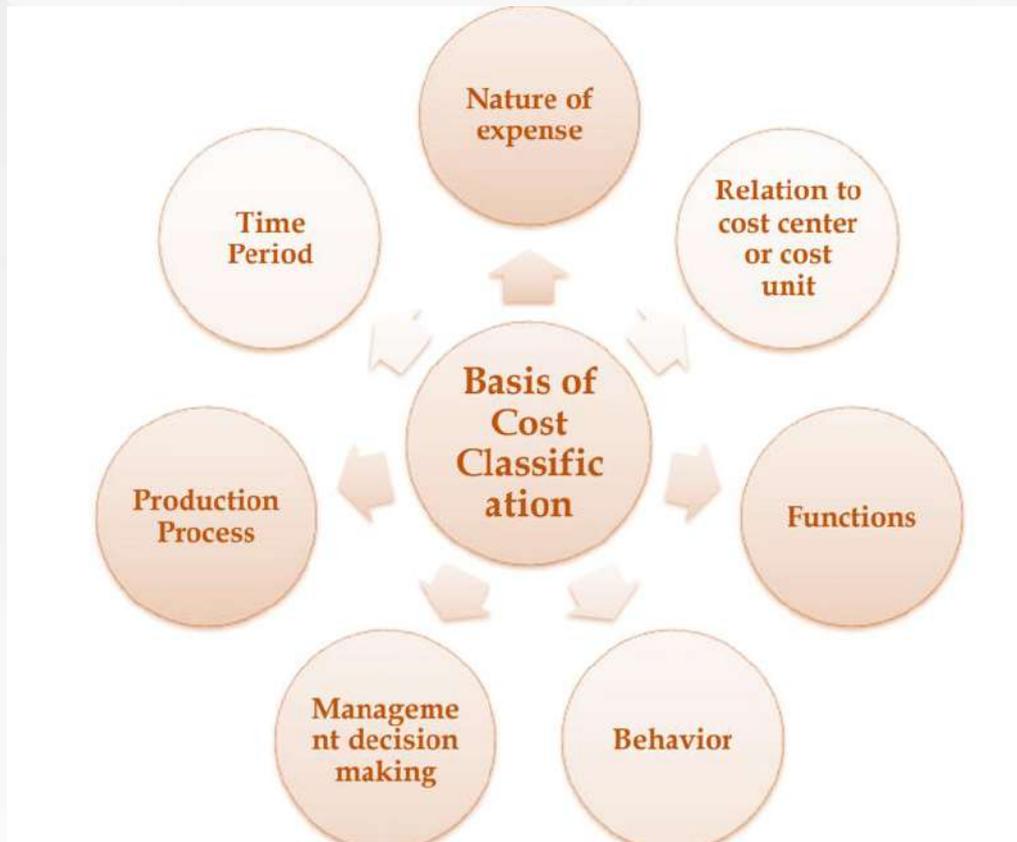
## Labour Cost



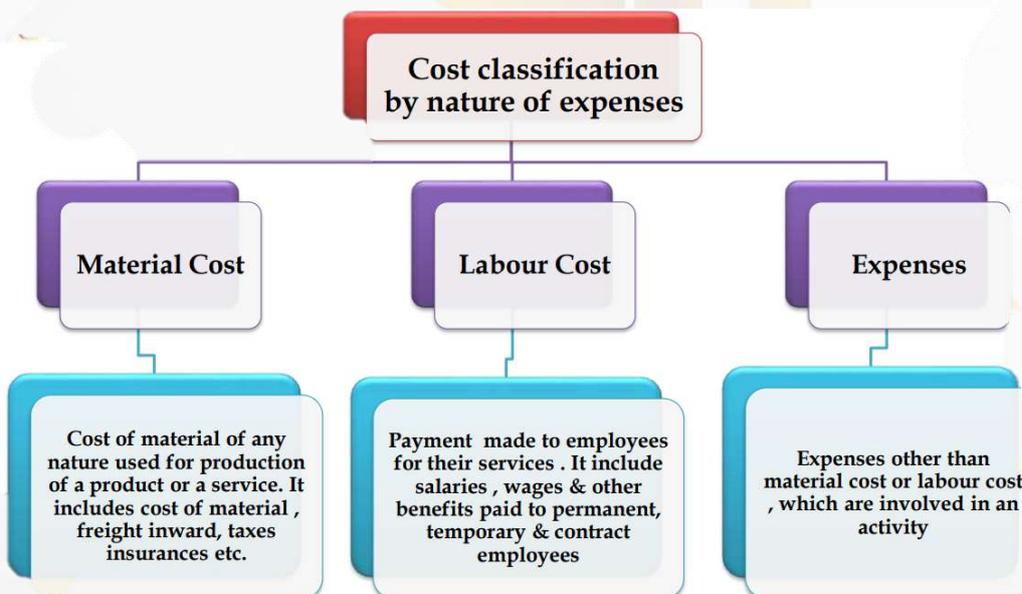
## Expenses



