

Contents

Unit 1 : Introduction to Cost Accounting

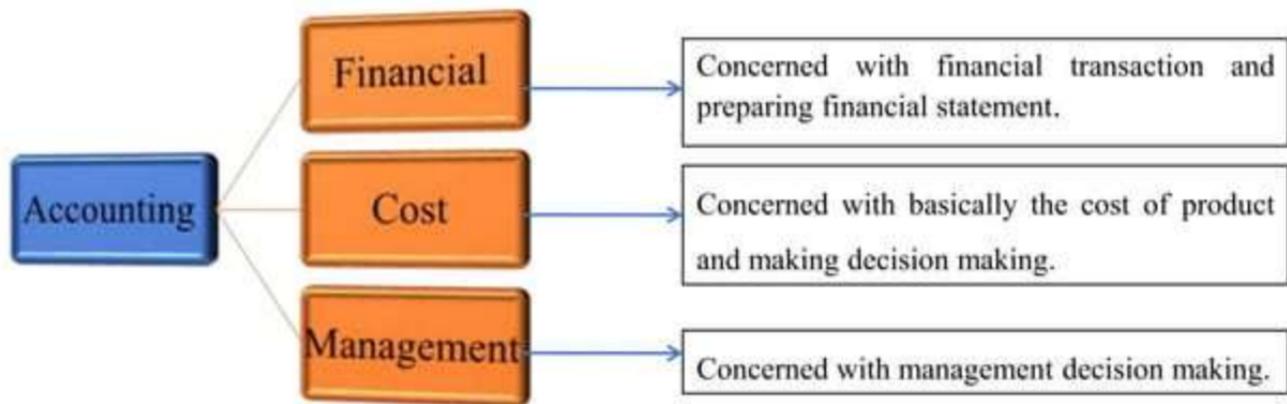
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Accounting & Its Types:-

Accounting is the art of recording, measuring and communicating information about the financial transaction for a particular year. In other words the accounting is basically the business language through which we can understand the working of any business entity.



Accounting & Its Types:-



Cost Accounting vs Financial Accounting

Basis of Difference	Cost Accounting	Financial Accounting
Nature	It classifies, costs records, present, and interprets it in a significant manner	It classifies records, present and interprets transactions in monetary terms.
Objectives	Ascertainment of cost for the purpose of cost control and decision making.	It provides information about the financial performance of an entity.
Recording of Data	It makes use of both historical and pre-determined costs.	It records Historical data.
Rules & Regulations	It follows certain principles and procedures for recording costs of different products.	It uses Accounting Standard and Laws Framed by Statutory Authority

Cost Accounting vs Management Accounting

Basis of Difference	Cost Accounting	Management Accounting
Nature	It classifies, costs records, present, and interprets it in a significant manner	It records both qualitative and quantitative aspect.
Objectives	Ascertainment of cost for the purpose of cost control and decision making.	It provides information to management for planning and co-ordination.
Recording Data of	It makes use of both historical and pre-determined costs.	It is focused with the projection of figures for future.
Rules & Regulations	It follows certain principles and procedures for recording costs of different products.	It does not follow any specific rules and regulations.

Introduction To Cost Accounting

- ❑ After passing your 12th examination, if you set up a small manufacturing unit, say manufacturing of PEN, a problem will arise what price of each PEN you should quote to the buyer.
- ❑ Many factors are considered while fixing the price of a product/item such as competitors price etc. One of the basic factors is the cost of its production.
- ❑ Cost is essential not only to fix price but also to ascertain the margin of profit.
- ❑ Knowledge of the cost determination is also necessary to keep a check on the cost of product/control on wastages etc.
- ❑ The accounting used to study the various aspects of cost is known as cost accounting. In this lesson, you will learn about meaning, importance, limitations etc. of cost accounting.

To understand the meaning of Cost Accounting, there is need of explaining certain related terms also:-

Cost

- The amount of expenditure incurred or attributed on a given thing. For ex. Cost of Mobile is Rs. 8,000/-

Costing

- The technique and process of ascertaining cost. Techniques like process costing, marginal costing, batch costing etc.

Cost Accounting

- Cost accounting is accumulation, classification, analysis and interpretation of cost data for -
Ascertainment of cost, Operational planning and control, Decision-making

Cost Accountancy

- The application of costing and Cost Accounting principles, methods and techniques for ascertainment of profit.

Cost Control

- The guidance and regulation by executive action of costs of operating on undertaking. Cost control is exercised through a number of techniques such as Standard Costing and Budgetary Control.

