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SUBJECT: ADVANCED COST ACCOUNTANCY

ADVANCE COST ACCOUNTING

UNIT – I Introduction: Meaning, Definition and Need for Cost Accounting; Classification of Cost; Installation of a Costing System.

INTRODUCTION OF COST ACCOUNTING

AN INTRODUCTION Cost accounting is an important branch of accountancy. It is the technique and process of ascertainment of costs. It also includes determination of future costs efforts to control cost and improve the quality of the product, which was not possible all such information that is useful to the management for decision making. In the initial stages cost accounting was merely considered to be a technique for ascertainment of costs of products or services on the basis of historical data. According to **Charles Horgen**, cost accounting is a quantitative method that accumulates classifies, summaries, and interprets information for three major purposes.

Due to technological development in all fields, now cost reduction has also come within the ambit of cost accounting. Cost accounting is thus concerned with recording, classifying and summarizing costs for determination of costs of products or services, planning, controlling and reducing such costs and furnishing of information to management for decision making.

MEANING OF COST ACCOUNTING

Cost accounting is the classifying, recording and appropriate allocation of expenditure for the determination of the costs of products or services, and for the presentation of suitably arranged data for purposes of control and guidance of management. It includes the ascertainment of the cost of every order, job, contract, process, service or unit as may be appropriate. It deals with the cost of production, selling and distribution.

It is thus the provision of such analysis and classification of expenditure as will enable the total cost of any particular unit of production or service to be ascertained with reasonable degree of accuracy and at the same time to disclose exactly how such total cost is constituted (i.e. the value of material used, the amount of labour and other expenses incurred) so as to control and reduce its cost.

With the increase in production, different types of costs are calculated which have different roles in the cost structure. Thus the variety of expenditures increase and many new types of cost enter in to the calculations and become essential parameters for taking important decisions by the top level management.

Although financial accounting can provide profit, it cannot highlight the loss-making products, which can be quite easily located by cost accounting.

DEFINITIONS OF COST ACCOUNTING

"Cost accounting is a quantitative method that accumulates, classifies, summarizes and interprets information for three major purposes: (in) Operational planning and control ;(ii) Special decision; and (iii) Product decision." **-Charles T. Horngren**

"Cost accounting is the process of accounting for costs from the point at which the expenditure is incurred of committed to the establishment of its ultimate relationship with cost units. In its widest sense, it embraces the preparation of statistical data, the application of cost control methods and the ascertainment of the profitability of the activities carried out or planned is defined as the application of accounting and costing principles, methods and techniques in the ascertainment of costs and the analysis of saving and/or excess as compared with previous experience or with standards." **– Institute of Cost and Management Accountants of London**

"Cost accounting 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. It includes the presentation of information derived therefore for the purposes of managerial decision making. **–Wheldon**

Cost accounting thus provides information to the management for decision of all sorts. It serves multiple purposes on account of which it is generally indistinguishable from management accounting or so-called internal accounting. **Wilmot** has summarized the nature of cost accounting as “the analysing, recording, standardizing, forecasting, comparing, reporting and recommending” and the role of a cost account as that of “a historian, news agent and rophet”.

According to **Morse**, “Cost accounting is the processing and evaluation of monetary and non-monetary data to provide information for external reporting internal planning and control of business operations and special analysis and decisions.”

“Cost accounting is a system of recording in accounts the material used and labour employed in the manufacture of a certain commodity or a particular job.”

Cost accounting is the process of accounting for costs. It begins with recording of income and expenditure on his basis on which they are calculated and ends with the preparation of statistical data. Cost accounting is thus the formal mechanism by means of which costs of products or services are ascertained and controlled.