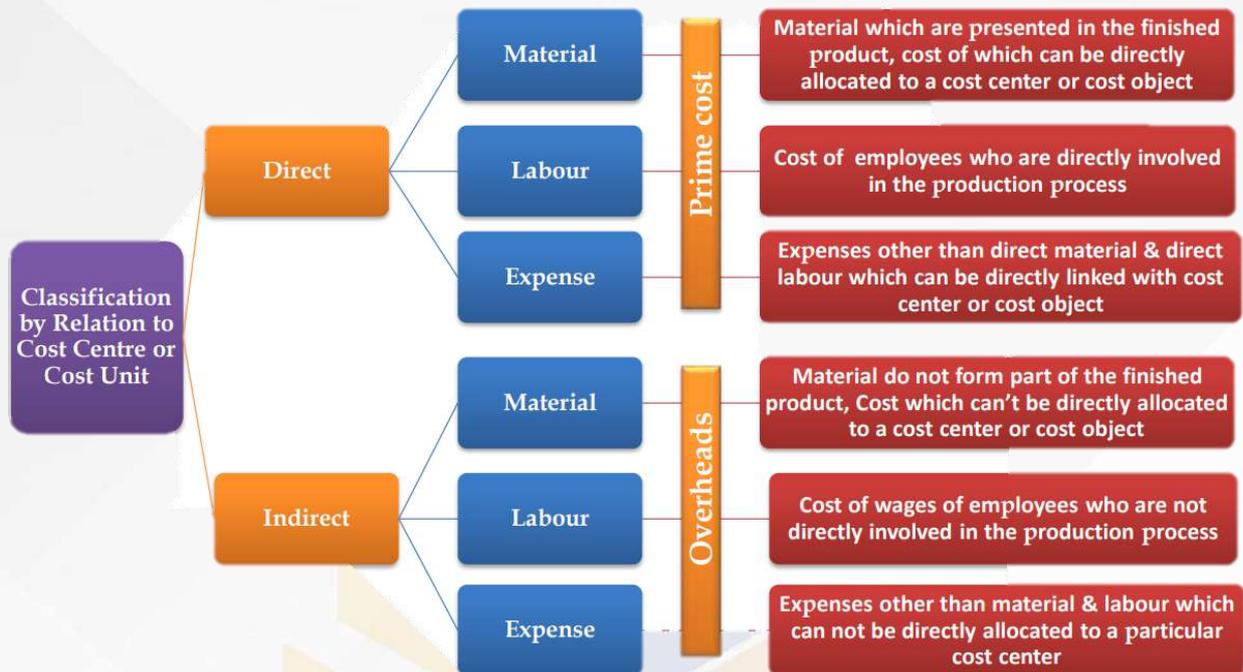
## Basis of Cost Classification



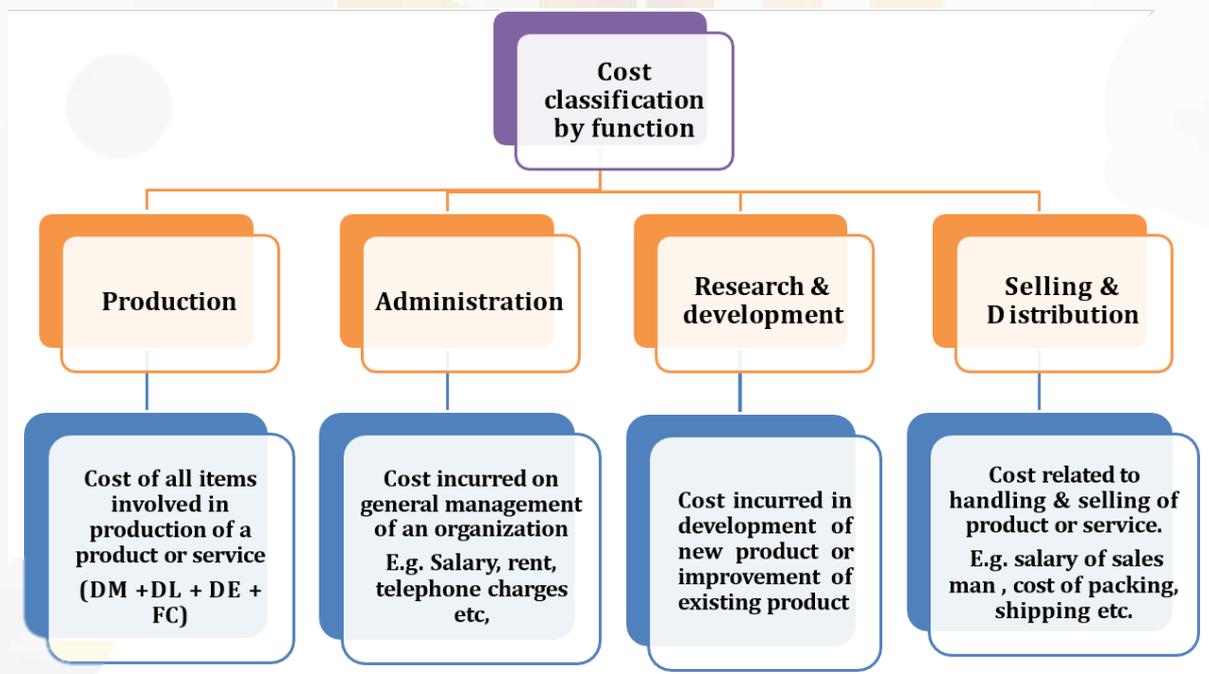
## Cost classification