

Auxilium college of arts and science for women

Regunathapuram, Pudukkottai-622302.

Ms.A.Anitha Janova Assistant professor

Department of commerce

Cost and Management Accounting

Introduction

Financial Accounting: It is “the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events, which are in part at least, of a financial character and interpreting the results thereof”

The information supplied by financial accounting is summarized in the following statements, generally at the end of an year:

P & L Account

Balance Sheet

Cash Flow Statement

Limitations of Financial Accountin

1. Shows only overall performance
 2. Historical in nature
 3. No performance appraisal
 4. No material control system
 5. No labour cost control
 6. No proper classification of costs
 7. No analysis of losses
 8. Inadequate information of price fixation
 9. No cost comparison
 10. Fails to provide useful data to management
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Cost (Introduction)

- Cost is a measurement, in monetary terms, of the amount of resources used for the purpose of production of goods or rendering services.
- Cost is the amount of actual or notional expenditure relating to a product, job, service, process or activity.
- Cost is often used as a generic term to describe various types of costs.

Cost Concepts

- ▶ Cost Unit –It is a unit of product, service or time in terms of which costs are ascertained or expressed. It is a unit of measurement.
 - ▶ It is unit of measurement of cost
 - ▶ Example for unit of production: a tonne of steel, a meter of cloth, a ream of paper, a bale of cotton, a barrel of petrol etc.
 - ▶ Example for unit of services: passenger miles, cinema seats, consulting hours etc.

 - ▶ Responsibility Centers – is the unit or function of an organization under the control of a manager who has direct responsibility for its performance. E.g. Cost Center, Revenue Center, Profit Center, Investment Center.

 - ▶ Cost Object – any product, service, process or activity for which a separate measurement of cost is required. For e.g. Car, Taxi service, weaving process, purchasing raw material etc.
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Cost Ascertainment and Cost Estimation

- Cost ascertainment: It is concerned with the computation of actual costs incurred. It refers to the methods and processes employed in ascertaining costs.
- Actual cost is useful to know unprofitable activities, losses and inefficiencies occurring in the form of idle time, excessive scrap etc.
- Cost estimation: It is pre-determination of cost of goods or services. Estimated costs are definitely the future costs and depends upon the past actual costs adjusted for anticipated future.
- It is useful in making price quotations, bidding for contracts, preparation of budgets, evaluating performance, preparing projected financial statements and controlling etc.

Cost Concepts

- ▶ Cost Center – Is a location, person or item of equipment for which costs may be ascertained and used for the purposes of cost control.

- ▶ Types of Cost Centers:
 - Personal Cost Center – person or group of persons
 - Impersonal Cost Center – location or equipment
 - Production Cost Center – where actual production takes place
 - Service Cost Center – departments which render service to other cost centers

Costing and Cost Accounting

- The CIMA, London has defined Costing as “the techniques and processes of ascertaining costs”
- Wheldon has defined Costing as “the proper allocation of expenditure and involves the collection of costs for every order, job, process, service or unit”
- Thus it simply means cost finding by any process or technique
- It consists of principles and rules which are used for determining:

The cost of manufacturing a product or the cost of providing a service

Introduction

- Cost Accounting is the process of accounting from the point at which expenditure is incurred or committed to the establishment of its ultimate relationship with cost centers and cost units. It includes:
 - Collecting, classifying, recording, allocating and analyzing costs
 - Preparation of periodical statements and reports for ascertaining and controlling costs
 - Application of cost control methods
 - Ascertainment of profitability of activities carried out or planned.
- Cost Accounting is the processing and evaluation of monetary and non-monetary data to provide information for internal planning, control of business operations, managerial decisions and special analysis.

Objectives and Functions of Cost Accounting

- I. Ascertainment of cost: In cost accounting, cost of each unit of production, job, process, or department etc. is ascertained. Costs are also predetermined for various purposes.
- II. Cost control and cost reduction: It aims to improve profitability by reducing and controlling costs. For this various specialized techniques like standard costing, budgetary control, inventory control etc. are used.
- III. Guide to business policy: Cost data provide guidelines for various managerial decisions like make or buy, selling below cost, utilisation of idle plant capacity, introduction of a new product etc.

Objectives and Functions of Cost Accounting

IV. Determination of selling price: It provides cost information on the basis of which selling prices of products or services may be fixed.

