

A stack of silver and gold coins is the central focus, resting on a document with some text visible. Several pens, including blue and black ones, are scattered in the background, creating a professional and financial atmosphere.

Cost Accounting **Chapter 1** **Costs & Accounting**

Financial Accounting

Financial Accounting: It is "the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events, which are in part at least, of a financial character and interpreting the results."

The information supplied by financial accounting is summarized in the following statements, generally at the end of an year:

P & L Account (Profit & Loss Account)

Balance Sheet

Cash Flow Statement

Limitations of Financial Accounting

1. Shows only overall performance
2. Historical in nature
3. No performance appraisal
4. No material control system
5. No labour cost control
6. No proper classification of costs
7. No analysis of losses
8. Inadequate information of price fixation
9. No cost comparison
10. Fails to provide useful data to management

Cost (Introduction)

- Cost is a measurement, in monetary terms, of the amount of resources used for the purpose of production of goods or rendering services.
- Cost is the amount of actual or notional expenditure relating to a product, job, service, process or activity.
- Cost is often used as a generic term to describe various types of costs.

Cost Concepts

- Cost Unit –It is a unit of product, service or time in terms of which costs are ascertained or expressed. It is a unit of measurement.
- It is unit of measurement of cost
- Example for unit of production: a tonne of steel, a meter of cloth, a ream of paper, a bale of cotton, a barrel of petrol etc.
- Example for unit of services: passenger miles, cinema seats, consulting hours etc.

Cost Concepts

- Responsibility Centers – is the unit or function of an organization under the control of a manager who has direct responsibility for its performance. E.g. Cost Center, Revenue Center, Profit Center, Investment Center.
- Cost Object – any product, service, process or activity for which a separate measurement of cost is required. For e.g. Car, Taxi service, weaving process, purchasing raw material etc.

Cost Concepts

- Cost Center – Is a location, person or item of equipment for which costs may be ascertained and used for the purposes of cost control.
- Types of Cost Centers:
 - Personal Cost Center – person or group of persons
 - Impersonal Cost Center – location or equipment
 - Production Cost Center – where actual production takes place
 - Service Cost Center – departments which render service to other cost centers