by nature of expenses



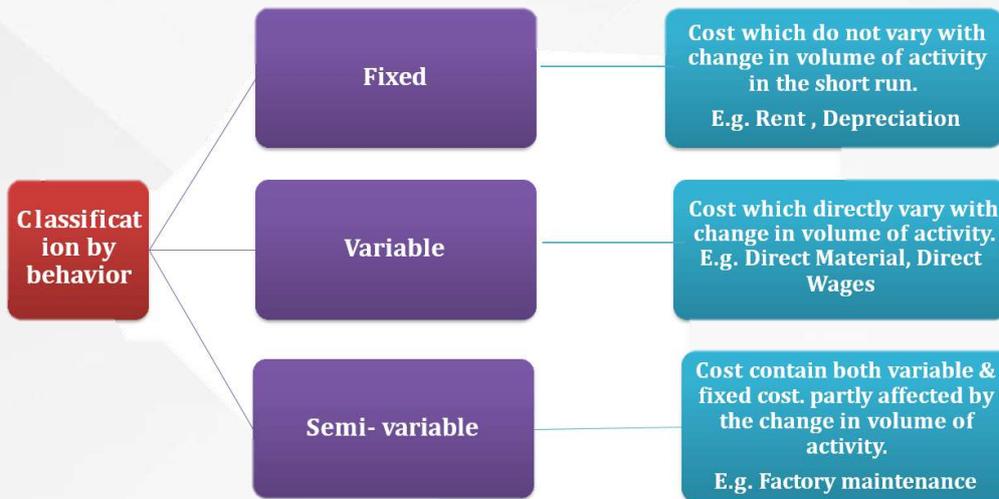
## Classification by Relation to Cost Centre or Cost Unit



