***B.COM 4th SEMESTER (NON-CBCS)***

***COST AND MANAGEMENT ACCOUNTING (MANAGEMENT MAJOR)***

***PAPER- 405***

***GROUP- A : COST ACCOUNTING***

***UNIT 1***

***INTRODUCTION TO COST ACCOUNTING***

Q1. **Explanation of certain cost accounting concepts.**

1. **COSTING** – The term costing is defined by the Institute of Cost & Management Accounting (ICMA) London as “the technique and process of ascertaining costs.”

In simple words, costing is a systematic procedure for determining the unit cost of output produced or service rendered.

1. **COST ACCOUNTING** - KOHLER defines Cost Accounting as “That branch of accounting dealing with the classification, recording, summarisation and reporting of current and prospective costs.”

In simple words, Cost Accounting is that part of accounting which identifies, measures, analyses and reports the various elements of direct and indirect costs associated with manufacturing of goods or providing costs of services.

1. **COST ACCOUNTANCY** – The Institute of Cost & Management Accounting (ICMA) London defines Cost Accountancy 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. It includes the presentation of information derived there from for the purpose of managerial decision making.”

In simple words Cost Accountancy is a wider term which contains theoretical and practical aspects of several subjects like costing, cost accounting, budgetary control, cost control and cost audit.

1. **COST CENTRE** - Institute of Cost & Management Accounting (ICMA) London defines Cost Centre as “A location, a person or an item of equipment (or a group of these) in respect of which costs may be ascertained and related to cost units.”

In simple words, a cost centre is the smallest organisational segment or area of activity to accumulate costs. A cost centre is an individual activity or a group of similar activities for which costs are accumulated. Example: a cost centre may be a location (a department or section), an area( a sales area) or an item of equipment(a machines delivery vehicle) etc.

1. **COST** – Cost is the amount of resources given up in exchange for some goods or services. The resources given up are money or money’s equivalent, expressed in monetary units. ICWA (Institute of Cost and Works Accountants) defined the term ‘cost’ as “The amount of expenditure incurred on or attributable to a specified thing or activity.”
2. **OPPORTUNITY COSTS** - Opportunity Cost is the value of the benefits which is forgone by not choosing the second best alternative in favour of the best one. It is the maximum possible alternative earning which might have been earned if the productive capacity or service is put to some alternative use. Thus if we decide to follow one alternative, we are also deciding not to follow another. The benefits given up are measured in terms of money and such money value is the opportunity cost. This is relevant for decision making.
3. **SHUTDOWN COSTS** – Shutdown costs are the costs which are incurred if a department or a division or an enterprise or a machine is closed temporarily. Thus shutdown costs are defined as those costs which could be incurred in the event of suspension of the operation of a department or division of an enterprise or a plant and the costs which would be saved if the operations are continued.
4. **REPLACEMENT COST** – It is the cost at which an identical asset or a material could be purchased or acquired in order to replace the existing one (asset or material). Thus replacement cost is the current market price of an asset or material which is intended to replace the existing one. It does not include any cost which is associated with the improvement of an asset or a material.
5. **PROFIT CENTRE** - Profit centre is a segment of activity of a business to which both revenues and costs are assigned and the profit of that segment of activity is measured. It is created to delegate responsibility to an individual and to measure his performance. Example- department in departmental stores.

Q2. **Distinguish between Costing, Cost Accounting and Cost Accountancy**.

**Answer** –

**Difference # Cost Accountancy:**

1. Cost Accountancy is broadest in its nature.

2. It is concerned with formulation of costing principles, techniques and methods to be adopted by a business.

3. Periodicity of functioning in cost accountancy is a starting point.

4.The persons involved are management accountant.

**Difference # Costing:**

1. Costing is broader in its scope.

2. It is concerned with ascer­tainment of cost.

3. Periodicity of functioning in costing begins where cost accountancy ends.

4. The person involved is cost accountant.

**Difference # Cost Accounting:**

1. Cost Accounting is narrow in its scope.

2. It is concerned with record­ing of cost.

3.Periodicity of functioning in cost accounting begins where costing ends.

