COST ACCOUNTING (BKS51)

UNIT-I

Introduction & Meaning:

A cost is an expenditure required to produce or sell a product or get an asset ready for normal use.

Costing is any system for assigning costs to an element of a business. Costing is typically used to develop costs.

Costing may involve only the assignment of variable costs, which are those costs that vary with some form of activity (such as sales or the number of employees).

Costing can also include the assignment of fixed costs, which are those costs that stay the same, irrespective of the level of activity. This type of costing is called absorption costing. Examples of fixed costs are rent, insurance, and property taxes.

Cost accounting is the application of accounting and costing principles, methods, and techniques in the ascertainment of costs and the analysis of saving or excess cost incurred as compared with previous experience or with standards.

Cost accounting is a form of managerial accounting that aims to capture a company's total cost of production by assessing the variable costs of each step of production as well as fixed costs, such as a lease expense.

Cost Accounting is a business practice in which we record, examine, summarize, and study the company’s cost spent on any process, service, product or anything else in the organization. This helps the organization in cost controlling and making strategic planning and decision on improving cost efficiency.

Such financial statements and ledgers give the management visibility on their cost information. Management gets the idea where they have to control the cost and where they have to increase more, which helps in creating a vision and future plan.

Cost accounting is the art and science of recording, classifying, summarizing, and analyzing costs with the objective of cost control, cost calculations and projections, and cost reduction, thereby helping management make prudent business decisions.

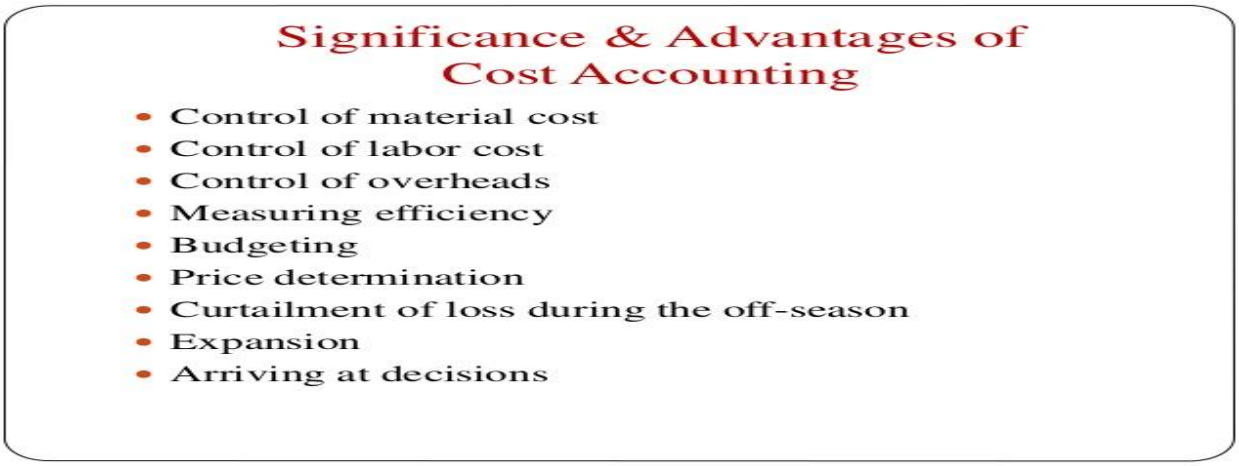
Definition of Cost Accounting:

Cost Accounting defined as "the systematic recording and analysis of the costs of material, labor, and overhead incident to production".

The Chartered Institute of Management Accountants in England (CIMA) has defined Cost Accounting as, 'the process of accounting for cost from the point at which expenditure is incurred or committed to establishment of its ultimate relationship with cost centre's and cost units. In its widest usage, it embraces the preparations of statistical data, the application of cost control methods and the ascertainment of the profitability of activities carried or planned'. It is a formal mechanism by means of which costs of products or services are ascertained and controlled.