BRANCHES OF ACCOUNTING

There are seven branches of accounting:-

a) **Financial Accounting:** This is called original accounting, which is mainly confined to the preparation of financial statement for the various concern parties and financial institutions.
b) **Cost Accounting:** The process of accounting for cost which begins with the recording of income and expenditure or the bases on which they are calculated and ends with the preparation of periodicals statements and reports for ascertaining and controlling cost.
c) **Management Accounting:** Management accounting is a distinctive form of resource management which facilitates management’s ‘decision making’ by producing information for managers within organization.
d) **Inflation Accounting:** This accounting system does not consider the cost constant at every time because the price of a commodity changes with time to inflation and decline purchasing power of money.
e) **Social Accounting:** This deals with the application of double entry system of book keeping to socio-economic analysis at the preparation, estimation and interpretation of nation and international income and balance sheet.

f) **Value –Added Accounting:** In this system income is measured by the value added by a firm in a particular period. It is the difference between the value of the product and the cost of raw material, stores and any brought out component used for production.

g) **Human Resource Accounting:** Human Resource accounting is the measurement of the cost and value of people for the organization or it is the process of identifying and measuring data about human resources and communicating this information to interested parties.

ADVANTAGES OF COST ACCOUNTING

A good system of costing is the technique of controlling the expenditure and helps bringing economy in production, so it serves the needs of a large section of people in the following ways.

(a) Benefits to the Management: The information revealed by cost accounting aims at mainly assisting the management in decision making and optimizing profits. Besides this there are certain advantages of cost accounting to the management i.e. it helps in price fixation, in revealing profitable and unprofitable activities, idle capacity, in controlling cost and also helps in inventory control.

(b) Benefits to the Employees: Cost accounting introduces wage scheme, bonus to the efficient & sincere employees which in turn increasing productivity, profitability and lowering cost.

(c) Benefits to Creditors: The better management of finance through cost accounting leads to timely debt servicing by company in the form of repayment of loan and payment of interest. To stay and grow in competition and for judging soundness of present and perspective borrower and cost reports give better picture of efficiency profit prospectus and capacity.

(d) Benefits to the Government: Cost accounting enables the Govt. to prepare plans for economic development of the country, to make policies regarding taxation, excise duty, export, price, ceiling, granting subsidy etc.

(e) Benefits to Consumers/Public: Cost accounting helps consumers in getting goods of better quality at reasonable price.

IMPORTANCE OF COST ACCOUNTING

Cost accounting gives information and reports to the management in the following ways:-

(a) Control of Material Cost –Cost of material is a major portion of the total cost of a product. It can be controlled by regular supply of material and spares for production, maintaining optimum level of funds in stocks of materials and stores.

(b) Control of Labour Cost: If workers complete their work within the specified time cost of labour can be controlled.

(c) Control of Overheads: By keeping a strict check over various overheads such as factory, administrative and selling & distribution, this can be controlled.

(d) Measuring Efficiency: Cost accounting provides information regarding standards and actual performance of the concern activity for measuring efficiency.

(e) Budgeting: The preparation of the budget is the function of costing department and budgeting is done to ensure that the practicable course of action can be chalked out and the actual perform corresponds with the estimated or budgeted performance.

(f) Price Determination: On behalf of cost accounting information, management is enable to fix remunerative selling price for various items of products and services in different circumstances.

(g) Expansion: The management may be able to formulate its approach to expansion on the basis of estimates of production of various levels.

ESSENTIAL OF A GOOD COST ACCOUNTING SYSTEM

A good cost accounting should possess the following essential features:

i) It should be simple, practical and capable of meeting the business concern requirements.
ii) Accurate data should be used by cost accounting system; otherwise it may distort the output of the system.
iii) To develop a good system of cost accounting necessary co-operation and participation of executives from various departments of the business is needed.
iv) The cost of installing and operating the system should be result oriented.
v) It should not sacrifice the utility by introducing unnecessary details.
vi) For the introduction of the system a carefully phased programmed should be prepared by using network analysis.
vii) Management should have faith on costing system and works as a helping hand for its development and success.