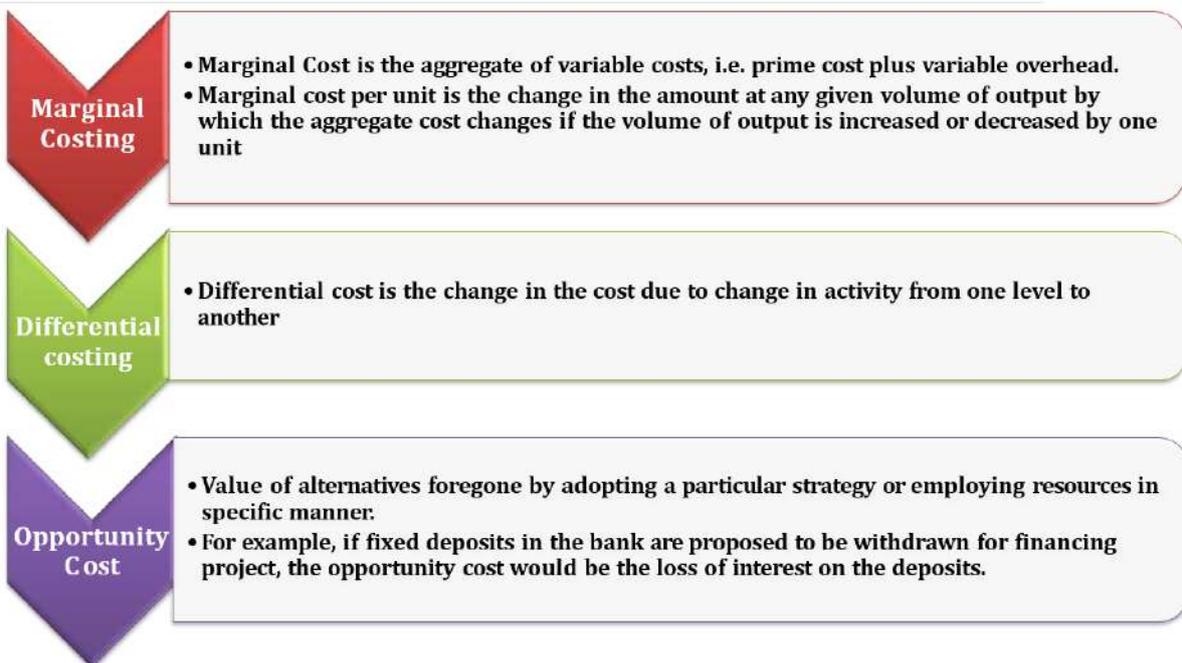
## Cost classification by function

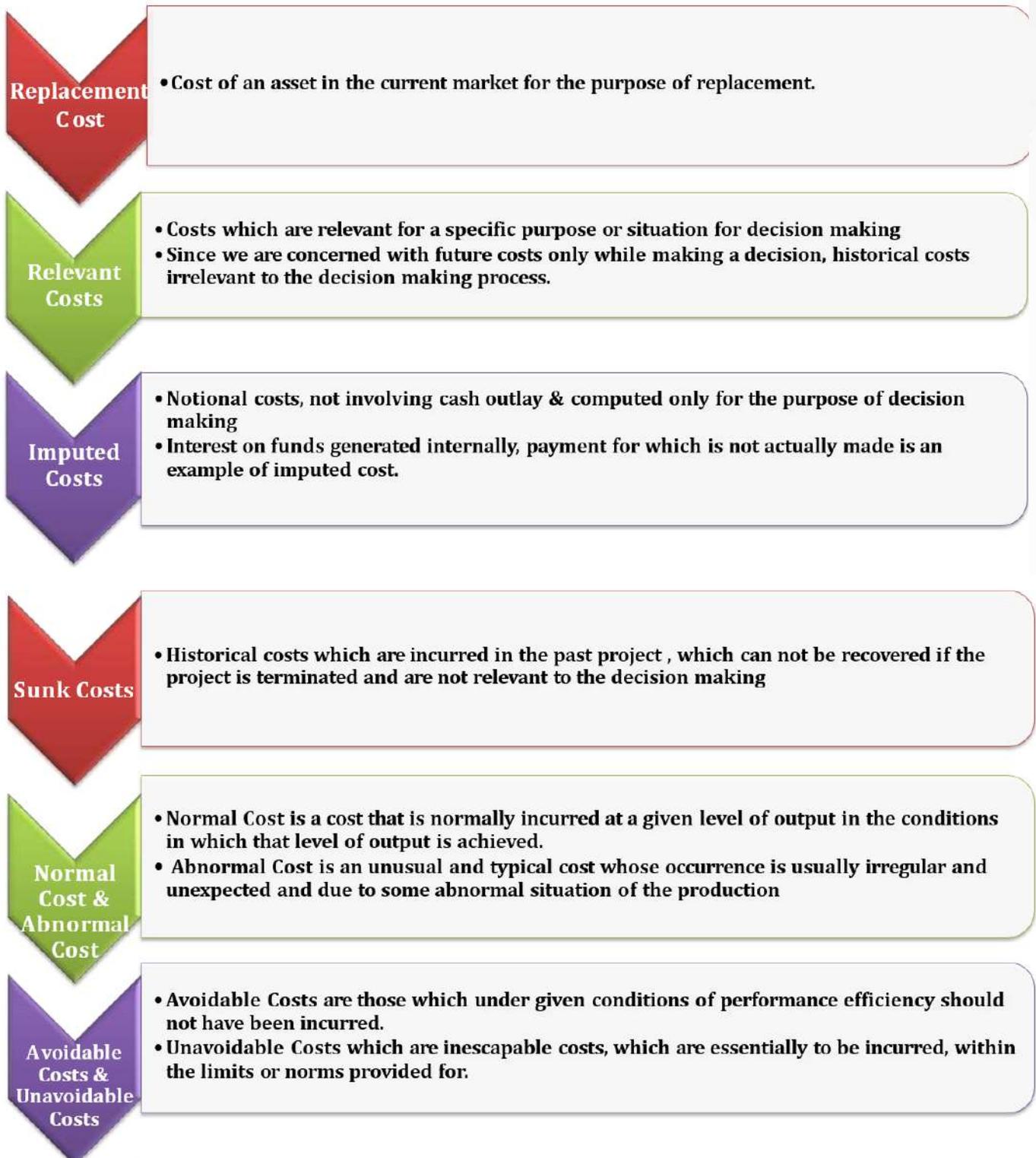


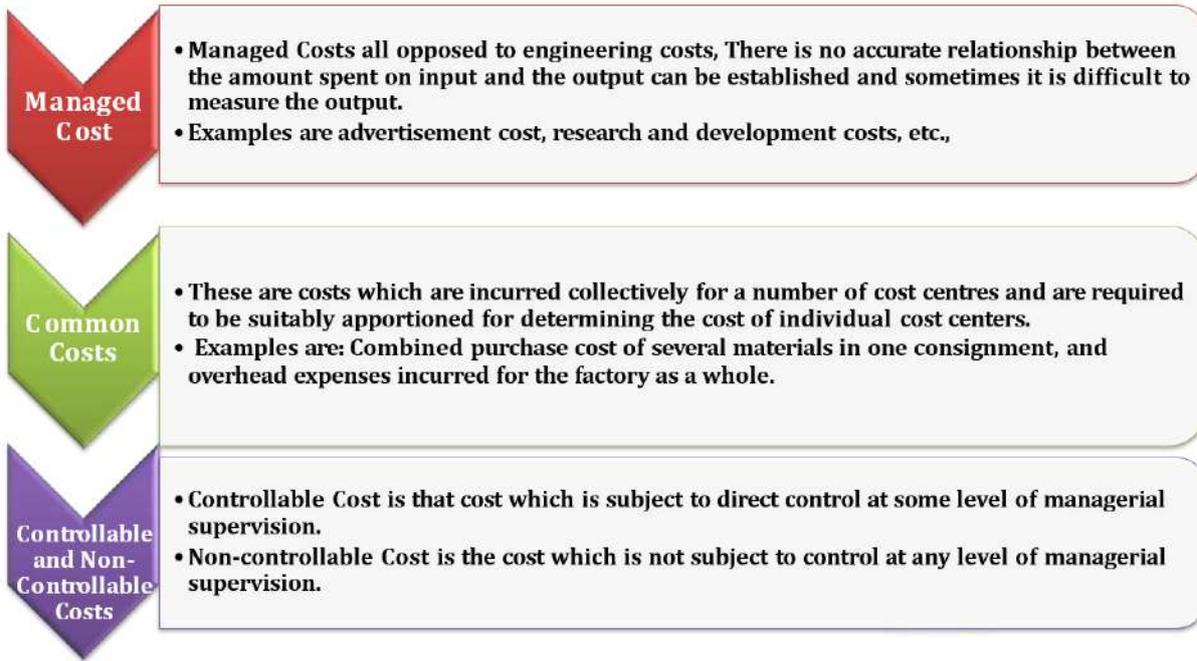
## Classification by behavior



## Classification based on