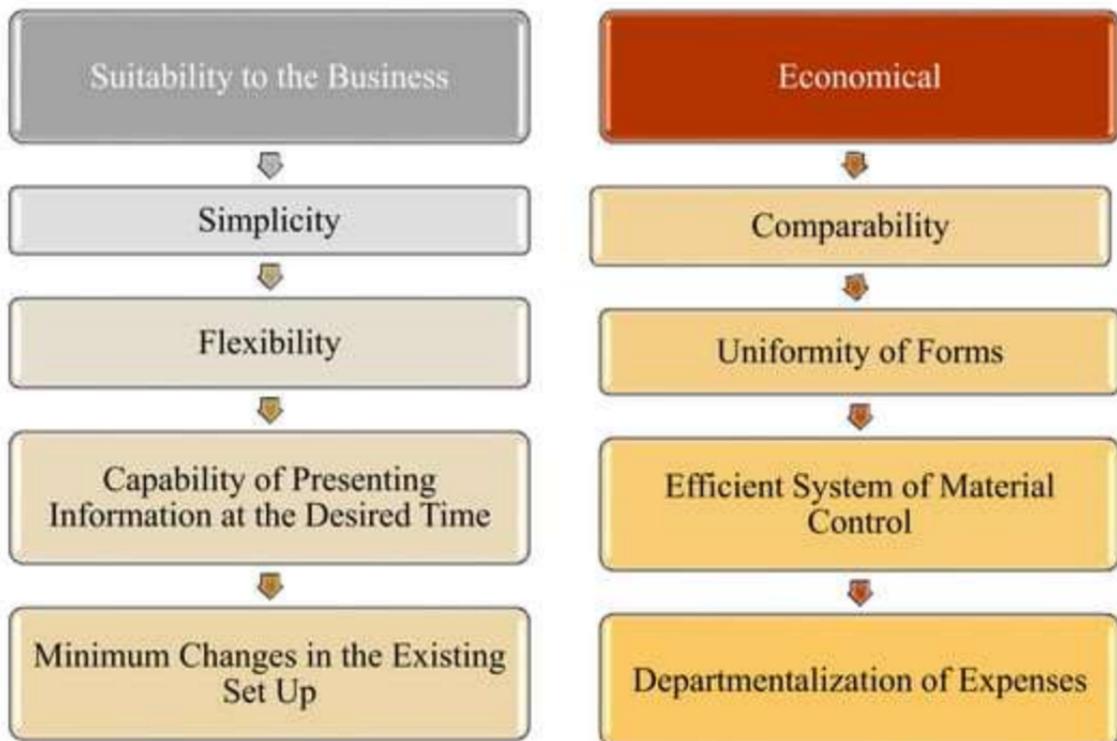
Cost Audit

- It the verification of cost accounts and a check on the adherence to the cost accounting plan by independent expert of the cost accounts.'