In order to realize these objectives, the data provided by cost accounting may have to be re-classified, re-organized and supplemented by other relevant business data from outside the formal cost accounting system

Advantages of Cost Accounting

- Helps in ascertainment of cost
- Helps in control of cost
- Helps in decision making (make or buy, retain or replace, continue or shut down, accept or reject orders, etc)
- Helps in fixing selling prices
- Helps in inventory control
- Helps in cost reduction
- Helps in measurement of efficiency
- Helps in preparation of budgets
- Helps in identifying unprofitable activities
- Helps in identifying material losses
- Helps in identifying idle time, idle capacity
- Helps in improving productivity
- Helps in cost comparison

Introduction

- Cost Accountancy is 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 there from for the purpose of managerial decision making.
 - Cost Accountancy includes costing, cost accounting, cost control and cost audit
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Financial & Cost Accounting

No.	Basis	Financial Accounting	Cost Accounting
1.	Objective	Financial performance and position	Ascertain cost and cost control
2.	Costs and profits	Shows overall costs and profit / loss	Shows details for each product, process, job, contract, etc
3.	Control / Report	Emphasis on reporting	Emphasis on control and reporting
4.	Decision making	Limited use	Designed for decision making
5.	Responsibility	Does not fix responsibility	Can effectively fix responsibility
6.	Time frame	Focus on historical data	Focus on present and future
7.	Type of reports	General reports like P&L Account, Balance Sheet, Cash Flow Statement	Can generate special reports and analysis
8.	Legal need	Statutory requirement	Voluntary, except for some cases
9.	Transactions	Records external transactions	Records internal and external transactions
10.	Reader	Everybody	Internal management
11.	Formats	Standard, as per law	Tailor made
12.	Access	Everybody, except for some	Very limited access
13.	Unit of value	Monetary	Monetary and physical

Management Accounting (Introduction)

According to CIMA, “management accounting is an integral part of management concerned with identifying, presenting and interpreting information used for-

- i) Formulating strategy
- ii) Planning and controlling activities
- iii) Decision making
- iv) Optimizing the use of resources
- v) Disclosure to shareholders and others external to the entity
- vi) Disclosure to employees
- vii) Safeguarding assets”

Management Accounting (Introduction)

The ICWAI has defined management accounting as “a system of collection and presentation of relevant economic information relating to an enterprise for planning, controlling and decision-making

The management accountant is called “Controller or Financial Controller” and generally is a part of top management team

Characteristics/ Nature of Management Accounting

- Useful in decision making
- Derived from Financial and Cost Accounting information
- Exclusively for internal use
- Purely optional
- Concerned with future
- Flexibility in presentation of information

Functions/ Objectives of Management Accounting

- Planning
- Coordinating
- Controlling
- Communication
- Financial analysis and interpretation
- Qualitative information
- Tax policies
- Decision making

Financial Accounting vs Management Accounting

Basis	Financial Accounting	Management Accounting
External and internal users	Mainly for external users	Mainly meant for internal user i.e. management
Accounting method	Double entry system	Not based on Double entry system
Statutory requirement	As per company law and tax laws	It is optional
Analysis of cost and profit	It shows loss/profit of business as a whole. It does not show the cost and profit for individual product, process or deptt.	It provides detailed information about individual product, plant, process or deptt.
Past and future data	It represents past/historical records	It uses past data for future projections
Periodic and Continuous reporting	Usually on an year to year basis	These are prepared frequently
Accounting standards	As per accounting standards issued by ICAI	It is not bound by accounting standards

Financial Accounting vs Management Accounting

Basis	Financial Accounting	Management Accounting
Types of statements prepared	P & L Account and Balance Sheet	Special purpose reports like performance report of a manager, department, product etc.
Publication and audit	Financial statements are published for general public use and also sent to shareholders. These are required to be audited by the Chartered accountants	These statements are for internal use and thus neither published nor are required to be audited by the Chartered accountants
Monetary and Non – monetary measurement	It provides information in terms of money only	May apply monetary or non-monetary units of measurement. For e.g. quantity, machine hour, labour hour etc.

Cost Accounting vs Management Accounting

Basis	Cost Accounting	Management Accounting
Scope	Limited to providing cost information for managerial uses	Broader scope as it provides all types of information
Emphasis	Mainly on cost ascertainment and cost control to ensure maximum profit	Mainly on planning, controlling and decision making to maximize profit
Techniques employed	Standard costing and variance analysis, marginal costing and cost volume profit analysis, budgetary control, uniform costing etc.	All the techniques of cost accounting but in addition it also uses ratio analysis, fund flow statement, statistical analysis, operation research, mathematics, economics etc., whatsoever help management in tasks
Evolution	Its evolution is mainly due to the limitations of financial accounting	Its evolution is due to the limitations of cost accounting
Statutory requirement	Maintenance of cost records has been made compulsory in selected industries as notified by the govt. from time to time	It is purely voluntary and its use depends upon the utility of management