Costs for Management Decision Making





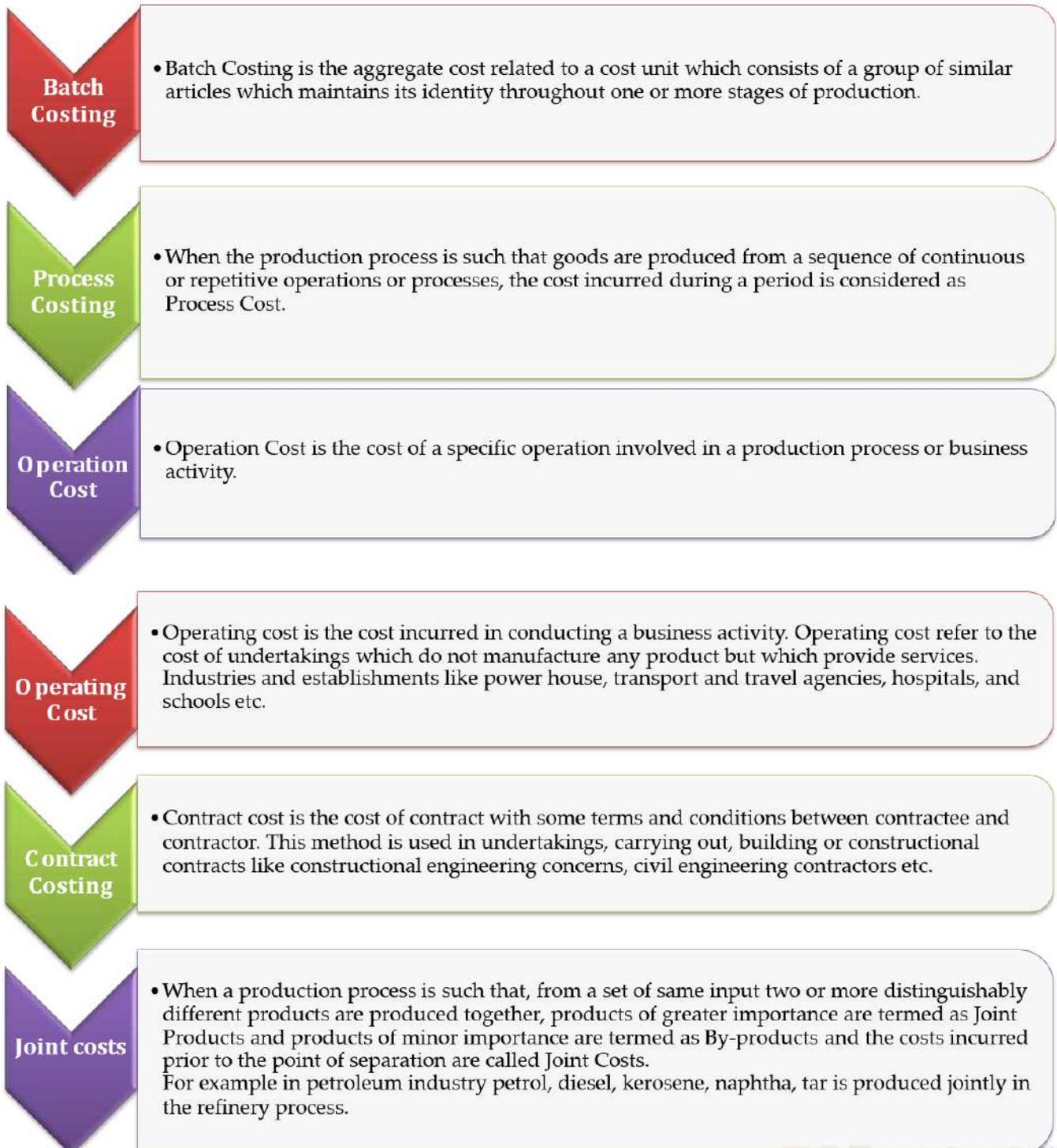


### What is explicit and implicit cost?

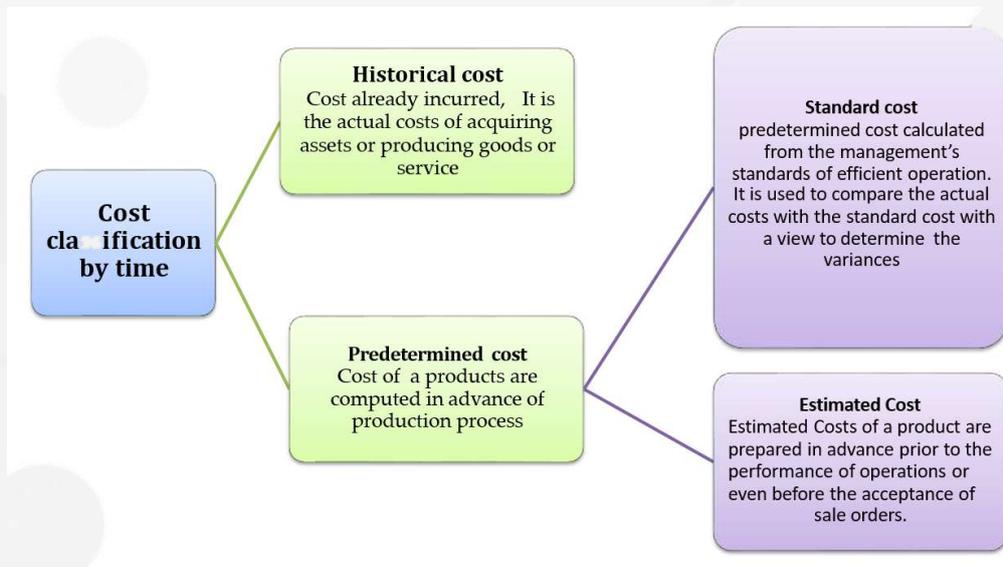
Explicit costs are out-of-pocket costs for a firm—for example, payments for wages and salaries, rent, or materials. Implicit costs are the opportunity cost of resources already owned by the firm and used in business—for example, expanding a factory onto land already owned.