Cost Ascertainment and Cost Estimation

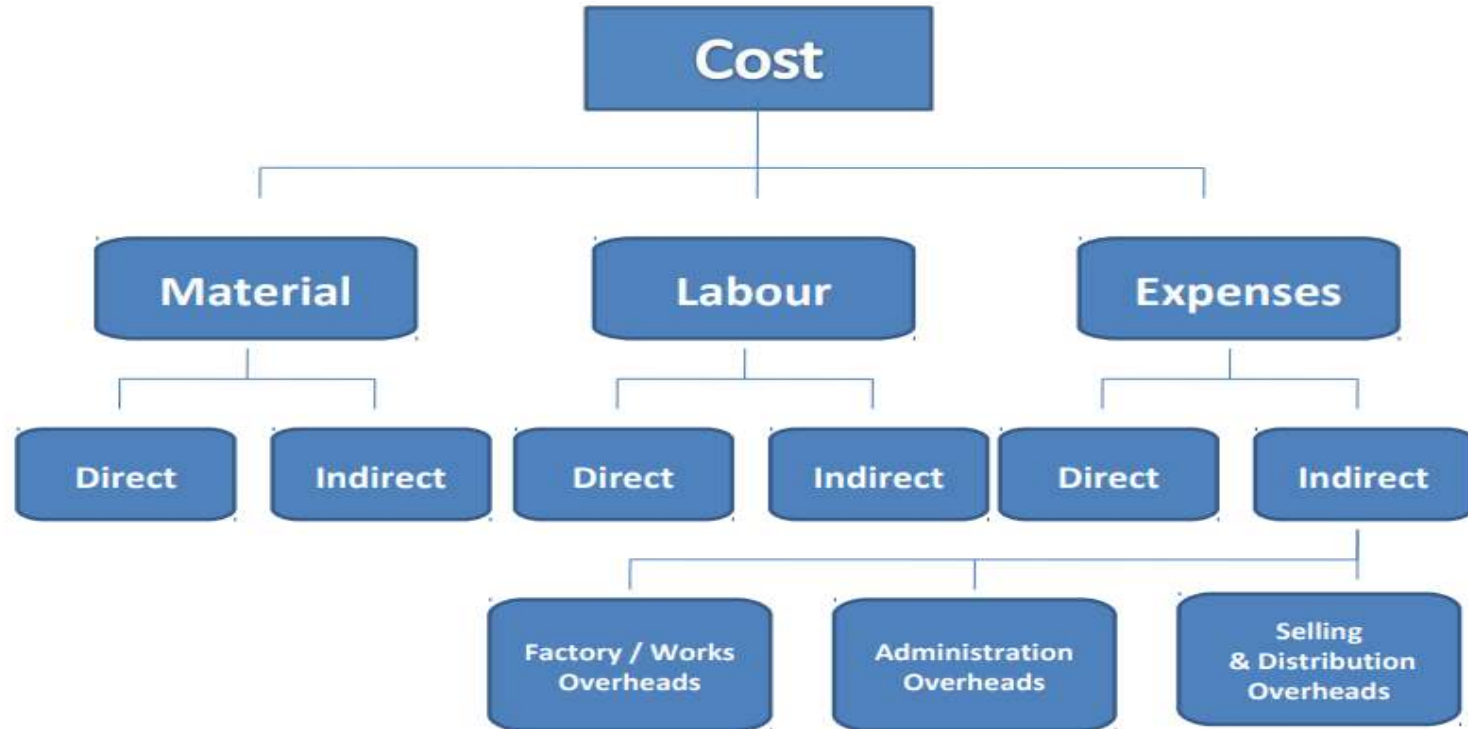
- Cost ascertainment: It is concerned with the computation of actual costs incurred. It refers to the methods and processes employed in ascertaining costs.
- Actual cost is useful to know unprofitable activities, losses and inefficiencies occurring in the form of idle time, excessive scrap etc.
- Cost estimation: It is pre-determination of cost of goods or services. Estimated costs are definitely the future costs and depends upon the past actual costs adjusted for anticipated future.
- It is useful in making price quotations, bidding for contracts, preparation of budgets, evaluating performance, preparing projected financial statements and controlling etc.

Elements of costs

In order to interpret the term cost correctly and to ascertain the cost with respect to the cost centers, the cost attached with the manufacturing process may be subdivided, known as Elements of Costs.

- (A) Material
- (B) Labour
- (C) Expenses

Elements of costs



Material Cost

The cost of commodities and materials used by the organization. It includes cost of procurement, freight inwards, taxes, insurance etc.

Direct Material Cost – all raw materials, either purchased from outside or manufactured in house, that can be conveniently identified with and allocated to cost units.

It generally becomes part of the finished product. However in many cases a material becomes part of finished product but not considered as direct material because the value of such material is so small that it is quite difficult and futile to measure it. e.g. nails in furniture, thread in garments etc. e.g. Cotton used in a textile firm, Clay in bricks, leather in shoes Cloth in garments, Timber in furniture etc.

Material Cost

Indirect Material Cost – material which cannot be identified with the individual cost centre, assist the manufacturing process and does not become an integral part of finished goods. These are minor in importance i.e. small and relatively inexpensive items which may become the part of finished product. E.g. Consumable stores, pins, screws, nuts and bolts, thread etc., also those items which do not become part of finished product e.g. coal, cotton, oils and lubricants, stationary material, sand paper etc.

Labour Cost

The cost of remuneration (wages, salaries, bonus, commission etc.) paid to the employees of the organisation.

Direct Labour Cost – identified with the individual cost centre i.e. it can be conveniently identified with a particular product, job or process and is incurred for those employees who are engaged in the manufacturing process.

Indirect Labour Cost – cost which cannot be identified with the individual cost centre and is incurred for those employees who are not engaged in the manufacturing process but only assist. wages paid to foreman/storekeeper, salary of works manager, Accountant / Personnel dept. salaries etc.