Cost Accounting vs Management Accounting

Basis	Cost Accounting	Management Accounting
Data base	It is based on data derived from financial accounts	It is based on data derived from financial accounting, cost accounting and other sources
Status in organisation	In an organisational setup, cost accountant is placed at a lower level in hierarchy than the management accountant	In an organisational setup, management accountant is placed at a higher level in hierarchy than the cost accountant
Installation	Cost accounting can be installed without management accounting	Management accounting cannot be installed without a proper system of cost accounting

Elements of costs

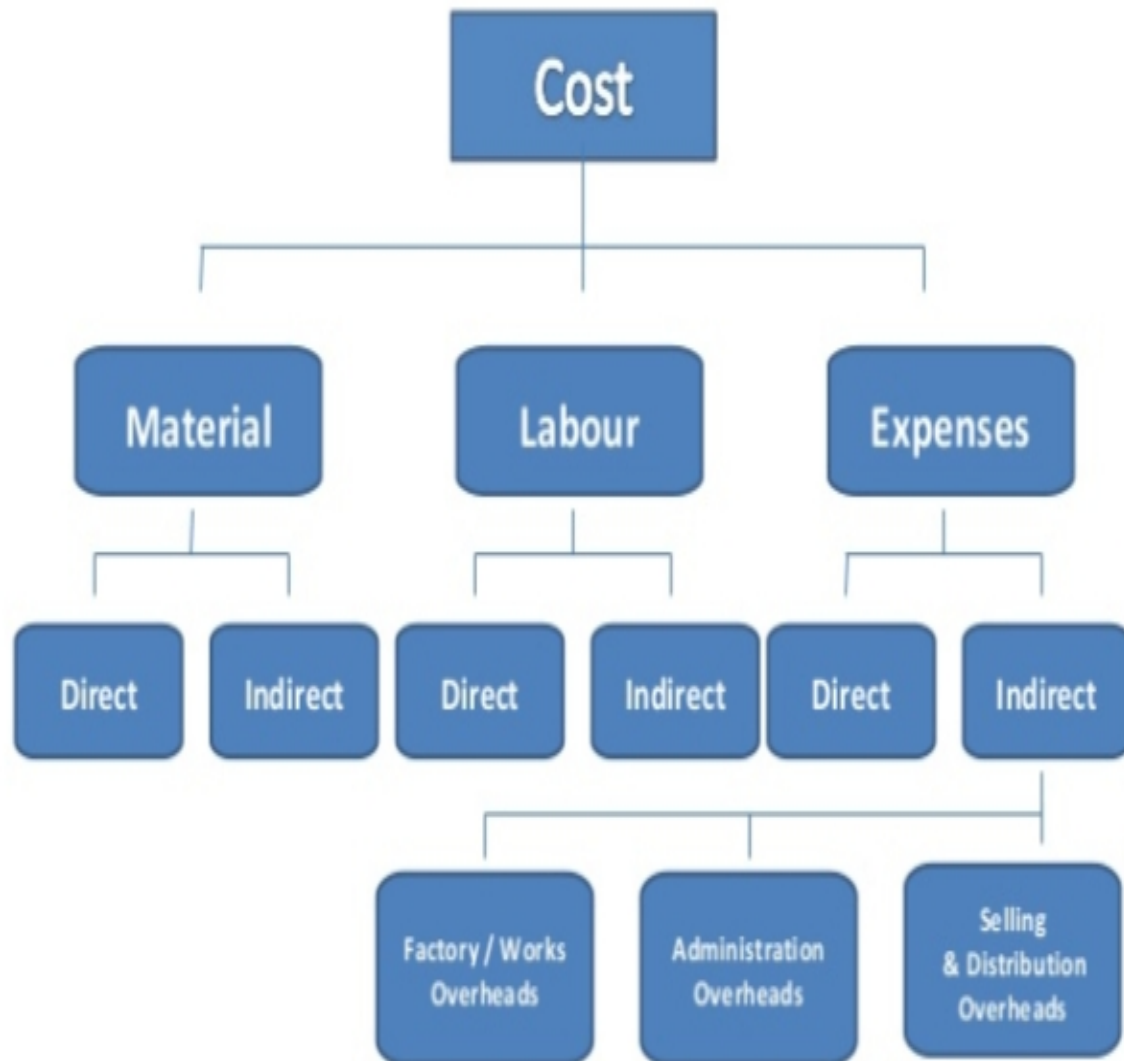
In order to interpret the term cost correctly and to ascertain the cost with respect to the cost centers, the cost attached with the manufacturing process may be subdivided, known as **Elements of Costs**.

(A) Material

(B) Labour

(C) Expenses

Elements of Cost



Material Cost

The cost of commodities and materials used by the organization. It includes cost of procurement, freight inwards, taxes, insurance etc.