### Cost classification by nature of production or process

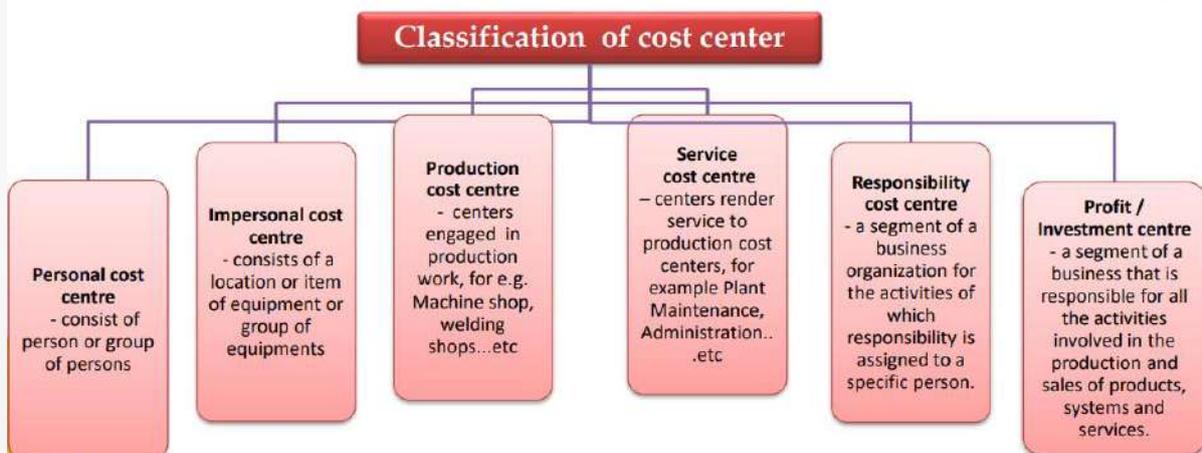
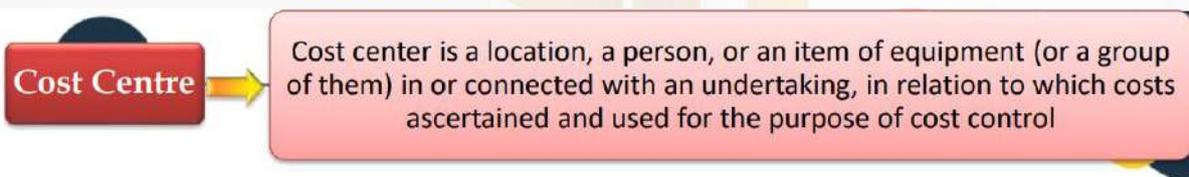
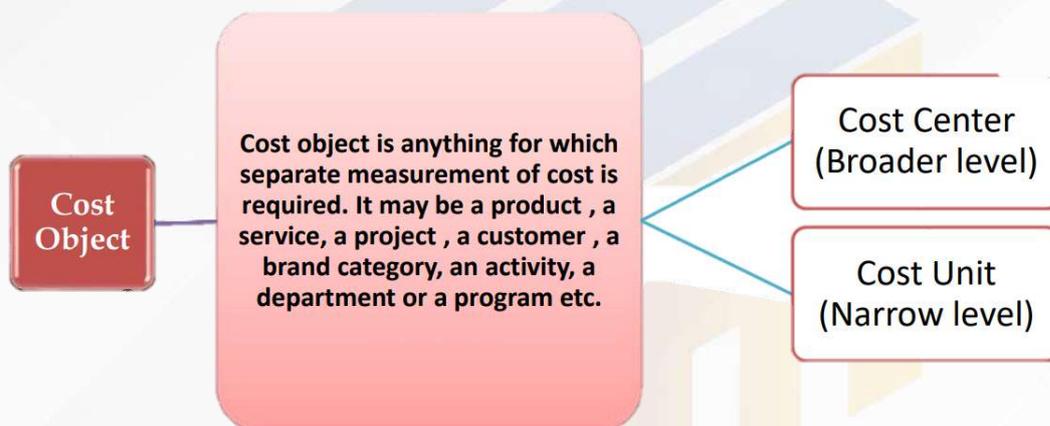