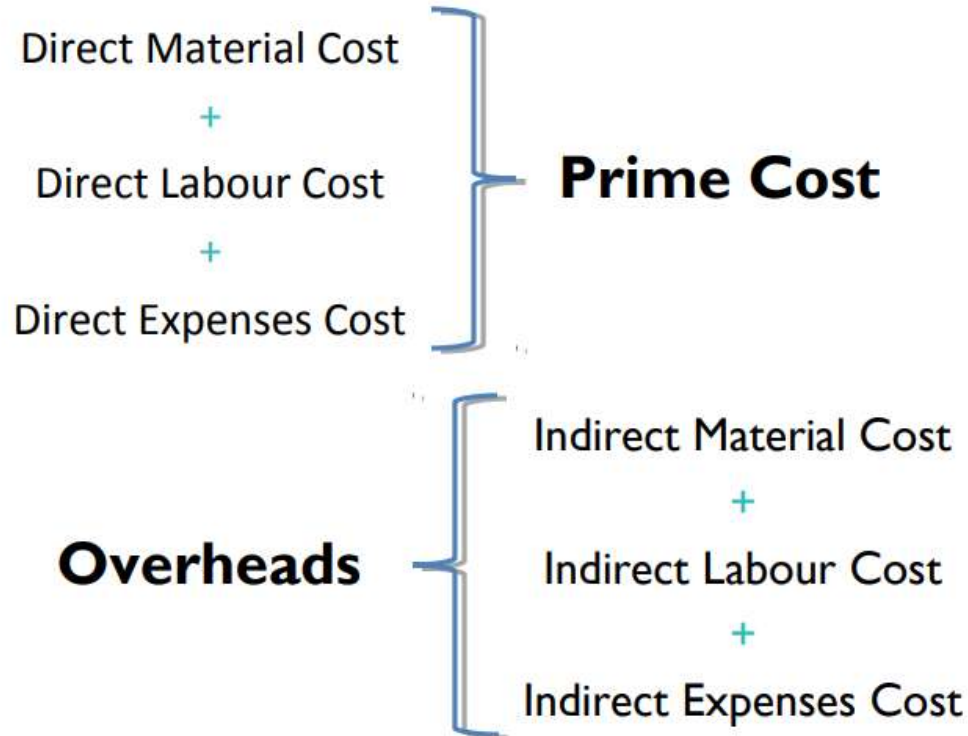
Expenses

This is the cost of services provided to the organisation and the notional cost of assets owned.

Direct Expenses Cost – Expenses which can be identified with and allocated to individual cost centers or units. Also known as chargeable expenses hire charges of machinery/equipment for particular job, cost of defective work , cost of patent rights, experimental cost, cost of special design, drawings, layout, royalty, depreciation on plant etc.

Indirect Expenses Cost – Expenses which cannot be identified by individual cost centers. Rent , Telephone expenses, Insurance, Lightening , Advertising, repairs etc.

