UNIT 66 – UPSC - Cost Accounting

Cost accounting is associated with accounting of the cost. It comprises of Cost and Accounting. The term cost signifies the total of all expenditures involved in the process of production. Thus, it includes the costs involved in the production and the cost involved while receiving it. Accounting is a process to collect and maintain financial records of each income and expenditure and make avail of such information to the concerned officials. Therefore, cost accounting is a practice and process of cost which regulates the productivity of a business concern by controlling the cost with the application of accounting norm, process and rules.

Cost accounting embraces the presentation of the information derived there for managerial decision making. It has been described in management literature that cost accounting is an arts as well as science. According to the Terminology of Management and Financial Accountancy Published by the Chartered Institute of Management Accountants, London, cost accountancy entails, "the application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control. It includes the presentation of information derived there for the purpose of managerial decision making. It is science because it is a form of systematic knowledge having certain principles. It is an art as it requires the aptitude with which a cost accountant applies the principles of cost accounting in several managerial problems.

Scope of Cost Accounting: Cost accounting deals with business expenditures, or sums that company spends to operate its infrastructure and provide customers with products and services. The procedure of cost accounting tracks variable costs, or expenditures such as materials and payroll that go directly into the products and services offers. Cost accountants also register fixed costs, or other expenses such as rent and utilities that do not change much irrespective of sales volume. It has been revealed in management reports that cost accounting has limited scope. It is concerned with cost accumulation for stock valuation to meet the requirement of external reporting (Nigam, and Jain, 2001).

Theoretical studies described Cost accounting as the provision of such analysis and classification of expenditure as well as the total cost of any particular unit of production to be ascertained with reasonable degree of accuracy and at the same time to disclose exactly how such total cost is constituted (W.W.Bigg). Another accounting professional, R.N. Carter stated that "Cost accounting is a system of recording in accounts the materials used and labour employed in the manufacture of a certain commodity or on a particular job."

It has been established that cost accounting is a major part of accounting system which records systematically the cost involved in raw materials and labour used in the process of production and at the same time determines the total cost and unit cost of product. The process of recording, categorizing and analysing of cost is the cost accounting.

Objectives of Cost accounting: The objective of cost accounting is to document and recognise the ways business spends its cash. This process is significant for tax purposes, so the returns company file accurately reflect company's expenses. Cost accounting information is also valuable for internal company operations, giving the tools to analyse trends and make strategic decisions. Calculating unit costs, or the amount company spend to create each unit it sell, provides with a benchmark for evaluating overall profitability and break-even points. Major objectives are:

1. Ascertaining cost: Primary objective of cost accounting is to find out cost of a product, process or service.
2. Determining Selling Price: Business enterprises are to run on a profit. Therefore it is necessary that the revenue should be greater than the costs incurred in producing goods and services from which the revenue is to be derived. Cost accounting provides information regarding the cost to make and sell such products or services.
3. Measuring and Increasing Efficiency: Cost accounting involvers a study of the various operations used in manufacturing a product or providing a service. The study enables accountant to measure the efficiency of the organisation as a whole as well as of the departments besides devising means of increasing the efficiency.
4. Cost Control and Cost Reduction: Cost accounting helps in cost control through application of various techniques such as budgetary control, standard costing etc. for controlling costs. Budgets are prepared well in advance. The standards for each item of cost are determined and the actual costs are compared with the standard costs and variances are found out as to their causes. This increases the operating efficiency of the enterprise. Besides it, cost is required to be reduced. Constant research and development activities help in reduction of costs without compromising with the quality of goods or services.
5. Cost Management: Cost Management is one of the objective of cost accounting. It includes the actions of managers in short-run and long-run planning and control of costs. It includes both cost control and cost reduction.
6. Determining Profits: Main objective of Cost accounting is to determine the profits of each and every activity. It produces statements at such intervals as the management may require. The financial statements are prepared under financial accounting, generally once a year or half a year, are spaced too far apart in time to meet the needs of the management. To increase efficiency of business, it is indispensable for the management to have a frequent review of production, sales and operating results. Cost accounting provides daily, weekly or monthly volumes of units produced, accumulated costs together with appropriate analysis so that company gains profit.
7. Providing Basis for Managerial Decision Making: Lastly, the objective of costs accounting is to assist the management in devising operative policies. These policies may relate to various matters such as determination of cost volume and profit relationship, shutting

down or operating at a loss, making or buying from outside supplies, continuing with the existing plant and machinery or replacing them by improved and economical means.

