



UNIT:1

BASICS OF COST ACCOUNTING

Topics:

1. Basics Concept of Cost.
2. Limitations of Financial Accounting
3. Origin of Costing
4. Objectives of Cost Accounting
5. Advantages and Limitations of Costing
6. Difference between Financial Accounting and Cost Accounting
7. Cost Unit and Cost Centers

• INTRODUCTION

In today's competitive environment, the nature and functioning of business organizations have become very complicated. Various parties like owners, creditors, employees, government agencies, tax authorities, investors, management of the business etc. are interested to do business activities. Accounting provides required and important information to all these parties, In order to satisfy their needs, a sound organization of accounting system is essential. The needs of the majority of the users of accounting information can be satisfied by Financial Accounting. Financial Accounting is mainly concerned with preparation of two important statements, like Statement of Profit and Loss and Balance Sheet. This information provides the needs of all those who indirectly associated with the management of business. To carry out the functions of planning, decision-making and control more efficiently, the management require more analytical information relating to cost. The Financial Accounting system fails to some extent to provide all these required information to management and hence a new system of accounting necessitates, which fulfils all the needs of management. Thus, Cost Accounting is developed to offset the limitations of Financial Accounting, Broadly speaking, there are three branches of like Financial Accounting, Cost Accounting and Management Accounting which are concerned with presenting analytical business data to the users. The following example clearly indicates the need and importance of Cost Accounting as a separate branch of accounting, which has emerged mainly because of the limitations of Financial Accounting.



Cost is something which is incurred to produce a product or rendering of services.

Eg:1. Cost of an ice-cream is the amount incurred for milk, cream, sugar, labour, packing charges, etc.

2. Cost for a patient for illness is a fee of a doctor.

COST: Total of expenses incurred to manufacture a product or rendering a services is called cost.

Example

For the manufacturing of a pen: Material expenses (Plastic + Ink+ Nib)

Labour expenses (manpower use to prepare pen)

Any other expenses (selling and distribution, packing, etc)

For rendering of a services: Fee of doctor, salary of a teacher etc

When the margin of profit is included in a cost it is called price, therefore cost is the total of all expenses whereas price is the total of expenses and profit.

According to ICMA, London, "Cost is the amount of expenditure actual or notional) incurred on, or attributable to, a specified thing or activity or cost unit."

DNYANSAGAR
ARTS AND COMMERCE
COLLEGE

COST – COSTING – COST ACCOUNTING – COST ACCOUNTANCY

COST

- Cost is commonly defined as ‘sacrificed resource’ for a particular thing.
- Cost can be of anything which is measurable in terms of money.

COSTING

- ‘Costing’ is a process for determining the cost.
- It is the technique for ascertaining the cost of production of any product or service in the business organization.

COST ACCOUNTING

- Cost Accounting is basically the next step to costing. Cost accounting involves analyzing relevant costing data, interpret it and present various management problems to management.

COST ACCOUNTANCY

- This term is over and above costing and cost accounting.
- It facilitates management with cost control initiatives, ascertainment of profitability and informed decision making.

Meaning and Definition of costing

Different techniques and process used to determine the cost of a product is called costing. **Example:** Process costing techniques is used in the dairy industries for the manufacturing of different dairy products like, ice- cream, paneer, ghee, curd. etc.

According to ICMA, London, has defined costing as the ascertainment of costs. Costing include, “the techniques and process of ascertaining costs.”. the techniques refers to principles and rules which are applied for ascertainment cost of product manufactured and services rendered.

Different Costing Methods

1. Job Costing
2. Marginal costing
3. Standard costing
4. Operational costing



5. Process Costing

Purpose of Costing

- 1.. To ascertain the exact cost of a product.
2. To determine the cost incurred during each operation and process
3. To decide the selling price of a product.
4. To prevent the excessive loss during manufacturing process.
5. Suggest better and low cost design.