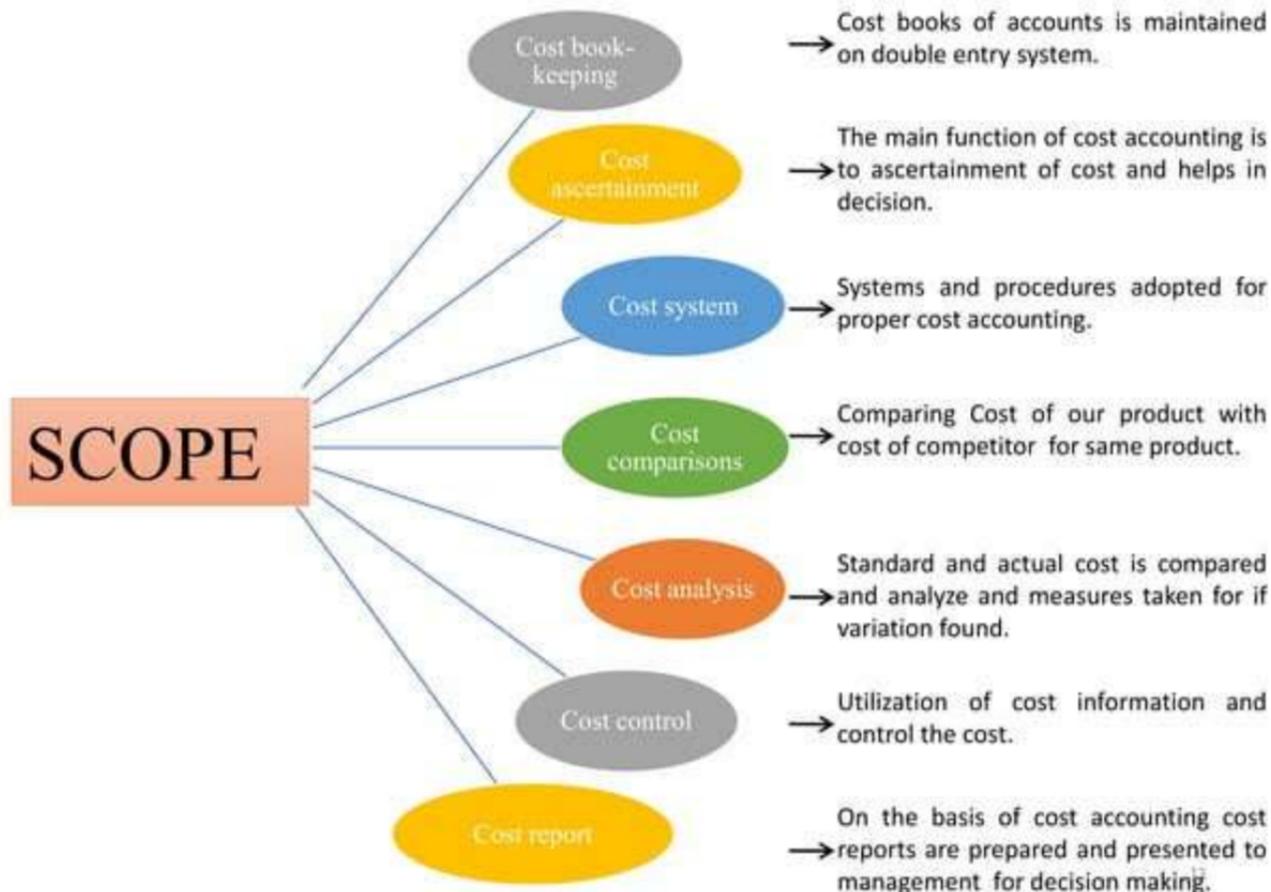
Objectives of Cost Accounting:-



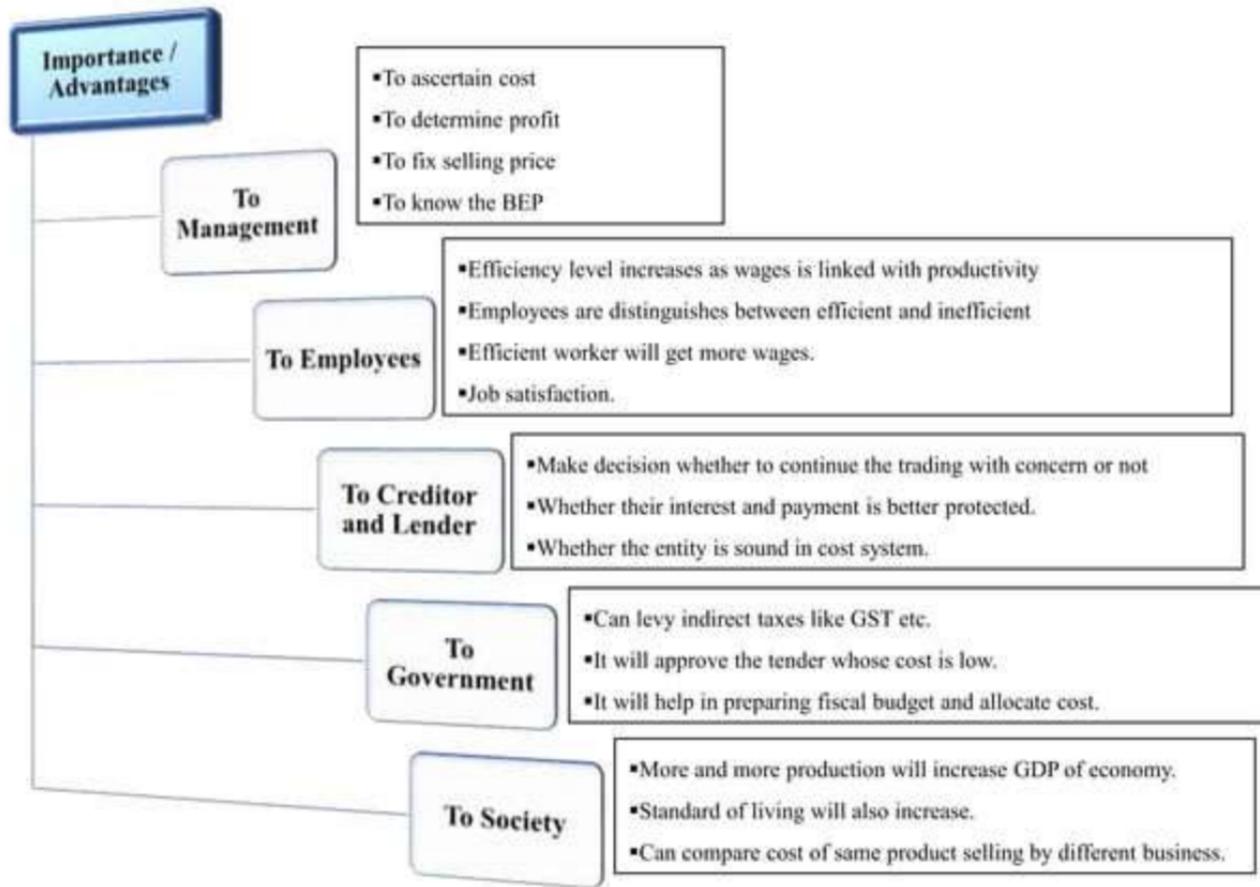
FEATURES / CHARACTERISTIC:-



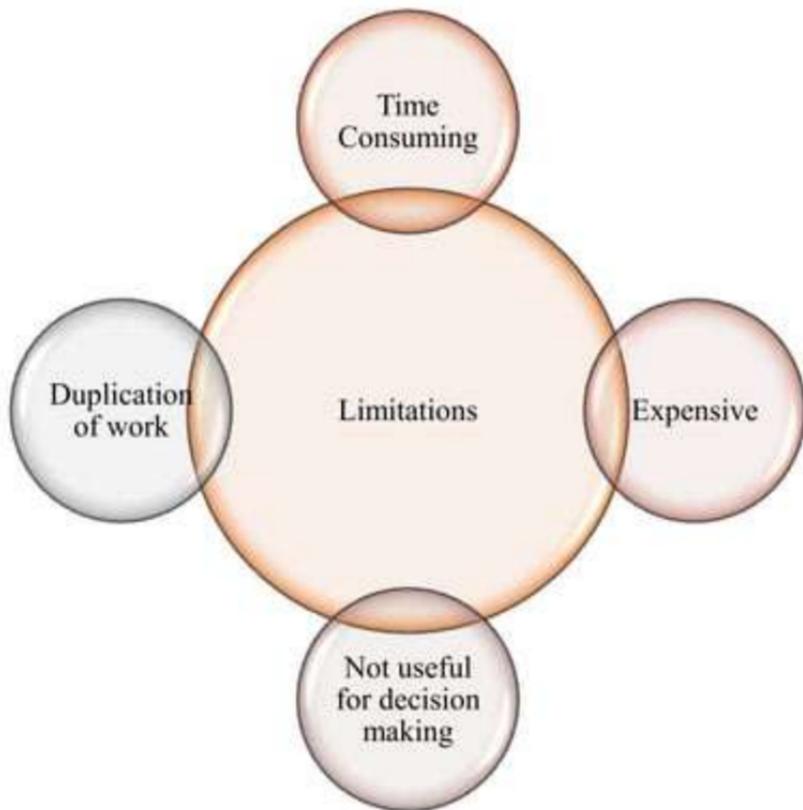
Scope of Cost Accounting



Importance of Cost Accounting



Limitations of Cost Accounting



Classification of Cost

Classification of Cost

On the basis of
Nature

On the basis of
Variability

On the basis of
Component

On the basis of
Controllability

On the basis of
Managerial

On the basis of
Function

Classification of Cost on the Basis of Nature

On the
Basis of
Nature

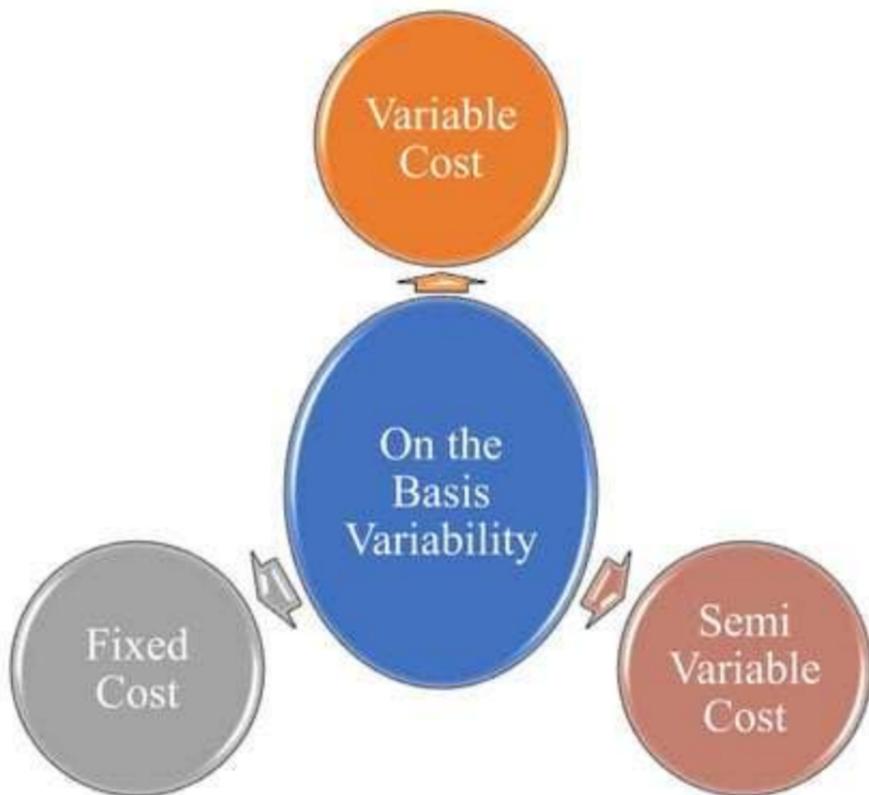
Direct
Cost

Directly Attributable to Product or Services For E.g. Steel is required for Manufacturing Cars.

Indirect
Cost

Not Directly Attributable to Product or Services For E.g. teel is required for Manufacturing Cars.

Classification of Cost on the Basis of Variability



Classification of Cost on the Basis of Component

On the Basis of Component

Material Cost