Direct Material Cost –

all raw materials, either purchased from outside or manufactured in house, that can be conveniently identified with and allocated to cost units.

It generally becomes part of the finished product. However in many cases a material becomes part of finished product but not considered as direct material because the value of such material is so small that it is quite difficult and futile to measure it. e.g. nails in furniture, thread in garments etc.

e.g. Cotton used in a textile firm, Clay in bricks, leather in shoes
Cloth in garments, Timber in furniture etc.

Indirect Material Cost –

material which cannot be identified with the individual cost centre, assist the manufacturing process and does not become an integral part of finished goods.

These are minor in importance i.e. small and relatively inexpensive items which may become the part of finished product. E.g.

Consumable stores, pins, screws, nuts and bolts, thread etc.,

also those items which do not become part of finished product e.g. coal, Cotton, oils and lubricants, stationary material, sand paper etc.

Labour Cost

The cost of remuneration (wages, salaries, bonus, commission etc.) paid to the employees of the organisation.

Direct Labour Cost –

identified with the individual cost centre i.e. it can be conveniently identified with a particular product, job or process and is incurred for those employees who are engaged in the manufacturing process.

Indirect Labour Cost –

cost which cannot be identified with the individual cost centre and is incurred for those employees who are not engaged in the manufacturing process but only assist.

wages paid to foreman/storekeeper, salary of works manager, Accountant/Personnel dept. salaries etc.

Expenses

This is the cost of services provided to the organisation and the notional cost of assets owned.

Direct Expenses Cost –

Expenses which can be identified with and allocated to individual cost centers or units.

Also known as chargeable expenses

Hire charges of machinery/equipment for particular job, cost of defective work , cost of patent rights, experimental cost, cost of special design, drawings, layout, royalty, depreciation on plant etc.

Indirect Expenses Cost –

Expenses which cannot be identified by individual cost centers.

Rent , Telephone expenses, Insurance, Lightening , Advertising, repairs etc.

Direct Material Cost

+

Direct Labour Cost

+

Direct Expenses Cost

Prime Cost

Overheads

Indirect Material Cost

+

Indirect Labour Cost

+

Indirect Expenses Cost

Overheads- Classification

Production/ Manufacturing/Factory / Works Overheads

Consist of all overhead costs incurred from the stage of procurement of material till the production of finished goods.

- Indirect material such as Consumable stores, Cotton waste, oils and lubricants, stationary material etc.
- Indirect labour cost such as wages paid to foreman/storekeeper, salary of works manager, Accountant/Personnel dept. salaries, salaries of factory office staff etc.
- Indirect Expenses cost such as Carriage inward cost, Factory lightening/power expenses, rent/ Insurance /repairs for factory building/machinery, depreciation on factory building or machinery etc.

Overheads- Classification

Office and Administrative Overheads

These overheads consists of all overheads costs incurred for the overall administration of the organisation. i.e. planning and controlling the functions, directing and motivating the personnel etc. They include :

- Indirect material such as stationary items, office supplies , broom, brush etc.
- Indirect labour cost such as salaries paid to account and administrative staff, office staff, Directors' remuneration etc.
- Indirect expenses such as postage/telephone, depreciation on office building, legal/audit charges, Bank charges . Rent/insurance / repairs in offices etc.

Overheads- Classification

Selling and Distribution Overheads

Selling cost is the cost of promoting sales and retaining customers. Distribution cost consist of all overhead costs incurred from the stage of final manufacturing of finished goods till the stage of sale of goods in the market and collection of dues from customers.

- Indirect material such as packaging material, samples , catalogues, oil, grease for delivery vans etc.
 - Indirect labour like salaries paid to sales personnel, commission paid to sales manager, salary of warehouse staff, salary of driver of delivery vans etc.
 - Indirect expenses like carriage outward, warehouse charges, advertisement, bad debts, repairs and running of distribution van, discount offered to customers , insurance of goods in transit etc.
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Classification	Meaning	Example
By Nature or Element		
Direct Material Cost	Which can be directly allocated to a product, job or process	Basic raw material, primary packing material
Indirect Material Cost	Which cannot be directly allocated to a product, job or process	Stores, consumables, some low value items
Direct Labour Cost	Labour directly engaged for a specific job, contract or work order.	Shop floor labour
Indirect Labour Cost	Labour not directly engaged for a specific job, contract or work order.	Staff departments
Direct Expenses	All direct costs other than materials and labour costs.	Processing charges, machine hire charges, excise duty, etc
Indirect Expenses	All indirect costs other than indirect materials and indirect labour costs.	Rent, repairs, telephones, electricity, utility costs, insurance, depreciation
Factory Overheads	Sum of indirect material, indirect labour and indirect expenses for the factory.	
Administration Overheads	Sum of indirect material, indirect labour and indirect expenses for the office.	
Selling Overheads	Sum of indirect material, indirect labour and indirect expenses for selling.	
Distribution Overheads	Sum of indirect material, indirect labour and indirect expenses for distribution.	