4. The persons involved are cost clerks.

Q3. **What is meant by Cost Accounting? In what essential respects does Cost Accounting differ from Financial Accounting?**

**Answer** - KOHLER defines Cost Accounting as “That branch of accounting dealing with the classification, recording, summarisation and reporting of current and prospective costs.”

In simple words, Cost Accounting is that part of accounting which identifies, measures, analyses and reports the various elements of direct and indirect costs associated with manufacturing of goods or providing costs of services.

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| **BASIS FOR COMPARISON** | **COST ACCOUNTING** | **FINANCIAL ACCOUNTING** |
| **Meaning** | **Cost Accounting is an accounting system, through which an organization keeps the track of various costs incurred in the business in production activities.** | **Financial Accounting is an accounting system that captures the records of financial information about the business to show the correct financial position of the company at a particular date.** |
| **Information type** | **Records the information related to material, labour and overhead, which are used in the production process.** | **Records the information which is in monetary terms.** |
| **Type of cost is used for recording** | **Both historical and pre-determined cost** | **Only historical cost.** |
| **Users** | **Information provided by the cost accounting is used only by the internal management of the organization like employees, directors, managers, supervisors etc.** | **Users of information provided by the financial accounting are internal and external parties like creditors, shareholders, customers etc.** |
| **Mandatory** | **No, except for manufacturing firms it is mandatory.** | **Yes for all firms.** |
| **Time of Reporting** | **Details provided by cost accounting are frequently prepared and reported to the management.** | **Financial statements are reported at the end of the accounting period, which is normally 1 year.** |

Q4. **Why are cost accounts necessary? (OR) What are the various objectives of cost accounting?**

**Answer**- Cost accounting serves various purposes which justify its introduction in a business unit. Following are the purposes for which cost accounting is needed:

1. **Product costing** - Product costing means the ascertainment of cost per unit by accumulating manufacturing and other costs. It helps in:

* Determination of selling price.
* Analysis and classification of costs of production.
* Submission of quotations
* Valuation of inventory in order to facilitate the preparation of final accounts.

1. **Planning and Control** - Cost accounting creates useful cost data and information for planning and control by the management. The following tools of planning and control are provided by cost accounting :

* Determination of standard costs on the basis of cost data and other cost information as provided by cost accounting.
* Preparation of budgets
* Comparison of actual performance with budgeted performance and
* Fixation of responsilities and adoption of remedial measures.

1. **Cost Reduction** – Cost data and other cost information are analysed, the causes of wastages and inefficiencies are determined and suitable action is taken to eliminate them. Thus the cost of production and selling prices can be reduced. Again productivity of the labour force can be increased by imparting adequate training and unnecessary production processes can be abolished by careful study of the production processes. All these lead to cost reduction.
2. **Decision Making** - Cost accounting provides useful cost data and costing techniques for decision making purpose and determining business policy. Management can use the techniques of standard costing , marginal costing, differential costing, responsibility centre costing for selecting the best one out of many alternatives in certain situations such as :

* To make or buy decision;
* Whether or not price should be reduced for increased sale;
* Whether or not a new product should be introduced;
* Whether or not an investment should be made in any asset;
* Whether or not the factory should be shut down, etc.

Q5 **Discuss the advantages and limitations of Cost Accounting.**

**Answer** - **Some of the advantages of Cost Accounting are as follows:**

#### 1. Measurement and Improvement of Efficiency:

The chief advantage to be gained is that Cost Accounting will enable a concern to, first of all, measure its efficiency and then to maintain and improve it. This is done by suitable comparisons and analysis of the differences that may be observed. For example, if materials spent upon a pair of shoes in 2001 come to Rs. 100 and for a similar pair of shoe the amount is Rs. 120 in 2002. It is an indication of decline in efficiency.

#### 2. Profitable and Unprofitable Activities:

It will throw light upon those activities which bring profits and those activities which result in losses. This will be done only if the cost of each product or each job is ascertained and compared with the price obtained.

#### 3. Fixation of Prices:

In many cases a firm is able to fix a price for its products on the basis of the cost of production. In such a case, price cannot be properly fixed if no proper figures of cost are available. In case of big contracts, no quotation can be made unless the cost of completing that contract can be ascertained.

#### 4. Guide in Reducing Prices:

In certain periods it becomes necessary to reduce the price even below the total cost. This will be so when there is a depression or slump. Costs, properly ascertained, will guide management in this direction.