Choice of costing method depends on following factors:

- (i) Nature of Industry,
- (ii) Class of products manufactured,
- (iii) Quantity of goods produced, and
- (iv) Types of labour required for production.

Meaning and Definition of Cost Accounting

Cost accounting is a process of recording, analysing and reporting a cost of a product. This is a formal system of cost records so that ascertainment of cost became easy and reliable. Cost accounting determines fixed and variable element of cost associated with the product. Example:

Techniques of cost Accounting:

1. Uniform Costing
2. Absorption Costing
3. Historical Costing
4. Batch Costing
5. Unit Costing



According to ICMA, London, “Cost accounting means a specialized application of the general principles of accounting in order to ascertain the cost of producing and marketing any unit of manufacture or of carrying out any particular job or contract”

Meaning and Definition of Cost Accountancy

Cost Accountancy is the process of applying the costing principles, methods, and techniques. It also helps in decision making process of management. Cost accountancy is characterised as arts, science and practice.

Cost accountancy as an art: Arts include special techniques and skill to do a work, here cost accountant need special skills to ascertain a cost of a product, therefore we can conclude that cost accountancy as an art.

Cost accountancy as a science: science involve organised body of knowledge, principles, techniques and procedures, Cost accountancy also need organised body of knowledge, it required special techniques and procedures.

Cost accountancy as a practice: Practice required regularity in a field, Cost accountancy need regular practice in order to achieve effective result and proper cost management

Origin of Cost Accounting

Cost accounting is incredibly previous conception. it's needed for all businesses and organization to stay track of their activities and prices. it's a really useful in higher cognitive process activity.

The age of the economic revolution resulted within the beginning of enormous businesses and organizations. therefore these organizations were a lot of complicated and dynamic.

So the origin and evolution of accounting is copied back to the economic revolution. the thought was to assist the businessmen to record and keep a track of their prices and expenses.

During the early industrial era ,cost accountant think about all business value as “variable cost”

However, once manufacture took off, these businesses had a lot of ‘fixed costs’. These are prices that don't seem to be directly associated with the assembly of products or services. Some samples of fastened prices are rent, depreciation, storage prices etc.



Objectives of Cost Accounting

Following are the objectives of cost Accounting:

- To ascertain the cost of a product
- To ascertain the profits.
- To find the selling price of a product
- To regulate the Business policy.
- Help the management in decision making process.
- To help in cost reduction.

Features of cost Accounting

- It is a process of accounting to determine costs and price of a product.
- It records incomes and expenditures, required for manufacturing of product and rendering services.
- It provides statistical data for preparing estimates and budgets
- It is the basis for cost control and cost reduction policies of a company.
- It evaluates efficiency by comparing actual with standard and find the reasons for variance.
- It involves recording, analysis, comparison and reporting of data in order to ascertain cost.

Conceptual analysis of cost unit and cost centre

COST UNIT: Total expenditure incurred to produce, store, and sell one unit of a product or service is called as cost unit. Unit cost of a product include variable cost and fixed cost.

There are various factors which should be considered while selecting cost unit.

Example: milk is quantified as per litres, per gallon, whereas power and electricity is measured as Kilowatt-hours.



Single cost unit:

It involves the use of a single standard or unit of measurement of the goods manufacture e.g. Product per piece, per kilogram, per quintal, per tonne, per gallon, per meter etc.

Composite Unit or Complex Unit: It is a combination of two simple units e.g., per passenger-kilometer, per tonne-kilometre , per kilowatt-hour etc.

COST CENTRE

A cost centre is a division within a company. The manager and employees of different cost centre are responsible for its costs but are not directly responsible for sales or profit decisions. Some of the cost centre are Research and development centre, marketing centre, Customer Care centre.

According to CIMA “a production or service, function, activity or item of equipment whose costs may be attributed to cost units. A cost centre is the smallest organizational sub-unit for which separate cost allocation is attempted.”