Prime Cost and Overheads



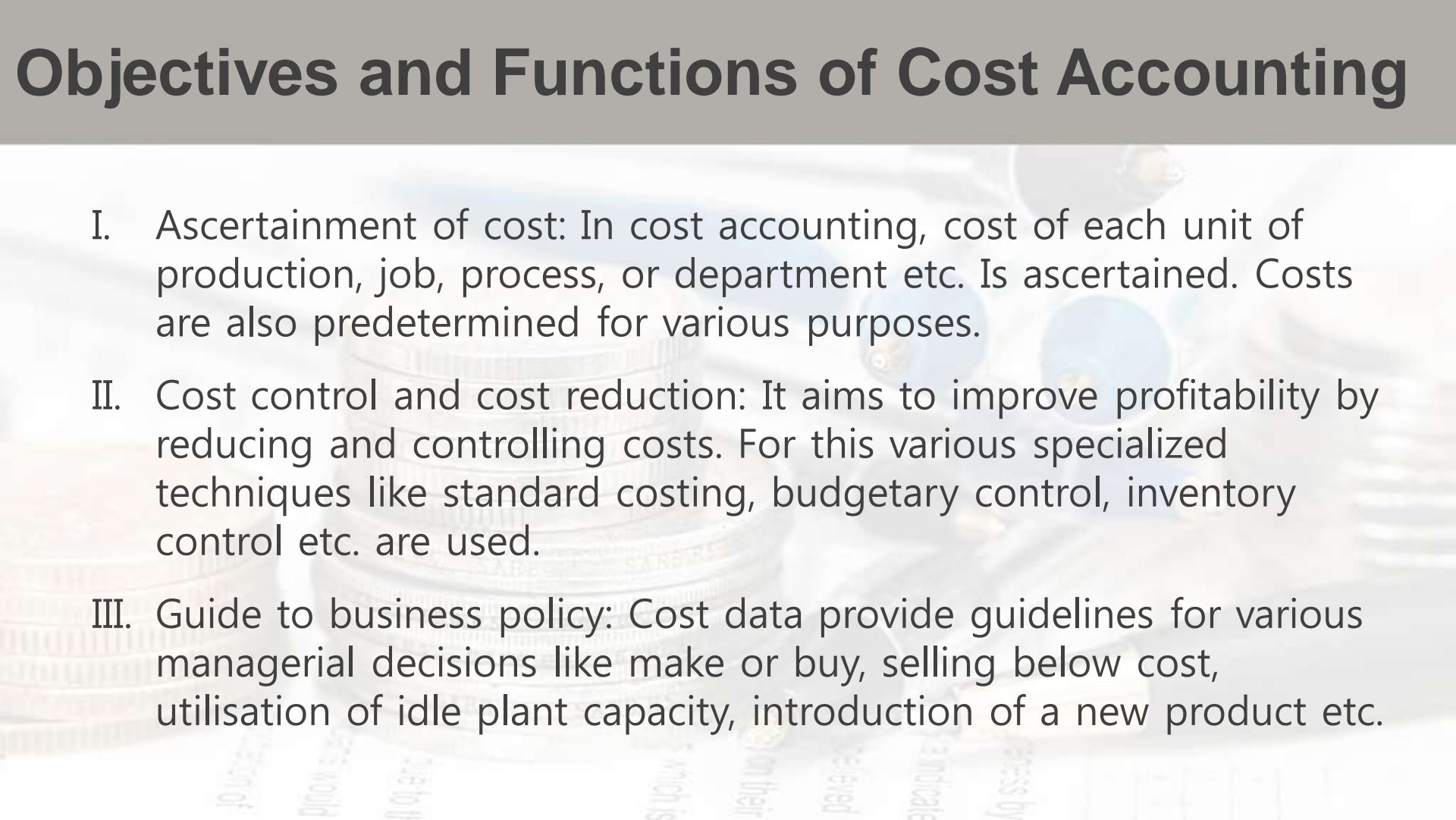
Costing and Cost Accounting

- Costing definition 1: "the techniques and processes of ascertaining costs"
- Costing definition 2: "the proper allocation of expenditure and involves the collection of costs for every order, job, process, service or unit"
- Thus it simply means cost finding by any process or technique
- It consists of principles and rules which are used for determining:
The cost of manufacturing a product or the cost of providing a service