- *Direct Material
- *Indirect Material

Labour Cost

- *Direct Labour
- *Indirect Labour

Overhead Cost/Expenses

- *Direct Exp/Cost
- *Indirect Exp / Cost

Material Cost

Direct Material	Indirect Material
<p>➤ Direct material cost is that which can be conveniently identified with and allocated to cost units.</p> <p>➤ It generally become a part of the finished product.</p> <p>➤ For example, cotton used in a textile mill is a direct material.</p> <p>➤ However, in many cases, though a material forms a part of the finished product , yet, it is not treated as direct material; e.g., nails used in furniture, thread used in stitching garments, etc.</p> <p>➤ This is because value of such materials is so small that it is quite difficult and futile to measure it. Such materials are treated as indirect materials.</p>	<p>➤ Indirect Materials are those materials which cannot be conveniently identified with individual cost units.</p> <p>➤ These are minor in importance, such as:-</p> <p>(i) Small and relatively inexpensive items which may become a part of the finished product ; e.g., pins, screws, nuts and bolts, thread, etc.</p> <p>(ii) Those items which do not physically become a part of the finished products; e.g., coal, lubricating oil and grease, sand paper used in polishing, soap, etc.</p>

Labour Cost

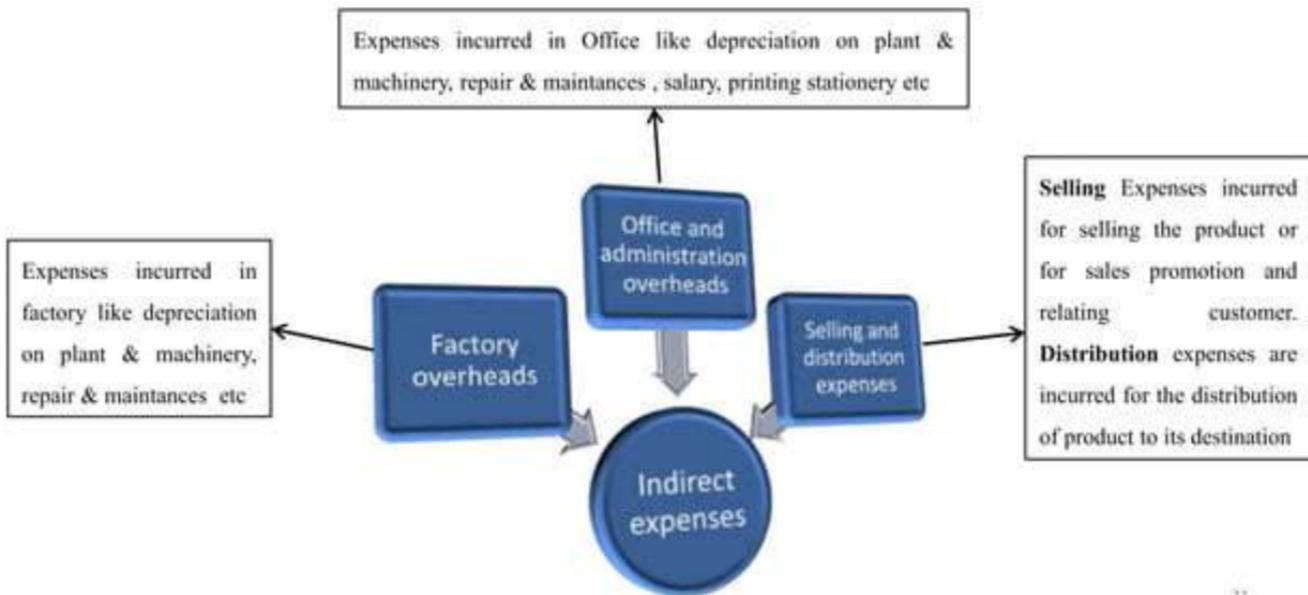
Direct Labour	Indirect Labour
<ul style="list-style-type: none">➤ Direct labour cost consists of wages paid to workers directly engaged in converting raw materials into finished products.➤ These wages can be conveniently identified with a particular product, job or process. Wages paid to a machine operator is a case of direct wages.	<ul style="list-style-type: none">➤ It is of general character and cannot be conveniently identified with a particular cost unit.➤ In other words, indirect labour is not directly engaged in the production operations but only to assist or help in production operations.