COST ACCOUNTING VS. FINANCIAL ACCOUNTING

Basis	Cost Accounting	Financial Accounting
1) Purpose	Its main purpose to guide the management for proper planning, controlling and decision-making etc.	It reveals the final results during the particular period for every concern.
2) Coverage	It deals with expenses related to or identified with products.	This deals with whole organization connected with manufacturing and also other activities or areas.
3) Basis	It deals with expenses related to or identified with products.	This deals only with the actual financial transactions and figures and not on estimation.
4) Scope	It is related to a particular product or service.	It includes all commercial translation of organization for a particular period of time.
5)Parties Involved	This deals with internal translations between departments within the organisation.	This concern with external parties as well as external transactions.
6)Final Statement	Only one statement is prepared i.e. statement of cost.	Profit & Loss A/c and balance sheet both are prepared.
7) Valuation of Stock	Stock is valued at cost	Market value or cost whichever is lower is considered as the value of stock.
8) Nature	It does not consider only historical records but also predetermined cost.	It is related to the historical records.
9) Classification	It is clearly classifies the cost into fixed and variable cost.	In this cost is not classified into fixed and variable cost.
10)Legal Generally	Generally these accounts are kept to meet management requirements. Now it has become obligatory.	It is required by companies act, Income Tax Act, etc. to keep these accounts.

FEATURE OF COST ACCOUNTING

1) It is a process of accounting for costs.
2. It records income and expenditure relating to production of goods and services.
3) It provides statistical data on the basis of which future estimates are prepared and quotations are submitted.
4. It is concerned with cost ascertainment, cost control and cost reduction.
5) It establishes budgets and standards so that actual cost may be compared to find out deviations or variances.
6) It involves the presentation of right information to the right person at the right time so that it may be helpful to management for planning, evaluation of performance, control and decision making.

OBJECTIVES OF COST ACCOUNTING

Cost accounting aims at eliminating the loopholes in the production process and ensures manufacturing of goods at the lowest possible cost.

Other than this, there are multiple objectives of the cost accounting practices. Let us now discuss its importance in detail:

1. Control and Reduce Cost: Cost accounting continuously focuses on managing the cost of production per unit to improve profitability without compromising with the quality of the product.
2. Determine Selling Price: It provides the total cost incurred in the product or service, which is the base for fixing an appropriate selling price.
3. Assist Management in Decision Making: The reports and cost sheets generated based on cost accounting back the managerial decision-making of the organization.
4. Ascertain Closing Inventory: It determines the closing inventory value at the end of the financial year.
5. Ensure Profit from each Activity: Cost accounting reviews the cost and takes corrective actions at each level to ensure profitability from all business activities.

6. Budgeting: It generates the estimated cost of products or services to assist in budget planning, implementation and control.
7. Setting Performance Standards: It provides a standard cost of goods or services to sets a level for the future course of action.
8. Business Expansion: It estimates the cost of production at different stages, based on this analysis, the management can plan for expansion.
9. Minimising Wastage: Cost control and reduction so attained helps in reducing the wastage during the manufacturing process.
10. Improve Efficiency: Cost Accounting assures cost management, profit appreciation and less wastage which ultimately enhances the overall production and manufacturing process of products.

PRINCIPLES OF COST ACCOUNTING

1) Cause – Effect Relationship: Cause-effect relationship should be established for each item of cost. Each item of cost should be related to its cause as minutely as possible and the effect of the same on the various departments should be ascertained. A cost should be shared only by those units which pass through the departments for which such cost has been incurred.

2) Charge of Cost Only after its Incurrence: Unit cost should include only those costs which have been actually incurred. For example unit cost should not be charged with selling cost while it is still in factory.

3) Past Cost should not Form Part of Future Costs: Past Costs (which could not be recovered in past) should not be recovered from future costs as it will not only affect the true result of future period but will also distort other statements.

4) Exclusion of Abnormal Costs from Cost Accounts: All costs incurred because of abnormal reasons (like theft, negligence) should not be taken into consideration while computing the unit cost. If done so, it will distort the cost figures and mislead management resulting in wrong decision.

5) Principle of Double Entry should be followed Preferably: To lessen the chances of any mistake or error, cost ledgers and cost control account, as far as possible, should be maintained on double entry principles. This will ensure the correctness of cost sheets and cost statements which are prepared for cost ascertainment and cost control.

SCOPE OF COST ACCOUNTING

Planning, decision-making and control are basic management functions. Cost accounting system provides the necessary tool, such as standard costing, budgetary control, inventory control, marginal costing and differential costing for carrying out such functions efficiently.

The term scope here refers to field of activity. Cost accounting refers to the process of determining the cost of a particular product or activity. It provides useful data both for internal and external reports reporting. Internal reporting presents details of cost data in a summarized and aggregate form.