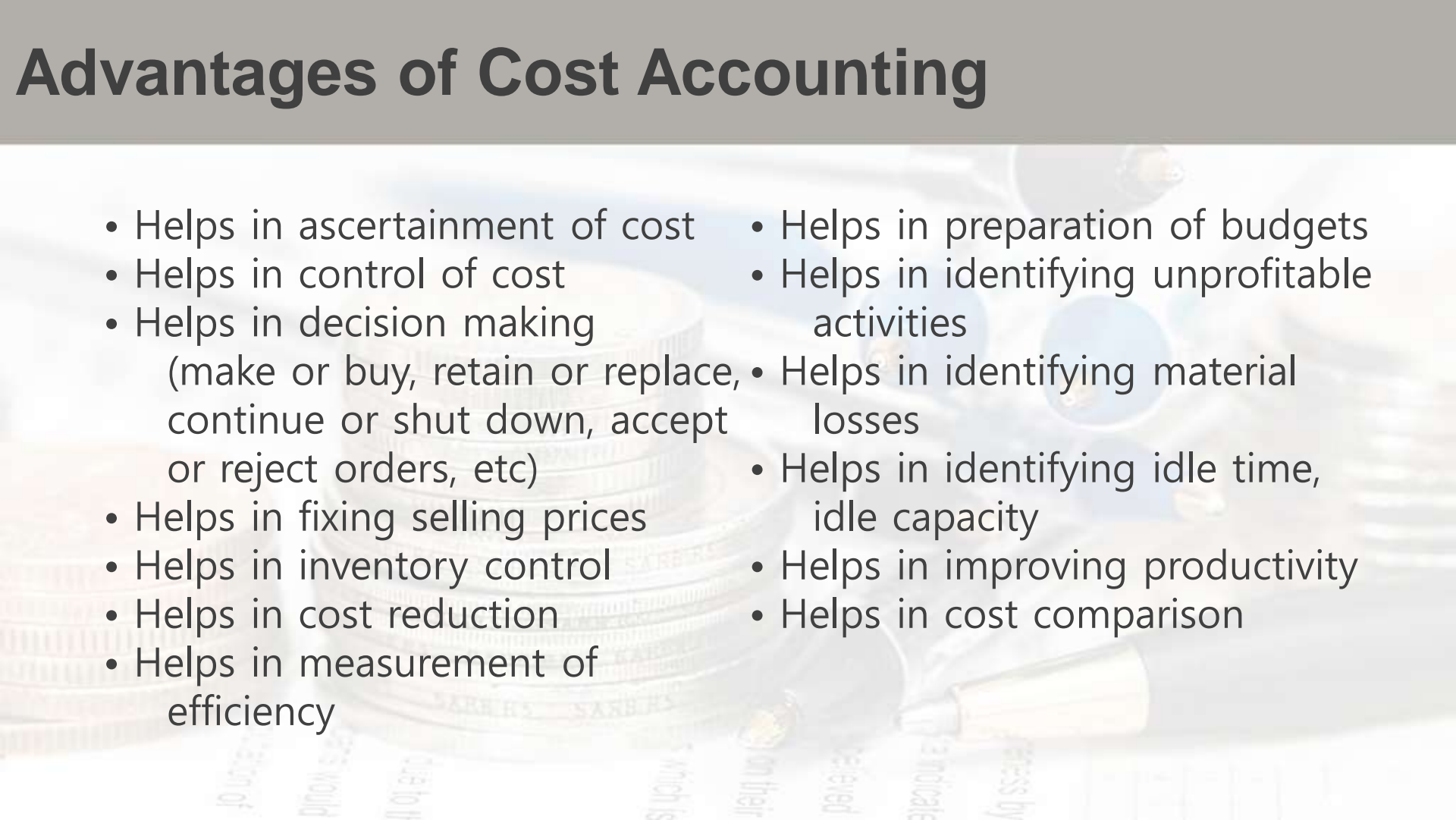
Cost Accounting

- Cost Accounting is the process of accounting from the point at which expenditure is incurred or committed to the establishment of its ultimate relationship with cost centers and cost units. It includes:
 - Collecting, classifying, recording, allocating and analyzing costs
 - Preparation of periodical statements and reports for ascertaining and controlling costs
 - Application of cost control methods
 - Ascertainment of profitability of activities carried out or planned.
- Cost Accounting is the processing and evaluation of monetary and non-monetary data to provide information for internal planning, control of business operations, managerial decisions and special analysis.

Objectives and Functions of Cost Accounting

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- I. Ascertainment of cost: In cost accounting, cost of each unit of production, job, process, or department etc. Is ascertained. Costs are also predetermined for various purposes.
 - II. Cost control and cost reduction: It aims to improve profitability by reducing and controlling costs. For this various specialized techniques like standard costing, budgetary control, inventory control etc. are used.
 - III. Guide to business policy: Cost data provide guidelines for various managerial decisions like make or buy, selling below cost, utilisation of idle plant capacity, introduction of a new product etc.