Expenses

It is defined as *“the cost of services provided to an undertaking and the notional cost of the use of owned assets.”* (CIMA).

<u>Direct expenses:-</u>	<u>Indirect expenses:-</u>
According to CIMA, UK, “direct expenses are those expenses which can be identified with and allocated to cost centres or units.”	All indirect costs, other than indirect materials and indirect labour costs, are termed as indirect expenses.
These are those expenses which are specifically incurred in connection with a particular job or cost unit .	These cannot be conveniently identified with a particular job, process or work order and are common to cost units or cost centres.
Direct expenses are also known as chargeable expenses.	

Indirect expenses:-



Classification of Cost on the Basis of Controllability



Classification of Cost on the Basis of Managerial Decision Making

Types	Meaning
Relevant Cost	Relevant cost is a managerial accounting term that describes avoidable costs that are incurred only when making specific business decisions
Sunk Cost	Historical costs incurred in the past are known as sunk costs. They play no role in decision making in the current period. For example, in the case of a decision relating to the replacement of a machine, the written down value of the existing machine is a sunk cost and therefore, not considered.
Differential Cost	It represents the change (increase or decrease) in total cost (variable as well as fixed) due to change in activity level, technology, process or method of production, etc. For example, if any change is proposed in the existing level or in the existing method of production, the increase or decrease in total cost or in specific elements of cost as a result of this decision will be known as incremental cost or decremental cost.
Opportunity Cost	This cost refers to the value of sacrifice made or benefit of opportunity foregone in accepting an alternative course of action. For example, a firm financing its expansion plan by withdrawing money from its bank deposits. In such a case the loss of interest on the bank deposit is the opportunity cost for carrying out the expansion plan.

Classification of Cost on the Basis of Managerial Decision Making

Types	Meaning
Out of Pocket Cost	It is that portion of total cost, which involves cash outflow. This cost concept is a short-run concept and is used in decisions relating to fixation of selling price in recession, make or buy, etc. Out-of-pocket costs can be avoided or saved if a particular proposal under consideration is not accepted.
Product Cost	These are the costs which are associated with the purchase and sale of goods
Period Cost	These are the costs, which are not assigned to the products but are charged as expenses against the revenue of the period in which they are incurred. All non-manufacturing costs such as general & administrative expenses, selling and distribution expenses are recognized as period costs.
Imputed Cost	These costs are notional costs which do not involve any cash outlay. Interest on capital, the payment for which is not actually made, is an example of imputed cost. These costs are similar to opportunity costs.

Classification of Cost on the Basis of Functions (Elements of Cost Sheet)



Cost Sheet

A Cost Sheet is a statement which shows the break-up and build-up of costs. It is a document which provides for the assembly of the detailed cost of a cost center or a cost unit. Further cost sheet document can be prepared either by using historical cost or by referring to estimated costs. A historical cost sheet is prepared based on the actual cost incurred for a product. An estimated cost sheet, on the other hand, is prepared based on estimated cost just before the production begins.