Objectives of Cost Accounting:

Advantages of Cost Accounting:

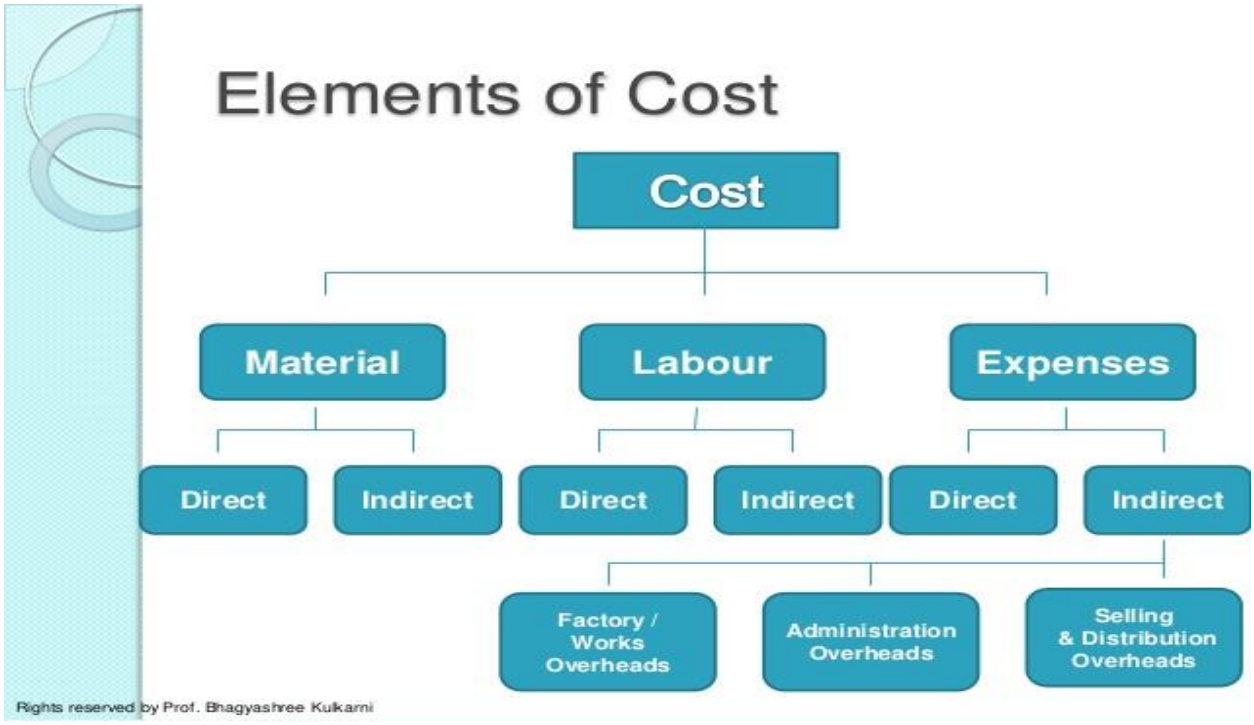


Limitations of Cost Accounting

Different Concepts of Cost:

- ✓ **Cost:** It refers to an amount to be paid or given up for acquiring any resource or service.
- ✓ **Costing:** The technique and process of ascertaining costs.
- ✓ **Cost Control:** Cost control is a tool of management executives to regulate the working of the manufacturing concern.
- ✓ **Cost Audit:** The verification of the correctness of cost accounts and of the adherence to the cost accounting plan.
- ✓ **Cost Centre:** It is a location, person or item of equipment for which cost may be ascertained and used for the purpose of cost control.
- ✓ **Cost Unit:** It refers to the unit of quantity of product, service or time (or combination of these) in relation to which costs may be ascertained or expressed.

Elements of Cost:



The elements that constitute the cost of manufacture are known as the elements of cost. Such element of cost is divided into three categories. In a manufacturing concern, raw materials are converted into a finished product with the help of labour and other service units. They are Material, Labour and Expenses.

Again, these elements of cost are divided into two categories such as Direct Material and Indirect Material, Direct Labour and Indirect Labour, Direct Expenses and Indirect Expenses. All direct material, direct labour and direct expenses are added to get prime cost. Likewise, all indirect, material, indirect labor and indirect expenses are added to get overhead.

Again, overhead is divided into four categories. They are factory overhead, administration overhead, selling overhead and distribution overhead.

1. D**irect Material**: It refers to the material out of which a product is to be produced or manufactured. The cost of direct material is varied according to the level of output. For example: Milk is the direct material of butter.

2. **Indirect Material**: It refers to material required to produce a product, but not directly and does not form a part of a finished product. For example: Nails are used in furniture. The cost of indirect material is not varying in direct proportion of product.

3. **Direct Labour**: It refers to the amount paid to the workers who are directly engaged in the production of goods. It varies directly with the output.