Cost Components

No.	Cost Component	Description
1.	Prime Cost	Direct Material Cost + Direct Labour Cost + Direct Expenses (Direct Material Cost = Opg. Stock of RM + Net Purchase Cost – Clg. Stock of RM)
2.	Works or Factory Cost	Prime Cost + Factory Overheads + Opg. Stock of WIP – Clg. Stock of WIP
3.	Cost of Production or Cost of Goods Produced	Factory Cost + Admin Overheads
4.	Cost of Goods Sold	Cost of Production + Opg. Stock of FG – Clg. Stock of FG
5.	Cost of Sales	Cost of Goods Sold + Selling & Distribution Overheads

Output or Unit Costing (Cost Sheet)

Output/ Unit/ Single costing is a method of cost ascertainment which is used in those industries where:

Production consist of a single or few variety of same product with variation in size, shape, colour etc.

Production is uniform and on continuous basis

It is a statement which is prepared periodically to provide detailed cost of a cost center or cost unit. A cost sheet not only shows the total cost but also the various components of the total cost.

Costing P&L Account

No.	Particulars	Amount	Per Unit
	Direct Material Cost		
	= Opening Stock of Materials		
	+ Purchases		
A	+ Expenses on Purchases		(on number of units produced)
	- Purchase Returns		
	- Closing Stock of Materials		
	- Value of Normal Scrap of Direct Materials		
	Direct Labour Cost		
	= Direct Labour Cost Paid		
B	+ Outstanding / Payable		(on number of units produced)
	- Prepaid		
C	Direct Expenses		(on number of units produced)
D	Prime Cost = (A + B + C)		(on number of units produced)
	Works / Factory Overheads		
	= Factory Overheads Paid		
E	- Value of Normal Scrap of Indirect Materials		(on number of units produced)
	+ Opening Stock of WIP		
	- Closing Stock of WIP		
F	Works or Factory Cost = (D + E)		(on number of units produced)

Costing P&L Account

No.	Particulars	Amount	Per Unit
G	Office and Admin Expenses		(on number of units produced)
H	Cost of Goods Produced = (F + G)		(on number of units produced)
I	FG Stock Adjustment + Opening Stock of FG - Closing Stock of FG		
J	Cost of Goods Sold = (H + I)		(on number of units sold)
K	Selling & Distribution Expenses		(on number of units sold)
L	Cost of Sales = (J + K)		(on number of units sold)
M	Profit		(on number of units sold)
N	Sales = (L + M)		(on number of units sold)

Expenses excluded from Costs

Item of expenses which are apportionment of profit should not form a part of the costs. These are-

- Income tax
- Dividend to share holders
- Commission to partners, managing agents etc.
- Capital Loss
- Interest on Capital
- Interest paid on debentures
- Capital expenses etc.

Statement of Cost / Cost Sheet

	Rs.	Rs.
Raw Materials		
Opening stock of Raw materials	✓	•
Raw Material purchased	✓	•
Cost of Materials available for use	✓	•
Less : Closing stock of raw Materials	(✓)	•
Cost of Raw materials used / Consumed	•	✓
Direct labour Wages	•	✓
Other Direct charges	•	✓
Prime Cost	•	✓
Factory Overheads:	•	•
Indirect materials	✓	•
Indirect Labour	✓	•
Depreciation on factory Building	✓	•
Depreciation on Factory equipments	✓	•
Insurance	✓	•
Repairs and maintenance	✓	•
Other factory overheads	✓	✓
Gross Factory Cost	•	✓
Add : Work-in-progress (Opening)	•	✓
Less: Work-in-progress (Closing)	•	(✓)
Factory cost	•	✓
Office and Administrative overheads	•	•
Office salaries	✓	•
Office rents, Insurance	✓	•
Other office overheads	✓	✓
Office Cost / Cost of Production	•	✓
Add : Opening Stock of Finished goods	•	✓
Goods available for sale	•	✓
Less: Closing Stock of Finished Goods	•	(✓)
Cost of Goods sold	•	✓
Selling and Distribution Expenses	•	✓
Cost of Sales	•	✓
Profit	•	✓
sales	•	✓

From the viewpoint of managerial needs, cost concepts fall into four broad categories.