Cost Sheet Format (Basic Cost Sheet)

PARTICULAR	AMOUNT	AMOUNT
DIRECT MATERIAL	XXXXX	
DIRECT LABOUR	XXXXX	
DIRECT EXPENSES	XXXXX	
PRIME COST		XXXXX
FACTORY OVERHEADS		XXXXX
FACTORY COST		XXXXX
OFFICE OVERHEADS		XXXXX
COST OF PRODUCTION		XXXXX
SELLING & DIST OVERHEADS		XXXXX
COST OF SALES		XXXXX
PROFIT		XXXXX
SALES		XXXXX

Cost Sheet Format (Standard Cost Sheet)

PARTICULAR	AMOUNT	AMOUNT
Direct Material Consumed (Op. Stock of R/M + Purchase – Cl. Stock of R/M)	XXXXX	
Direct Labour	XXXXX	
Direct Expenses	XXXXX	
PRIME COST		XXXXX
<u>Add:- Factory Overhead</u>		
Factory Rent, Power & Fuel , Indirect Material, Depreciation on Machinery, Oil & Water Charges Etc	XXXX	
Total Factory Overhead	XXXX	
Add:- Opening Stock of WIP	XXXX	
Less:- Closing Stock of WIP	XXXX	
WORKS COST/ FACTORY COST		XXXXX
<u>Add:- Office & Admin O/H's</u>		
Audit Fees, Directors fees, Legal Fees, Depreciation of furniture Etc	XXXX	
COST OF PRODUCTION		XXXXX
Add:- Opening Stock of FG	XXXX	
Less:- Closing Stock of FG	XXXX	
COST OF GOODS SOLD		XXXXX
Add:- Selling & Distribution Exp.		
TD, CD, Commission, Brokerage, Advertisement, Bad debts, After Sale Services etc	XXXX	
COST OF SALES / TOTAL COST		XXXXX
PROFIT		XXXXX
SALES		XXXXX

Items Excluded from Cost Sheet

Incomes

- (a) Profit on sale of Fixed Assets
- (b) Profit on sale of investments
- (c) Interest Income
- (d) Dividend Income
- (e) Rental Income
- (f) Transfer fees

Expenditures

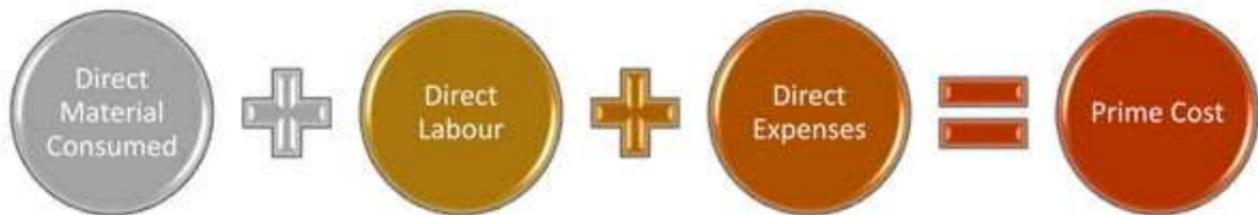
- (a) Loss on sale of fixed assets
- (b) Loss on sale of Investments
- (c) Interest on mortgage and loans
- (d) Preliminary expenses written off
- (e) Goodwill written off
- (f) Underwriting commission and debenture discount written off
- (g) Fines and penalties

Appropriations

- (a) Income tax
- (b) Dividend Distribution tax
- (c) Transfer to General Reserves
- (d) Transfer to Special Reserves like Dividend Equalisation Reserve etc.

Classification of Cost on the Basis of Functions

Prime Cost:-

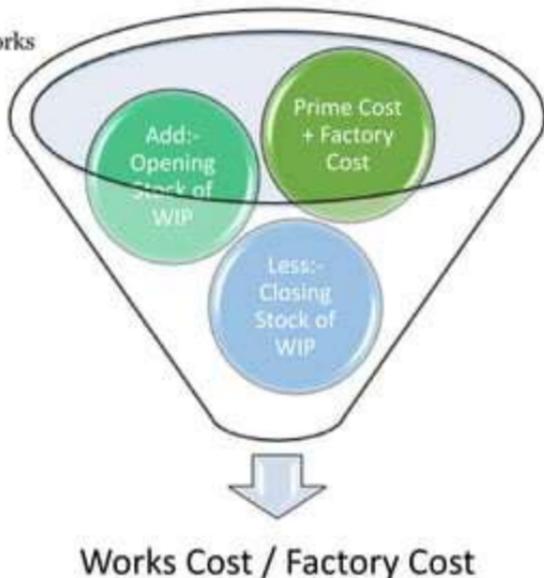


Classification of Cost on the Basis of Functions

Factory Cost or Works Cost:- Factory cost is the summation of prime cost and factory overheads that includes indirect material, indirect labour and indirect expenses of factory. It is also known as work cost, manufacturing cost or production cost.