4**.** **Indirect Labour**: It refers to the amount paid to the workers who are indirectly engaged in the production of goods. It does not vary directly with the output.

5. **Direct Expenses**: It refers to the expenses that are specifically incurred by the company to produce a product. A product cannot be produced without incurring such expenses. It varies directly with the level of output.

6. **Indirect Expenses**: It refers to the expenses that are incurred by the organization to produce a product. But, these expenses cannot be easily found out accurately. For example: Power used for production.

7. **Overhead**: It is the combination of all indirect materials, indirect labour and indirect expenses.

8. **Factory Overhead**: It is otherwise called Production Overhead or Works Overhead. It refers to the expenses that are incurred in the production place or within factory premises. For example: Indirect material, rent, rates and taxes of factory, canteen expenses etc.

9. **Administration Overhead**: It is otherwise called Office Overhead. It refers to the expenses that are incurred in connection with the general administration of the company. For example: Salary of administrative staff, postage, telegram and telephone, stationery etc.

10. **Selling Overhead**: It refers to all expenses incurred in connection with sales. For example: Salary of sales department staff, travelers' commission, advertisement etc.

11. **Distribution Overhead**: It refers to all expenses incurred in connection with the delivery or distribution of goods and services from the producer to the consumer. For example: Delivery van expenses. loading and unloading, customs duty, salary of deliverymen etc.

Meaning of Cost Sheet:

A cost sheet is a statement which represents the various costs incurred at different stages of business operations, in a tabular format. It determines the total cost or expenditure made by the organization, along with the cost incurred on each unit of a product or service in a particular period.

Meaning of Tender & Quotation:

Quotation is a document of setting out the estimated **cost**, for supplying goods or services or procuring something.

Tender refers to a process of soliciting suppliers, to bid on the goods or services needed by the buyer.

Comparison between Cost Accounting & Financial Accounting:

Basis	**Cost Accounting**	**Financial Accounting**
Meaning	Cost accounting is an accounting system that aspires to capture an enterprise's costs of manufacturing by evaluating the input costs of each step of manufacturing as well as fixed costs, such as the depreciation of capital equipment.	Financial accounting is the procedure of documenting, encapsulating and reporting the multiple transactions resulting from trading operations over a timeframe.

Information	Documents the data associated with the labour and material which are utilised in the manufacturing procedure.	Documents the data that are in monetary terms.
Estimation of Stock	At cost	Net Realisable value or Cost, which is less between these both factors.
Profit Analysis	Normally, the gains are investigated for a specified job, batch, product and procedure.	Profits, Income and expenditure are investigated together for a specific period of the entire trading concern.
Aim	Controlling and reducing cost.	Maintaining the complete record of the financial transactions.

Comparison between Cost Accounting & Management Accounting:

Basis	Cost Accounting	Management Accounting
Meaning	Cost accounting is an accounting system that aspires to capture an enterprise's costs of manufacturing by evaluating the input costs of every step of manufacturing as well as the fixed costs, namely, depreciation of capital equipment.	Management Accounting refers to the outlining of financial and non-financial data for the utilisation of management of the enterprise. It is also known as managerial accounting.
Data type	Quantitative	Both Quantitative and Qualitative
Scope	Focused on distribution, allocation, determination and accounting factors of the cost	Convey (impart) and effect factor of the cost
Objective	Determined in cost production	Furnishing data to the managers to fix goals and anticipate strategies
Specific procedure	Yes	No
Planning	Short term planning	Both Short and long term planning

Recording	Records both past and present data	Focuses more on scrutinizing for future projects
Interdependency	Can be installed without a Management accounting	Cannot be installed without cost accounting

Formula : Overheads

1. Percentage of works cost on direct wages = Works Cost / Direct Wages x 100
2. Percentage of office cost on works cost = Office OH / Works Cost x100
3. Percentage of selling & distribution overheads on works cost =

   Selling & Distri. OH / Works Cost x100

   (Or)

   Percentage of selling & distribution overheads on cost of production =

   Selling & Distr. OH / Cost of production x100
4. Profit % on cost = Total cost x Percentage of profit / 100
5. Profit on selling price = Total Cost x Percentage of profit / 100 – Percntage of profit on sales

Format of Cost Sheet:

Cost Sheet for the period end

Units Produced = Units Sold =

PARTICULARS		TOTAL COST	COST/UNIT
DIRECT COST:			
Direct Material (Raw Material Consumed)	X		
Opening Stock of Raw Material	X		
Add: Purchases	X		
Add: Carriage inward, Freight Inward, Octroi & custom duty	X		
	X		
Less: Closing Stock of Raw Material	X	X	X
Direct Wages		X	X
Direct Expenses		X	X
PRIME COST		X	X
INDIRECT COST			
WORKS OR FACTORY OVERHEADS			
Indirect Materials	X		
Indirect Wages	X		
Leave/Overtime Wages	X		
Fuel & Motive Power	X		
Factory Rent & Taxes	X		
Plant, Electric Equiptment, etc.	X		
Work Salary	X		
Factory Lighting & Supervision	X		
Depriciation on Plant & Machinery	X		
	X		
Less: Sale of Scrap	X	X	X
		X	X
Add: Opening Stck of Work-in-progress		X	X
		X	X
Less: Closing stock of Work-in-progress		X	X
WORKS COST		X	X
Add: OFFICE & ADMINISTRATIVE OVERHEADS			
Office Salaries	X		
Office Rent & Rates	X		
Establishment Charges	X		
Depreciation on Office Furniture & Building	X		
Office Lighting	X		
Legal Charges	X		
Audit Fees	X		
Bank Charges & Commission	X	X	X
COST OF PRODUCTION		X	X
Add: Opening Stock of Finished Goods		X	
		X	
Less: Closing Stock of Finished Goods		X	
COST OF GOODS SOLD		X	
Add: SELLING & DISTRIBUTION OVERHEADS			
Salary & Commission of Salesmen		X	
Advertisiment Charges		X	
Depriciation on Delivery Vans		X	
Packing Charges		X	X
TOTAL COST OR COST OF SALES			X
PROFIT			X
SALES			X

References:

- Inflibnet.ac.in
- www.investopedia.com
- Cost Accounting - M. N.Arora
- Cost & Management Accounting – T.S.Reddy & Y.Hari Prasad Reddy
- Cost Accounting – A.Murthy & S.Gurusamy
- https://accountlearning.com

Cost Accounting

Questions Section – A

1. What is cost sheet?
2. What are elements of cost?
3. Calculate prime cost from the data given below:
   Direct material – Rs.66, 000; Direct Wages – Rs.44, 000 & Direct Expenses – Rs. 11,000.
4. What do you mean by Tender?
5. What do you mean by cost centre?

Section – B

6. Difference between Cost Accounting & Financial Accounting
7. Prepare a cost sheet with the following details:

Direct Material	Rs. 50,000
Direct Wages	Rs. 15,000
Factory Expenses	Rs. 5,000
Office Expenses	Rs. 1,000
Selling Expenses	Rs. 500

8. Discuss the limitations of Cost Accounting?
9. State the objectives of Cost Accounting?
10. Prepare a cost sheet from the following particulars:

Opening Stock of R.M	Rs. 10,000
Purchase of R.M	Rs. 2,90,000
Closing Stock of R.M	Rs. 12,500
Direct wages	Rs. 1,95,000
Works Overhead	Rs. 43,000
Office & general Expenses	Rs. 36,000
Opening Stock of finished stock	Rs. 25,500
Closing Stock of finished stock	Rs. 24,000
Sales	Rs. 6,06,000

Section – C

11. Distinction between Cost Accounting & Management Accounting.
12. Explain the advantages of Cost Accounting?
13. State the various elements cost in detail.
14. Prepare a Cost Sheet for the year ended 31.3.86 from the following figures extracted from the books of Best Engineering Co.**Opening Stock:**(i) Raw Material 40,350,(ii) Work-in-Progress 15,000 and

(iii) Finished Stock 35,590.

Cost incurred during the period: Materials purchased 2,50,000, Wages paid 2,00,000, Carriage inward 2,000, Consumable Stores 10,000, Wages of Storekeeper 7,000, Depreciation of Plant & Machinery 10,000, Materials destroyed by Fire 5,000, Repairs & Renewals 5,010, Office Manager's Salary 10,000, Salary to Office Staff 20,500, Printing & Stationary 10,000, Power 10,500, Lighting for Office Building 2,000, Carriage outward 3,000, Freight 5,000, Entertainment 2,500, Warehousing charges 1,500, Legal charges 2,000, Expenses for participating in Industrial exhibition-6,000.

Closing Stock: (i) Raw material 35,000, (ii) Work-in-Progress 14,500, and (iii) Finished Stock 40,030. Profit 25% on cost.