Cost Centre is a location, person or item of equipment for which cost may be ascertained and used for the purpose of cost control. From Practical approach a cost centre may be relatively easy to establish, because a cost centre is a unit of the organization to which costs can be separately assigned

A cost centre is an individual activity or group of similar activities for which costs are accumulated.

Example:

- 1) An item of equipment e.g., a machine, forklift, truck or delivery van.
- 2) A person e.g., a sales person, Marketing representative, Financial advisor etc.

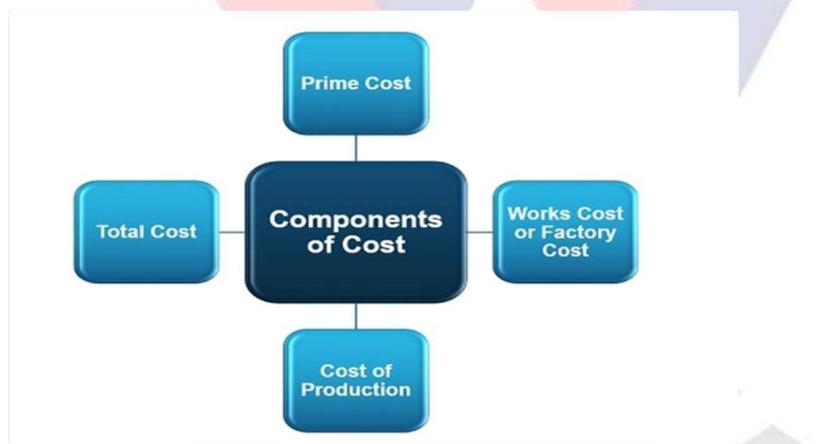
Unit-2

Elements of cost and Cost Sheet

Topics

1. Material, Labour and other Expenses
2. Classification of Cost &
3. Types of Costs
4. Preparation 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.



A. Prime Cost

The initial cost made for manufacturing a product, i.e., raw material, labour wages and other production-related expenses, is termed as prime cost.

Following is the equation for computing the prime cost:

$$\text{Prime Cost} = \text{Direct Labour} + \text{Direct Material} + \text{Direct Expenses}$$

Where direct material is calculated with the help of the following formula:

$$\text{Direct Material} = \text{Material Purchased} + \text{Op. stock of Raw material} - \text{Closing Stock}$$



of Raw Material

B. Works Cost or Factory Cost

The works cost is calculated by summing up the prime cost with the factory overheads and simultaneously adjusting the opening and closing stocks of work in progress. It can be denoted as:

Work Cost = Prime Cost + Factory Overheads + Op. Stock of WIP – Closing stock of WIP
Where –
WIP (Work in Process)

C. Cost of Production

The cost of production includes all the direct and indirect cost, including the material, labour and other expenses, i.e., production cost, factory cost and office or administration cost.

The following formula denotes the computation of cost of production: Cost of Production = Factory Cost + Administrative Expenses

After making an adjustment of the opening finished goods and the closing finished goods to the cost of production, we acquire the cost of production of goods sold.

D. Total Cost

The final value of a product or service can be determined after adding all the selling and distribution expenses to the cost of production of goods sold. The formula to find out the total cost or cost of sales is:

TOTAL COST = Cost of Goods Sold + Selling And Distribution Expenses

If the sales price of the products or service is known, the following method can be used to determine the profit:

Profit = Cost – Selling Price



	Particulars	Total Cost (Rs.)	Cost per unit (Rs.)
1.	Direct material Consumed:		
	- Opening Stock of Material	XXX	
	- Add: Purchases	XXX	
	- Less: Closing Stock of Material	(XXX)	
		XXX	
2.	Direct labor cost	XXX	
3.	Direct Expenses	XXX	
4.	Prime Cost (1+2+3)	XXX	
5.	Factory Overheads	XXX	
6.	Gross Works Cost (4+5)	XXX	
7.	Add: Opening Work in Progress	XXX	
8.	Less: Closing Work in Progress	(XXX)	
9.	Factory Cost (6+7+8)	XXX	
10.	Quality control cost	XXX	
11.	Research and Development cost	XXX	
12.	Administrative Overhead	XXX	
13.	Less: Credit for Recoveries/Scrap/By-Products	(XXX)	
14.	Add: Packing Cost (Primary)	XXX	
15.	Cost of Production (9+10+11+12-13+14)	XXX	
16.	Add: Opening stock of Finished Goods	XXX	
17.	Less: Closing stock of Finished Goods	XXX	
18.	Cost of Goods Sold (15+16-17)	XXX	
19.	Add: Administrative Overheads	XXX	
19.	Add: Selling and Distribution Overheads	XXX	
21.	Cost of Sales (18+19+20)	XXX	



UNIT:3

OVERHEADS

Topics:

1. Meaning and Definitions
2. Classification of Overheads
3. Collection, allocation, apportionment and reapportionment of overheads
4. Under and over absorption – Definition and Reasons

Meaning and definition of overheads

Overhead is those costs required to run a business, but which cannot be directly attributed to any specific business activity, product, or service

Overhead includes activities that are not directly related to the products or services that the firm offers, but they support the firm's profit-making activities. For example, paying the rent is not a profit-making activity, but it allows the firm to maintain a building and manufacture its products.

EXAMPLES: Employee salaries, Office equipment and supplies, External legal and audit fees

OVERHEADS= Indirect Material + Indirect wages+ Indirect Expenses

Features of overhead expenses

- ❖ Overheads are indirect costs.
- ❖ They are common costs.
- ❖ Overhead comprises of both cash expenses and non-cash expenses.
- ❖ Overhead consist of both Production and non-production expenses.
- ❖ Overhead are both variable and fixed.
- ❖ They include both escapable and inescapable.

“All overheads are the costs, but all costs are not the overhead”.



Composition of Overhead

Indirect Material Expenses

- Cleaning materials.
- Lubricants.
- Consumables stores.
- charges
- Oils.
- charge
- Cotton waste.

Indirect Labor

- Technical director's
- Store keepers wages
- Foremen salary
- Wages of packers
- Salary of office staff

Indirect

- Coal and coke.
- Audit fees.
- Publicity
- warehouse
- Legal charges

Classification of overheads

Classification of overheads





Steps involve in overheads Accounting.

1. Collection and Classification of overheads.
2. Allocation of overheads.
3. Apportionment of overheads.
4. Re-apportionment of overheads.
5. Absorption of Overheads.

Collection of Overheads.

The collection of overhead is the process of recording each item of cost in the book of accounts maintained for the purpose of ascertainment of cost of each cost Centre or cost unit.

Allocation of overheads

Overheads are common costs incurred for the benefits of a number of costs centers or cost units. Therefore, they can not be identified and allocated directly to a particular unit of output. As such, they are to be allocated among the units of output of a particular department or a number of departments or cost centers.

“Allocation of Overheads is always direct”

Apportionment of Overheads

Distribution of an overhead cost to several departments or cost centers is known as apportionment of overheads. It is the process of charging or apportioning costs to a number of cost centers or cost units. If a given cost is common to two or more departments or cost centers, such cost should be apportioned or divided among these departments on an equitable basis. For example, the amount of factory rent should be apportioned to all the departments.

Principles of Apportionment of Overhead Costs

1. Service or Use or Benefit Derived
2. Ability to Pay Method
3. Efficiency Method



4. Survey Method

Methods for re-apportionment of overhead

- ❖ Direct Redistribution Method
- ❖ Non-Reciprocal or Step Ladder Method
- ❖ Simultaneous Equation (Reciprocal) Method
- ❖ Repeated Distribution (Reciprocal) Method

Absorption: Meaning

Overhead absorption is the amount of indirect costs assigned to cost objects. Indirect costs are costs that are not directly traceable to an activity or product. Cost objects are items for which costs are compiled, such as products, product lines, customers, retail stores, and distribution channels.