There are three broad components of cost:

1. Material
2. Labour
3. Expenses

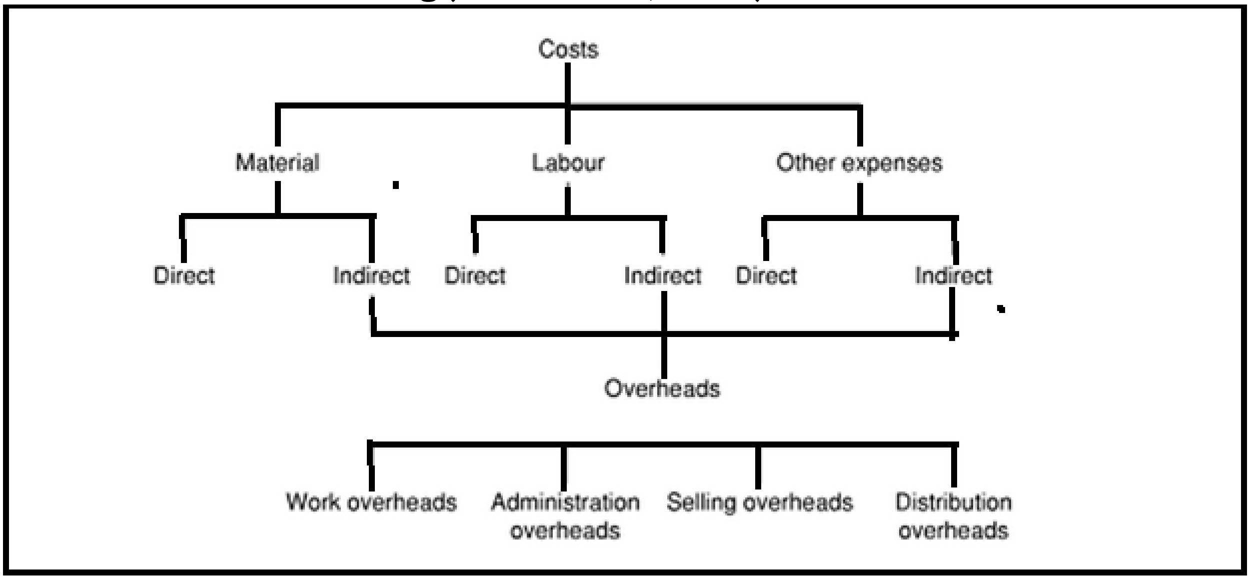
Material: It is the substance from which the product is made. It may be in a raw or a manufactured state. It can be direct as well as indirect. Direct Material becomes an integral part of the finished product and which can be suitably assigned to specific physical units such as all material or components specifically purchased produced or requisitioned from stores, primary packing material that include cartoon, wrapping, cardboard, boxes, purchased or partly produced components. Direct material is also called as raw-material, process material, prime material, production material, stores material, constructional material. Indirect Material is used for purposes auxiliary to the business and which cannot be conveniently assigned to specific physical units. Some examples of indirect material are consumable stores, oil and waste, printing and stationery. Indirect material may be used in the factory, the office or the selling and distribution division.

Labour: Second component of cost is labour. Human labour is required to produce finished product. These human efforts are called labour. Labour can be direct as well as indirect.

Direct labour is one which takes an active and direct part to produce particular commodity. Direct labour costs are specially and conveniently noticeable to specific products. Direct labour is also called as process labour, productive labour, operating labour, manufacturing labour, and direct wages. Indirect labour is one which is employed for the purpose of carrying out tasks incidental to goods or services provided. It cannot be practically traced to specific units of output wages of store such as keepers, foreman, time keepers, directors, fees, salaries of salesmen.

Expenses: Expenses are vital component of cost. It may be direct or indirect. Direct expenses are those which can be directly, conveniently and wholly allocated to specific cost centres or cost units. Such as hire of some special machinery required for a particular contract, cost of defective work incurred in connection with a particular job or contract. Indirect expenses are those which cannot be directly, conveniently and wholly allocated to cost centres or cost units.