#### 5. Information for Proper Planning:

For a proper system of Costing, it is necessary to have detailed information about the facilities available about machine and labour capacity. This helps in proper planning of work so that no section is overworked and no section remains idle.

**Some of the disadvantages of Cost Accounting are as follows:**

**1. Lack of uniformity:**

Cost accounting lacks a uniform procedure. It is possible that two equally competent cost accountants may arrive at different results from the same information. Keeping this limitation in view, all cost accounting results can be as mere estimates.

**2. Conceptual diversity:**

There are a large number of conventions and flexible factors such as classification of cost into its elements, issue materials on average or standards price, apportionment of overhead expenses, arbitrary allocation of joint costs, division of overhead into fixed and various and variable costs, division of cost into normal and abnormal and controllable and non-controllable and adoption of marginal and standard costs due to which it becomes difficult to have exact costs. In which a contacts, the reliable of cost accounting might be low.

**3. Costly:**

There are many formalities which are to be observed by a small and medium size concerned due to which the establishment and running costs are so much that it becomes difficult for their concerned to afford us cost. Thus it can be used only by big concerned.

**4. Ignorance of futuristic situation:**

The contribution of cost accounting for heading futures situation has not been much for example, it is has not evolved so far any tool for heading inflation situation.

**5. Lack of double entry systems:**

Under cost accounting a double entry system is not adopted that does not enable to checks the arithmetic's accuracy of the transaction and locate the errors.

**6. Developing stage:**

Cost accounting is to development stage since its principle concepts and conversions are not fully developed.

Q6 **What is a cost sheet? Explain its advantages.**

**Answer** - Cost sheet or statement of cost is a statement prepared at a given interval of time showing the various elements of costs of a product or a service or a job in total as well as per unit of output produced during the period. It is presented in a columnar form and arranged in a logical order under different heads. It is prepared to show the detailed cost of the total output for a certain period.

It is only a memorandum statement and does not form part of the double entry system. Additional columns can be provided to indicate cost per unit at different stages of production or to enable comparison to be made of the current costs with that of historical costs.

**Advantages of Cost Sheet:**

The main advantages of a cost sheet are:

1. It indicates the break-up of the total cost by elements, i.e. material, labour, overheads, etc.
2. It discloses the total cost and cost per unit of the units produced.
3. It facilitates comparison.
4. It helps the management in fixing selling prices.
5. It acts as a guide to the management and helps in formulating production policy.
6. It enables to keep control over cost of production.
7. It helps the management in submitting quotations or preparing estimates for tenders.
8. It is a simple and useful medium of communication of costs to various levels of management.

**COST SHEET -** The cost of a product consists of 3 elements – material cost, labour cost and other expenses. These are known as elements of cost.

Cost can be classified as direct cost and Indirect Cost. Thus total cost = direct cost + indirect cost

Grouping of cost:

1. Prime Cost = direct materials consumed + Direct labour + Direct Expenses
2. Factory Cost/Work Cost = Prime Cost + factory /work overhead
3. Cost of Production = work cost + office & administrative overhead
4. Cost of Sales = Cost of Production + Selling & distribution overhead
5. Profit = Sales – Total Cost

**NOTE (Important) Items Excluded while preparing the Costsheet**

The items of expenses, losses or incomes which are related to capital assets, appropriation of profits, amortization of fictitious or intangible assets, abnormal gains and losses or items of purely financial nature do not form part of the costs and these are excluded from cost accounts.

The examples of such items include— loss on sale of building or machinery, interest on capital, discount on issue or redemption of shares or debentures, expenses relating to previous period, cash discounts, damages payable, penalties and fines, interest or dividend received on investments, transfer fees received, profit on sale of fixed assets, appropriation of profits such as income-tax, dividend paid, transfer of profits to reserves or funds, donations and charities, excess provision for depreciation on fixed assets, amortization of fictitious or intangible assets such as goodwill written off, preliminary expenses written off, patents, trademarks and copyrights written off, capital issue expenses, underwriting commission, loss on issue of shares and debentures written off, etc. Thus, it should be noted that such items-are not taken into consideration (excluded) while preparing a cost sheet.

* **Bad debts can also be excluded ( in that case give a note)**

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