(1) Income Measurement

(2) Profit Planning

(3) Cost Control

(4) Special Situations

COST CONCEPTS RELATING TO INCOME MEASUREMENT

(i) Product Costs
and Period Costs

(ii) Absorbed Costs
and Unabsorbed
Costs

(iii) Expired Costs
and Unexpired
Costs

(iv) Joint product
Costs and Separable
Costs

(i) Product costs and Period costs

Production costs are costs which can be identified with goods produced/purchased for resale. Period costs are costs which are not necessary for production and are incurred even if there is no production and matched against the revenue of the current period.

(ii) Absorbed costs and Unabsorbed costs

Absorbed costs are defined as those costs, which have been charged to production. Costs, which remain uncharged to production are referred to as unabsorbed costs.

(iii) Expired costs and Unexpired costs

An expired cost is one which cannot contribute to the production of future revenues. An unexpired cost has the capacity to contribute to the production of revenue in future, for example, inventory.

(iv) Joint product costs and Separable costs

Joint product costs are the costs of a single process/series of processes that simultaneously produce two or more products of significant sale value. Separable costs refer to any cost that can be attributed exclusively and wholly to a particular product/process/division/department.

Example 1: Absorbed, Underabsorbed and Overabsorbed Costs

Suppose that fixed costs are Rs 30,000 and the normal production is 15,000 units. The standard fixed overhead rate (SFOR) of recovery is Rs 2 per unit ($\text{Rs } 30,000 \div 15,000 \text{ units}$). In other words, every unit of production absorbs Rs 2 of fixed costs.

If the company produces 10,000 units, the total absorbed costs will be Rs 20,000 ($10,000 \text{ units} \times \text{Rs } 2, \text{ SFOR}$). Obviously, Rs 10,000 constitutes unabsorbed costs ($\text{Rs } 30,000, \text{ actual cost} - \text{Rs } 20,000, \text{ absorbed costs}$).

In contrast, overabsorbed costs represent the positive difference of fixed costs charged to production and actual fixed costs. Such a situation will arise if actual production is more than the normal production.

In the above example, if the company produces 16,250 units, the costs charged to production will be Rs 32,500 ($16,250 \text{ units} \times \text{Rs } 2, \text{ SFOR}$). The overabsorbed cost will be Rs 2,500 [$\text{Rs } 30,000, \text{ actual fixed costs (AFC)} - \text{Rs } 32,500 \text{ charged to production}$]. Figure 1 portrays these relationships.

Absorbed costs = Units produced × SFOR

Unabsorbed costs = [AFC – (Units produced × SFOR)]

Overabsorbed costs = [(Units produced × SFOR) – AFC]

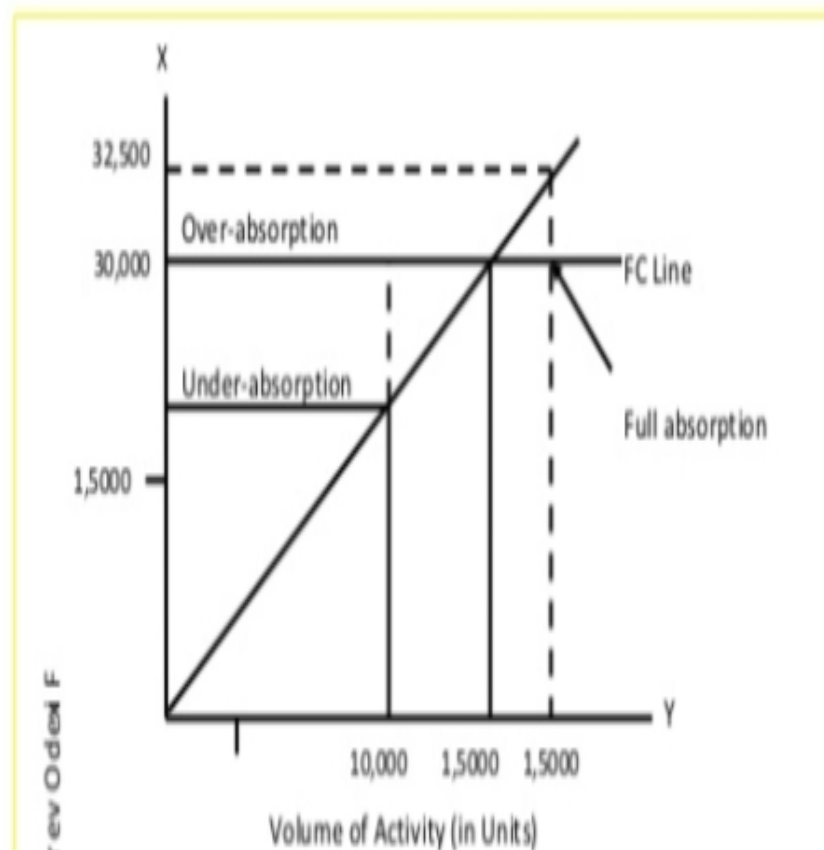


Figure 1: Absorbed and Unabsorbed Costs

COST CONCEPTS RELATING TO PROFIT PLANNING

(i) Fixed, Variable and Semi-
variable/Mixed Costs

(ii) Future Costs and Budgeted
Costs

Fixed Costs

Fixed (non-variable) costs do not change with changes in volume of output or activity within a specified range of activity/output (relevant range) for a given budget period.