The scope of cost accounting is very wide and includes the following :

(i) Cost Determination : This is the first step in the cost accounting system. It refers to determination of cost for a specific product or activity. This is a critical activity since the other three activities, explained below depend on it.

(ii) Cost Recording : Its is concerned with recording of costs in the cost journal and their subsequent posting to the ledger. Cost recording may be done according to integral or non-integral system. A separate set of books is maintained for costing and financial transaction.

(iii) Cost Analysis : It is concerned with critical evaluation of cost information to assist the management in planning and controlling the business activates. Meaningful cost analysis depends largely upon the clear understanding of the cost finding methods used in cost accounting.

(iv) Cost Reporting : Its is concerned with reporting cost data both for internal and external reporting purpose. In order to use cost information intelligently it is necessary for the managers to have good understanding of different cost accounting concepts.

(v) Cost-Book-keeping : It involves maintaining complete record of all costs incurred from their incurrence to their charge to departments, products and services.

(vi) Cost System : It provides for time to time monitoring and evaluation of the cost incurred in the production of goods and services to generate cost reports for the management..

(vii) Cost Comparison : Cost accounting also includes comparison between cost from alternative courses of action such as use of different technology for production cost of making different products and activities, and cost of same product/service over to period of time.

(viii) Cost Ascertainment : It deals with the collection and analysis of expenses the measurement of production of the different products at the different stages of manufacture and the linking up of production with expenses. In fact, the varying procedures for the collection of expenses give rise to the different systems of costing as historical of or actual costs, estimated costs, standard costs etc. Again the varying procedures for the measurement of production have resulted in different methods of costing as specific order or job costing operation costing single output costing, process costing etc. For linking up of production with the expenses the different techniques of costing such as marginal cost technique, the total cost technique, direct cost technique etc. have been evolved. All the three i.e. systems methods and technique can be used in one concern simultaneously.

(ix) Cost Audit : Cost audit is the verification of the correctness of cost accounts and a check on the adherence to the cost accounting plan. Its purpose is not only to ensure that the cost accounts and other records the arithmetically correct but also to see that the principles and rules have been applied correctly.

(x) Budgetary Control : It is the establishment of budgets relating to the responsibilities of executives to the requirements of a policy and the continuous comparison of actual with budgeted results either to secure by individual action on the objectives of that policy or to provide a basis for its revision. In short, it involves the fixation of budgets or estimated cost and comparison of actual cost with the budgeted fixed cost.

(xi) Cost Control : Cost control is the guidance and regulation by executive action of the costs of operating an undertaking. It aims at guiding the actual towards the line of targets, regulates the actual if they deviate or vary from the targets this guidance and regulations done by an executive action. The cost can be controlled by standard costing, budgetary control, proper presentation and reporting of cost data and cost audit.

(xii) Cost Computation: When the company is engaged in the production of bulk units of a particular product or commodity, the actual per unit cost is derived through cost accounting.

(xiii) Cost Reduction: It acts as a tool in the hands of management to find out if there is any scope of reducing the standard cost involved in the production of goods and services. Its purpose is to obtain additional gain.

SIGNIFICANCE OF COST ACCOUNTING

Managers depend on cost accounting to present a proposal of the actual cost of departments, processes, operations which is the foundation of their budget, permitting them to examine fluctuation and the way funds are used socially for profit. Cost accounting is used in management accounting, where managers justify the ability to cut costs for a company in order to increase that company's profit.

Cost accounting makes a financial value out of the production of a product, calculating currency that is nominal in two units that are measured by rule. By taking stored historic costs a bit more, cost accounting allocates a company's fixed costs over a particular time period to what items are in essence produced during that period of time, producing a total cost of product production. Products that were not sold from side to side that period of time created a "full cost" of those products, recording them in a compound inventory system that uses accounting techniques of its own that are in compliance with the GAAP typical. Managers are then able to focus on each period's results as it relays to the "standard cost" of any product.

Cost accounting is a vital part of the management accounting process. In turn for managers to determine the most excellent methods to increase a company's profitability, as well as saving company revenue in the future, cost accounting is a essential system in the management of a company's budget, given that important data to analyze fluctuation in company production costs.

The End