Over and Under absorption of overheads

If the absorbed overheads at predetermined rates are greater than actual overheads, this is known as OVER-ABSORPTION. Conversely, if absorbed overheads are less than the actual overheads, this is known as UNDER-ABSORPTION



UNIT:4

Contact and Process Cost and Methods of Costing

Topics

1. Contract Costing – Meaning And Features Of Contract Costing,
2. Works Certified And Uncertified,
3. Escalation Clause,
4. Cost Plus Contract,
5. Work In Progress, Profit On Incomplete Contract ,
6. Process Costing - Meaning, Features Of Process Costing,
7. Preparation Of Process Costing Including Normal And Abnormal Loss/Gains

Contract Costing – Meaning And Features Of Contract Costing

In this method costing is done for jobs that involve heavy expenditure and stretches over long period and across different sites. It is also called as terminal costing.

Example: Construction of roads and bridges, buildings etc.

Contract costing

Contract costing is a specialized system of Job costing applies to long-term contracts as distinct from short-term jobs. Contract costing is mainly applied in civil construction and engineering projects, ship building, road and railway line contracts, construction of bridges etc.

The contract costing method is used mostly by builders, civil contractors, ship builders, and construction and mechanical engineering firms. Generally, the contract is undertaken at the site of contract i.e. customer and according to the specifications of customer. Moreover, the period inquired to complete a contract is fairly long time or usually more than one year.



The main purpose of preparing contract account is the ascertainment of cost of each contract separately and profit on each contract.

Features of contract costing

1. A contract is undertaken according to the specific requirements of customers.
2. Generally, the duration of a contract is long period.
3. The contract is undertaken only at the site of the customer.
4. Contract work mainly consists of construction activities.
5. The specific order costing principles are applied in contract costing. The size of a contract is usually large or bigger than jobs.
6. It requires a long time to complete a contract.
7. Each contract is an independent one, quite distinct from another.
8. A distinctive number is assigned to each contract to differentiate the contract from one another.
9. A separate account is maintained and prepared for each contract to find out the profit earned from each contract separately.

IMPORTANT TERMS

1. Work certified: It is that part of the contract work which is being completed by the contractor for which a completion certificate has been issued by the contractee's architect. The amount of work certified is debited to contractee's Account and credited to contract account.

Value of work certified: $\text{Contract price} \times \text{work certified as \% of contract price}$

OR

$\text{Cash Received} / \text{Cash received as \% of work certified}$



2. Work uncertified: It is the cost of that part of the contract work which is being completed by the contractor but not certified by the architects because of the faulty work or the work not according to the specifications. In respect of such work there will be no payment from the contractee. The cost price of each work is Debited to work -in -progress account and credited to contract account.

Cost of work uncertified = Total cost incurred till date-cost of work certified.

OR

Total Cost incurred till date X %of work Uncertified / %of total work done till date.

WORK
CERTIFIED

- ⊙ “Work Certified is that proportion of the work completed which has been certified or and valued by the architect or surveyor.”
- ⊙ Payment is made on the basis of Work Certified.

WORK
UNCERTIFIED

- ⊙ “Work Uncertified is that part of the work completed which has not been certified/approved by the contractee’s architect or surveyor.”
- ⊙ There is no role of Work Uncertified in payment.



Profit on incomplete contracts

Case 1

When work-certified is less than 25% of contract price- No profit should be transferred to P & L A/c. The entire notional profit is kept in reserve for contingencies.

Case 2

When work certified is 25% or more but less than 50% of the contract- 1/3rd of the notional profit, subject to the ratio of cash received to work certified, and is transferred to P & L A/c.