Committed Fixed Costs

Committed fixed costs are costs that are incurred in maintaining physical facilities and managerial setup.

Discretionary/ Programmed Fixed Costs

Discretionary fixed costs are costs caused by management policy decisions i.e. these may be avoided

Table 1: Production Volume and Fixed Costs

Total fixed cost	Production (in units)	Average fixed cost per unit
Rs 10,000	1,000	Rs 10
10,000	2,000	5
10,000	5,000	2
10,000	10,000	1

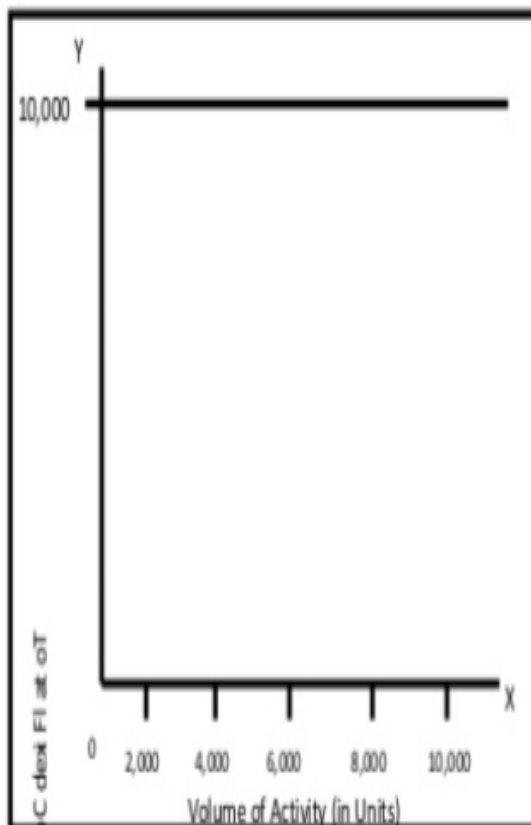


Figure 2: Volume and Total Fixed Costs

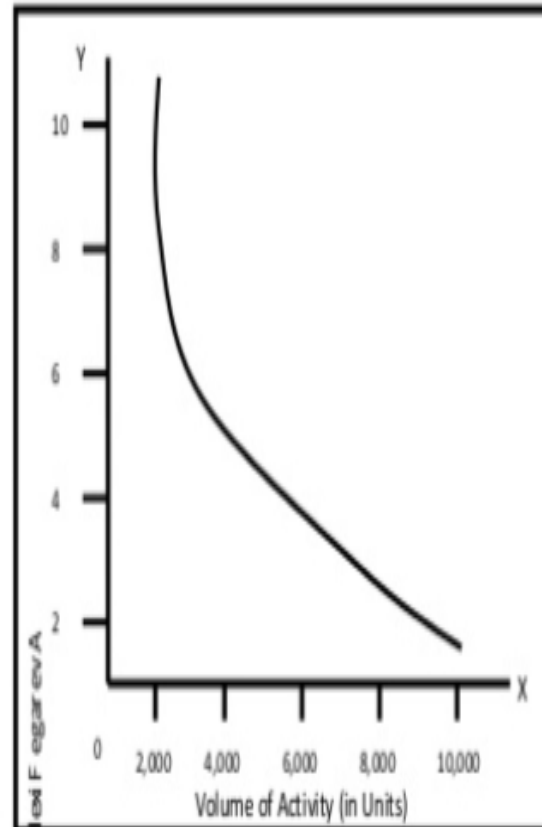


Figure 3: Volume and Fixed Costs Per Unit

Variable costs

Costs that tend to vary in total in direct proportion within a relevant range and for a given period to production/sales/some other measure of volume are variable costs.