Elements of cost accounting (Source: Alex, 2012)



Advantages of Cost accounting: Cost accounting has several benefits that are mentioned below:

1. Help in Cost control
2. Help in Decision making
3. Guides in Price fixation
4. Help in cost reduction
5. Finds outs profitable and unprofitable operations
6. Finds out idle capacity

Importance of Cost Accounting

1. Costing helps in periods of trade depression and trade competition: In periods of trade depression the business cannot afford to have leakages which pass unchecked. The management should know where economies may be sought, waste eliminated and efficiency increased. The management should distinguish the actual cost of their products before embarking on any scheme of reducing the prices on giving tenders.
2. Cost accounting facilitates in price fixation: Though economic law and supply and demand and activities of the competitors, determine the price of the article, cost to the producer does play an important part. The producer can take necessary guidance from his costing records.
3. Cost accounting helps in estimate: Appropriate costing records provide a reliable basis upon which tenders and estimates may be prepared. The chances of losing a contract on account of over rating or losing in the execution of a contract due to under rating can be minimized. In this way, "ascertained costs provide a measure for estimates, a guide to policy, and a control over current production.
4. Cost accounting assists in channelling production on right lines: Costing enables the management to distinguish between profitable and non-profitable activities. Profit can be maximized by focusing on profitable operations and eliminating non-profitable ones.

5. Through proper cost accounting, wastages are eliminated: As it is possible to know the cost of the article at every stage, it becomes possible to block various forms of waste, such as time, expenses etc. or in the use of machine, equipment and tools.
6. Costing makes comparison possible: If the costing records are constantly maintained, comparative cost data for different periods and various volumes of production will be available. It will help the management to develop future lines of action.
7. Costing provides data for periodical profit and loss accounts: Passable costing records supply to the management such data which may be needed for preparation of profit and loss account and balance sheet, at such intervals as may be desired by the management. It also describes in detail the sources of profit or loss revealed by the financial accounts thus helps in presentation of better information before the management.
8. Cost accounting helps in determining and enhancing efficiency: Losses due to wastage of material, idle time of workers, poor supervision will be disclosed if the various operations involved in manufacturing a product are studied by a cost accountant. The efficiency can be measured and costs controlled and through it various devices can be framed to increase the efficiency.
9. Cost accounting has great significance in controlling inventory: Costing provides control which management requires in respect of stock of materials, work-in-progress and finished goods.
10. Cost accounting helps in cost reduction: Costs can be reduced in the long run when alternatives are provided.
11. Cost accounting helps to enhance productivity: Productivity of material and labour is required to be increased to have growth and more profitability in the organisation costing renders great assistance in measuring productivity and suggesting ways to improve it.

Cost accounting also helps in determining selling price. It controls material and supplies. Management get more benefit with the initiating of cost accounting. It helps to ascertain the cost and selling price of the product. Cost data help management to develop the business policies.

Cost accounting is also beneficial for investors. Investors want to know the financial conditions and earning capacity of the business. An investor must collect information about organization before making investment decision and investor can gather such information from cost accounting.

Cost accounting is also beneficial for consumers. The decisive aim of costing is to reduce the cost of production to minimize the profit of business. Reduction in the cost is usually passed on to the consumers in the form of lowering price. Consumers get quality goods at affordable rate.

Cost accounting also extend its benefit to Employees. Cost accounting assists to fix the wages of the workforces. Competent workers are rewarded for their efficiency. It helps to induce incentive wage plan in business.

Cost accounting is one of the major sources to deliver reliable data to internal as well as external parties. It assists government agencies to regulate excise duty and income tax. Government formulates tax policy, industrial policy, export and import policy based on the information provided by the cost accounting.

To summarize, the cost accounting is aimed to identify the efficiencies and inadequacies, if any, in the use of material, labour and machinery. Cost accounting make use of standard cost against which actual costs are compared, variances are calculated and analysed into their causes so that corrective actions may be taken. Cost accounting is an information presented in more flexible way. The main focus of cost accounts to control and reduce cost. Cost accounting does not use financial accounting principles. Since cost accounting analyses each possible units therefore it is useful to management as well as the personnel.