**Profit credited to P/L= Notional profit X 1/3 X Cash received
work certified**

Case 3

When work certified is 50% or more of the contract price- 2/3rd of the notional profit is transferred to P & L A/c, after reducing it further in the ratio of cash received to work certified.

**Profit credited to P/L= Notional profit X 2/3 X Cash received
work certified**

Case 4

When work certified is 90% or more of the contract price than entire notional profit is transferred to P & L A/c.

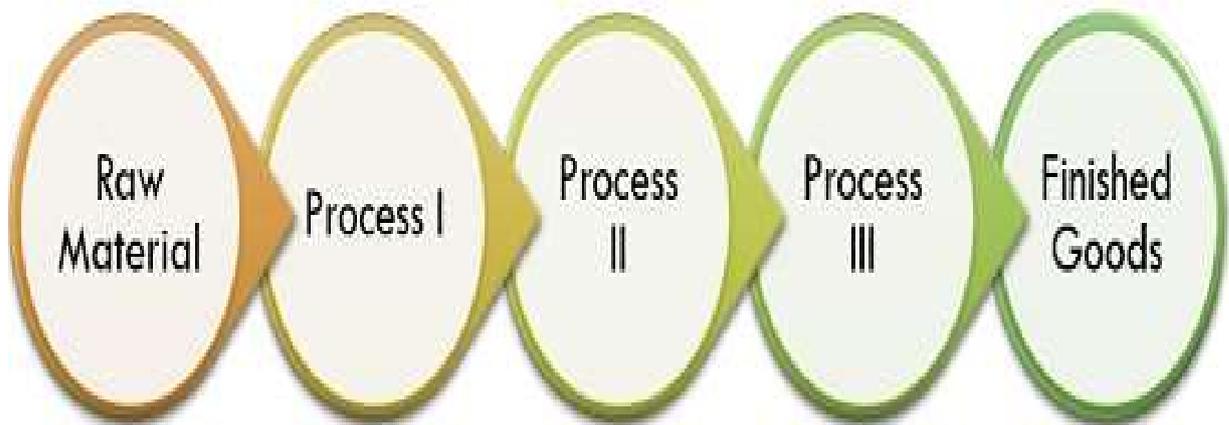
Meaning of Process Costing

Process Costing is defined as a branch of **operation costing**, that determines the cost of a product at each stage, i.e. process of production. It is an accounting method which is adopted by the factories or industries where the standardized identical product is produced, as well as it passes through multiple processes for being transformed into the final product.

In simple words, process costing is a cost accounting technique, in which the costs incurred during production are charged to processes and averaged over the total units manufactured. For this purpose, process accounts are opened in the books of accounts, for each process and

all the expenses relating to the process for the period is charged to the respective process account.

DIAGRAMATIC PRESENTATION



Features of Process Costing

- ❖ The plant has various divisions, and each division is a stage of production.
- ❖ The production is carried out continuously, by way of the simultaneous, standardized and sequential process.
- ❖ The output of a process is the input of another.
- ❖ The production from the last process is transferred to finished stock.
- ❖ The final product is homogeneous.
- ❖ Both direct and indirect costs are charged to the processes.
- ❖ The production may result in joint and by-products.
- ❖ Losses like normal and abnormal loss occur at different stages of production which are also taken into consideration while calculating the unit cost.
- ❖ The output of one process is transferred to another one at a price that includes the profit of the previous process and not at the cost.



- ❖ At the end of the period, if there remains the stock of finished goods, then it is also expressed in equivalent completed units. It can be calculated as:
Equivalent units of semi-finished goods or WIP = Actual number of units in process × Percentage of work completed

Preparation of process accounts including normal and abnormal loss/gain

Process Losses and Gains

It is usual that a certain amount of material introduced into the processes are lost, scrapped or wasted. There are many ways in which losses may arise e.g., evaporation, shrinkage, breakages, spoilage for various reasons.