Advantages of Cost Accounting

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- Helps in ascertainment of cost
 - Helps in control of cost
 - Helps in decision making
(make or buy, retain or replace, continue or shut down, accept or reject orders, etc)
 - Helps in fixing selling prices
 - Helps in inventory control
 - Helps in cost reduction
 - Helps in measurement of efficiency
 - Helps in preparation of budgets
 - Helps in identifying unprofitable activities
 - Helps in identifying material losses
 - Helps in identifying idle time, idle capacity
 - Helps in improving productivity
 - Helps in cost comparison

Cost Accountancy

- Cost Accountancy is 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.
- Cost Accountancy includes costing, cost accounting, cost control and cost audit

Financial & Cost Accounting

No.	Basis	Financial Accounting	Cost Accounting
1.	Objective	Financial performance and position	Ascertain cost and cost control
2.	Costs and profits	Shows overall costs and profit / loss	Shows details for each product, process, job, contract, etc
3.	Control / Report	Emphasis on reporting	Emphasis on control and reporting
4.	Decision making	Limited use	Designed for decision making
5.	Responsibility	Does not fix responsibility	Can effectively fix responsibility
6.	Time frame	Focus on historical data	Focus on present and future
7.	Type of reports	General reports like P&L Account, Balance Sheet, Cash Flow Statement	Can generate special reports and analysis
8.	Legal need	Statutory requirement	Voluntary, except for some cases
9.	Transactions	Records external transactions	Records internal and external transactions
10.	Reader	Everybody	Internal management
11.	Formats	Standard, as per law	Tailor made
12.	Access	Everybody, except for some	Very limited access
13.	Unit of value	Monetary	Monetary and physical

Management Accounting

Management accounting is an integral part of management concerned with identifying, presenting and interpreting information used for

- i) Formulating strategy
- ii) Planning and controlling activities
- iii) Decision making
- iv) Optimizing the use of resources
- v) Disclosure to shareholders and others external to the entity
- vi) Disclosure to employees
- vii) Safeguarding assets"

Management Accounting

Management accounting can also be defined as “a system of collection and presentation of relevant economic information relating to an enterprise for planning, controlling and decision-making

The management accountant is called “Controller or Financial Controller” and generally is a part of top management team

Characteristics/ Nature of Management Accounting

- Useful in decision making
- Derived from Financial and Cost Accounting information
- Exclusively for internal use
- Purely optional
- Concerned with future
- Flexibility in presentation of information

Functions/ Objectives of Management Accounting

- Planning
 - Coordinating
 - Controlling
 - Communication
 - Financial analysis and interpretation
 - Qualitative information
 - Tax policies
 - Decision making
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- The background of the slide features a blurred image of financial and office supplies. On the left, there are several stacks of gold-colored coins. To the right, there are several blue pens and a black pen with a gold-colored tip. These items are resting on what appears to be a document or ledger with some faint, illegible text visible at the bottom.

Cost Accounting vs Management Accounting

Basis	Cost Accounting	Management Accounting
Scope	Limited to providing cost information for managerial uses	Broader scope as it provides all types of information
Emphasis	Mainly on cost ascertainment and cost control to ensure maximum profit	Mainly on planning, controlling and decision making to maximize profit
Techniques employed	Standard costing and variance analysis, marginal costing and cost volume profit analysis, budgetary control, uniform costing etc.	All the techniques of cost accounting but in addition it also uses ratio analysis, fund flow statement, statistical analysis, operation research, mathematics, economics etc., whatsoever help management in tasks
Evolution	Its evolution is mainly due to the limitations of financial accounting	Its evolution is due to the limitations of cost accounting
Statutory requirement	Maintenance of cost records has been made compulsory in selected industries as notified by the govt. from time to time	It is purely voluntary and its use depends upon the utility of management

Cost Accounting vs Management Accounting

Basis	Cost Accounting	Management Accounting
Data base	It is based on data derived from financial accounts	It is based on data derived from financial accounting, cost accounting and other sources
Status in organisation	In an organisational setup, cost accountant is placed at a lower level in hierarchy than the management accountant	In an organisational setup, management accountant is placed at a higher level in hierarchy than the cost accountant
Installation	Cost accounting can be installed without management accounting	Management accounting cannot be installed without a proper system of cost accounting



QUESTIONS?