Table 2: Production Volume and Variable Costs

Production (unit)	Material costs	Labour costs	Total variable cost
1	Rs 5	Rs 2	Rs 7
10	50	20	70
100	500	200	700
1,000	5,000	2,000	7,000

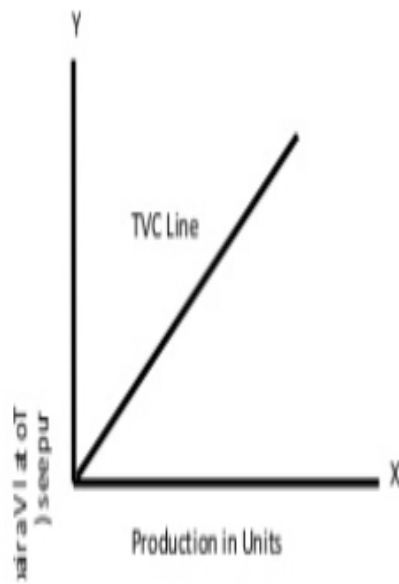


Figure 5: Total Variable Cost

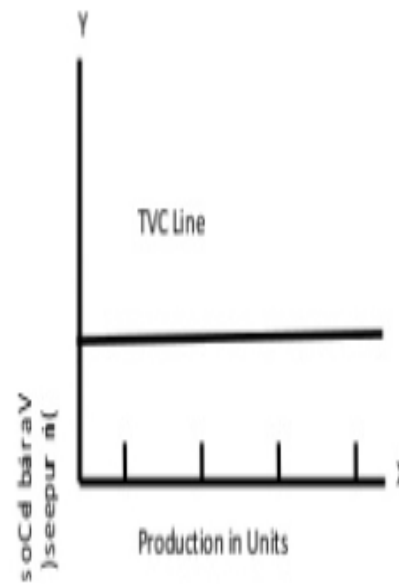


Figure 6: Variable Cost Per Unit

Semi-Variable (mixed) Costs

All costs which are neither perfectly variable nor absolutely fixed in relation to volume changes are called semi-variable (mixed) costs. They consist of both fixed costs and variable costs.

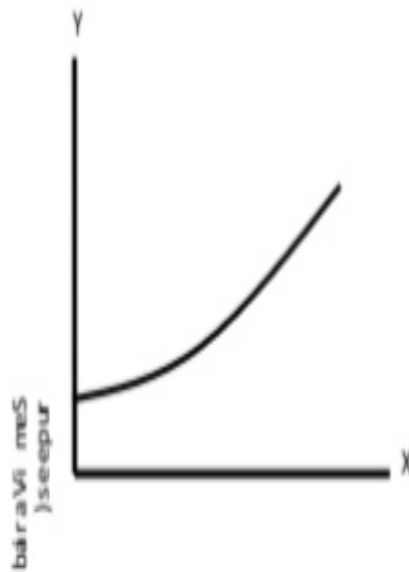


Figure 7: Semi-Variable Cost

Future Costs

Future costs are costs reasonably expected to be incurred at some future date as a result of a current decision.

Budgeted Costs

Budgeted costs are costs which are incorporated formally in the budgeted of a specific period.

Cost Concepts For Control

(i) Responsibility Cost

(ii) Controllable and Non-Controllable Costs

(iii) Direct and Indirect Costs

(i) Responsibility costs

Responsibility costs are costs which are classified/identified /accumulated with the person(s) responsible for their incurrence.

(ii) Controllable and Non-controllable costs

The costs which may be directly regulated at a given level of management authority. VC are generally controllable by Management heads. Otherwise, it is non-controllable like factory rents, salaries etc.

(ii) Direct and indirect costs

Those costs which can be identified logically and practically in their entirety to a particular department/product/cost unit/process are called direct costs. Those costs which are not practically identifiable exclusively and wholly to a particular product/division/segment are called indirect (common) costs.

Cost Concepts For Decision- Making

Relevant and
Irrelevant Costs

Differential Costs

Out-of-pocket
Costs and Sunk
Costs

Opportunity Costs
and Imputed Costs

Relevant and Irrelevant costs

Not all costs are relevant for specific decisions. Costs which are influenced by a decision are a relevant. These are future cost which are affected by a decision being made and cost which is not affected by a decision is irrelevant cost.

Differential costs

Differential/incremental costs are the differential/additional costs which would be incurred if the management chooses one course of action as opposed to another. They are differential/incremental costs caused by a particular decision.

Out-of-pocket costs and Sunk costs

A cost which requires a current/future cash expenditure as a result of a decision is an out of pocket cost. Costs which have already been incurred in the past are sunk costs.

Opportunity costs and Imputed costs

Opportunity cost represents the benefits foregone by not choosing the second best alternative in favour of the best one. Imputed costs are hypothetical costs that must be considered for correct decision, for example, interest on capital, rented value of building owned by the firm.

Marginal Cost

Additional cost of producing one additional unit. It is same as variable costs. It helps is decision like make or buy, pricing of products, selection of sales mix etc.

Conversion Cost

It is the total cost of converting raw material into finished product. In other words it is the total of direct labour and factory overhead costs