## Cost classification by time



## Cost Cente & Cost Unit

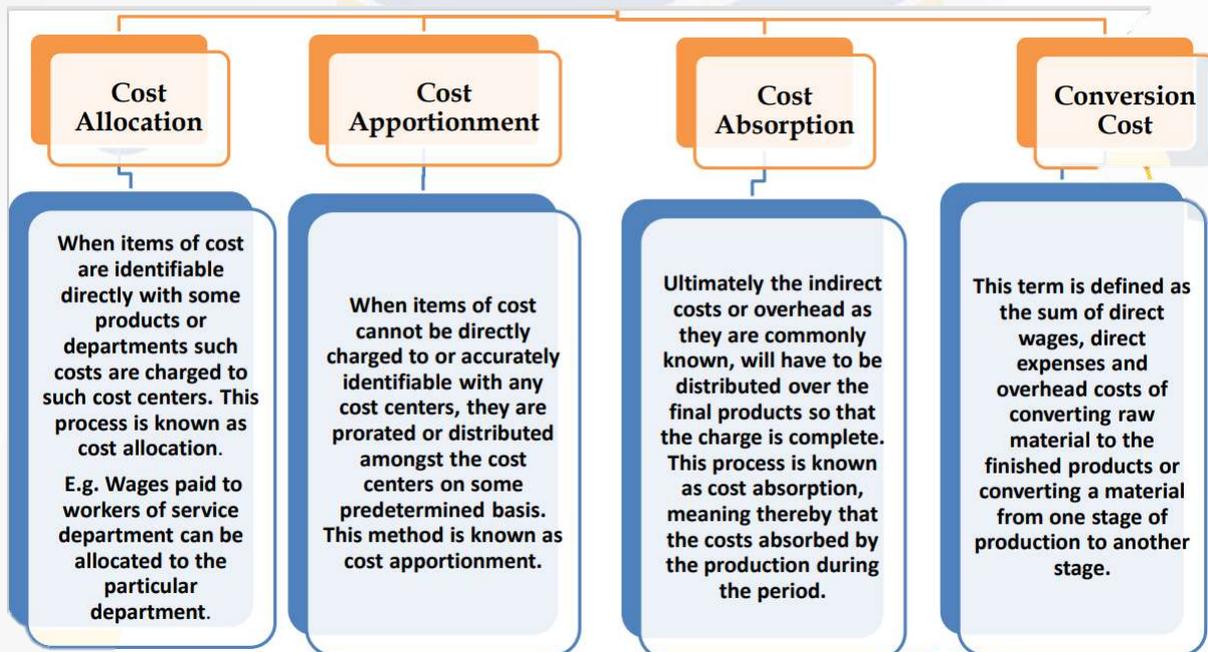


## Cost Unit

It is a unit of quantity of a product , service or time (or combination of these) in relation to which costs may be ascertained or expressed

### Examples of cost units

Industry / Product	Cost Unit
Automobile	Number of vehicles
Cement	Tonne
Education	Student year
Power - Electricity	Kilowatt Hour
Professional Service	Chargeable Hours
Transport	Tonne-Kilometre, Passenger-Kilometre



## Cost Control & Cost Reduction

### Cost Control

Cost Control is defined as the regulation by executive action of the costs of operating an undertaking, particularly where such action is guided by Cost Accounting

### Cost Reduction

Cost reduction may be defined as the real and permanent reduction in the unit costs of goods manufactured or services rendered without impairing their suitability for the use intended. As will be seen from the definition, the reduction in costs should be real and permanent

Two ways of cost reduction are

1. By reducing expenditure, the volume of output remaining constant, and
2. By increasing productivity, i.e., by increasing volume of output and the level of expenditure remains unchanged

### Steps in Cost Control



### Advantages of Cost Control



Cost Control	Cost Reduction
(a) Cost Control represents efforts made towards achieving target or goal.	(a) Cost Reduction represents the achievement in reduction of cost.
(b) The process of Cost Control is to set up a target, ascertain the actual performance and compare it with the target, investigate the variances, and take remedial measures.	(b) Cost Reduction is not concern with maintenance of performance according to standard.
(c) Cost Control assumes the existence of standards or norms which are not challenged.	(c) Cost Reduction assumes the existence of concealed potential savings in standards or norms which are therefore subjected to a constant challenge with a view to improvement by bringing out savings.
(d) Cost Control is a preventive function. Costs are optimized before they are incurred.	(d) Cost Reduction is a corrective function. It operates even when an efficient cost control system exists
(e) Cost Control lacks dynamic approach.	(e) Cost Reduction is a continuous process of analysis by various methods of all the factors affecting costs, efforts and functions in an organization.