The following expenses should be taken under the head factory expenses/works expenses-

- | | |
|---|-----------------------------------|
| i. Fuel and power, | ii. Factory rent, |
| iii. Foremen's wages, | iv. Lighting, |
| v. Heating, | vi. Tools used Consumable stores, |
| vii. Repairs to buildings, | viii. Indirect materials, |
| ix. Indirect wages, | x. Leave wages, |
| xi. Insurance, | xii. Overtime wages, |
| xiii. Supervision, | xiv. Works stationery, |
| xv. Canteen and welfare expenses, | xvi. Works salaries, |
| xvii. Depreciation of plant and machinery, | xviii. Works expenses , |
| xix. Gas & water, | xx. Technical director's fee, |
| xxi. Laboratory expenses, | xxii. Works telephone expenses , |
| xxiii. Internal transport expenses (Haulage) etc. | |

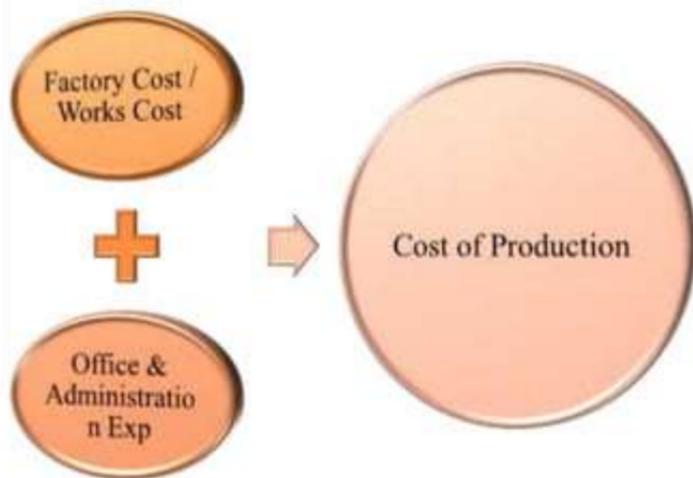


Classification of Cost on the Basis of Functions

Cost of Production:-

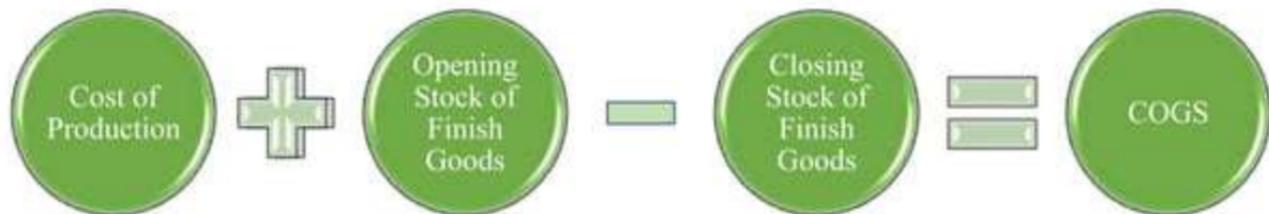
The following expenses should be taken under office and administration expenses-

- | | |
|---|---|
| i. Office salaries, | ii. Bank charges, |
| iii. Legal expenses, | iv. Office rent, |
| v. Director's fee, | vi. Printing and stationery, |
| vii. Office expenses, | viii. Depreciation of office furniture, |
| ix. Subscription to trade journals, | |
| x. Office lighting, | xi. Establishment charges, |
| xii. Director's traveling expenses , | |
| xiii. Postage, | xiv. Audit fee, |
| xv. Depreciation & repairs of office equipment's. | |



Classification of Cost on the Basis of Functions

Cost of Goods Sold (COGS):-



Classification of Cost on the Basis of Functions

Cost of Sales:-

The following expenses should be taken under selling and distribution overheads-

- i. Travelers commission,
- ii. Advertising Show room expenses,
- iii. Bad debts Salesmen salaries & expenses,
- iv. Packing expenses,
- v. Carriage outwards
- vi. Collection charges
- vii. Cost of catalog Expenses of sales branch establishment etc.



Tender / Quotations

The price **quoted** for future production is called **Quotation** Price or **Tender** Price. This price is ascertained on the basis of previous **cost sheet**. Tender sheet is also a kind of cost sheet. Sometimes a manufacturer is required to give quotation for order. The competitive quotation price needs to be submitted in advance for getting new work or order.

Different types of Cost Statement for Tender / Quotations

No Change in Cost & Profit % over the past period

Where there is a change in cost of Material & Labour but profit % remains same

Where tender is based on overhead % of past period & definite profit is required

When change in estimated cost of material & labour & overheads is to consider

When changes in expenses is indicated in %

When production capacity is different in one period from other & tender price

Depends upon the determination of capacity cost

Different types of Cost Statement for Tender / Quotations

THANK YOU