**II-B.COM-COST ACCOUNITNG(16CCCCM7)**

**V TH UNIT**

**RECONCILIATION COST ACCOUNTS WITH FINANCIAL RECORDS**

Where no separate accounts are maintained for costing and finance, the question of reconciliation does not arise. But where the cost and financial accounts are maintained independently of each other, it is indispensable to reconcile them. Though both the sets of accounts are same as far as the basic transactions are concerned but there are differences in the profits of two sets of books.

**Reasons for difference in profits of cost and financial accounts:**

**(i) Items shown in Financial Accounts:**

There are a number of items which are included in financial accounts but do not find place in cost accounts. They may be items of income or expenses, the former increases the profit and latter reduces the profit.

**A. Purely Financial Charges**

(a) Loss arising from the sale of fixed assets.

(b) Loss on sale of investments, discount on debentures, etc.

(c) Interest on bank loan, mortgage and debentures.

(d) Expenses of companies ‘Share Transfer Office’.

**B. Appropriation of Profits**

(a) Donations and Charities

(b) Income Tax

(c) Dividend Paid

(d) Transfer to Reserves

**C. Writing off Intangible and Fictitious Assets**

(a) Goodwill

(b) Patents & Copyrights

(c) Advertisement

(d) Preliminary Expenses

**D. Pure Financial Incomes**

(a) Rent received or Profit on Sale of Fixed Assets

(b) Share transfer fee received

(c) Interest received on Bank Deposits

(d) Dividend received etc.

**(ii) Items shown only in Cost Accounts:**

There are certain items which are included in cost accounts and not in financial accounts. Such items are very few.

E.g. Interest on capital employed, rent for own premises etc.

**(iii) Over or Under Absorption of Overheads.**

Overheads are absorbed in Cost Accounts on a certain predetermined estimated basis and in Financial Accounts, actual amounts incurred are recorded. If there is any over or under absorption it leads to difference in the profits of both sets of books.

**(iv) Differences due to different basis of stock valuation and depreciation methods.**

**Objects of Reconciliation:**

(a) To assure the mathematical accuracy and reliability of cost accounts.

(b) To have proper cost control and ascertainment.

(c) To find out the reasons for the profit or loss shown by the financial accounts.

(d) To ensure correct profit or loss in financial accounts.

(e) To ensure true and fair view of balance sheet of the business concern.

**Procedure for reconciliation**

Take Profits as per Financial Accounts.

**Add :**

(a) Items of income included in Cost Accounts but not in Financial Accounts.

(b) Items of expenditure included in Financial and not in Cost Accounts.

(c) Amounts by which items of income have been shown in excess in Cost Accounts over the corresponding entries in Financial Accounts.

(d) Amounts by which items of expenditure have been shown in excess in Financial Accounts over the corresponding entries in Cost Accounts.

(e) Under absorption of overheads in Cost Accounts.

(f) The amount by which closing stock of inventory is overvalued in Cost Accounts.

(g) The amount by which opening stock of inventory is undervalued in Cost Accounts.

**Less** :

(a) Items of income included in Financial Accounts but not in Cost Accounts.

(b) Items of expenditure (as interest on Capital, Rent on owned premises etc.) included in Cost Accounts but not in Financial Accounts.

(c) Amounts by which items of expenditure have been shown in excess in Cost Accounts as compared to the corresponding entries in Financial Accounts.

(d) Amounts by which items of incomes have been shown in excess in Financial Accounts as compared to the corresponding entries in Cost Accounts.

(e) Over absorption of overheads in Cost Accounts.

(f) The amount by which closing stock of inventory is undervalued in Cost Accounts.

(g) The amount by which opening stock of inventory is overvalued in Cost Accounts.

**CONTRACT COSTING**

Contract costing is the tracking of costs associated with a specific contract with a customer. For example, a company bids for a large construction project with a prospective customer, and the two parties agree in a contract for a certain type of reimbursement to the company. ... Cost plus

**Differences between Job costing and Contract costing:**

(a) While the number of jobs in hand at any time in a concern may be large, only a few contracts may be undertaken at a time.

(b) The accumulation, analysis, apportionment, allocation and control of costs is simplified in Contract Costing.

(c) Most of the expenses are chargeable direct to the Contract Account. Direct allocation to such an extent is not possible in job costing.

(d) As contracts may run for long periods, there arises the problem of assessment and crediting of profits on incomplete contracts at the end of the accounting period.

**Some special items under contract accounting are explained below:**

**Work-in-progress:**

In Contract Accounts, the value of the work-in-progress consists of:-

(a) the cost of work completed, both certified and uncertified,

(b) the cost of work not yet complete, and

(c) the amount of profit taken as credit.

In the Balance Sheet, the work-in-progress is usually shown under two heads, viz. certified and uncertified. The cost of work completed and certified and the profit credited will appear under the head ‘certified’ work-in-progress, while the completed work not yet certified and the cost of labour, material and expenses of work which has not reached the stage of completion are shown under the head ‘uncertified’ work-in-progress.

**Profit on incomplete contracts:**

For the purpose of finding out the portion of the profit out of notional profit to be transferred to Profit and Loss Account, the contracts are divided in the following manner:-

**(A) Contracts which have just commenced:**

In this case no portion of the notional profit shall be transferred to Profit and Loss Account and the entire amount is kept as reserve. There are no hard and fast rules to determine that a particular contract is just commenced or reasonably advanced or almost complete. However, as per general norms, the contracts in which less than 1/4th work is done are regarded as the contracts which have just commenced.

**(B) Contracts which have reasonably advanced:**

In this case the profit to be transferred to Profit and Loss Account out of notional profit is based on the degree of completion of the contract. The degree of completion of the contract can be found out by comparing work certified and the contract price.

(a) If the degree of the completion of the contract is less than or equal to 1/4th no portion of the notional profit shall be transferred to Profit and Loss Account and the entire amount would be kept as reserve.

(b) If the degree of completion of work is (> 1/4 and < 1/2), 1/3 of the notional profit shall be transferred to Profit and Loss Account and the remaining amount would be kept as reserve.

(c) If the degree of completion of work is more than or equal to 1/2, 2/3rd of the notional profit shall be transferred to Profit and Loss Account and the remaining amount would be kept as reserve.

The profit so arrived in the above manner shall further be reduced in the ratio of cash received to work certified. Thus, the formula is as follows:

(Notional Profit x 2 or 1 (as the case may be) x (Cash received) 3 3 (Work certified)

**(C) Contracts which are almost complete:**

In this case the portion of the profit to be transferred to Profit and Loss Account is calculated by using the estimated total profit which is ascertained by subtracting the total cost to date and the additional cost to complete the contract from the contract price. The different formulas for such computations of profit are as follows:-

(i) Estimated Profit x (Work certified)/ (Contract price)

(ii) Estimated Profit x (Work certified)/ (Contract price) x (Cash received)/ (Work certified)

(iii) Estimated Profit x (Total cost to date)/ (Total cost)

(iv) Estimated Profit x (Total cost to date)/ (Total cost) x (Cash received)/ (Work certified)

**PROCESS COSTING**

Process costing is that aspect of operation costing which is used to ascertain the cost of the product at each process or stage of manufacture. This method of accounting used in industries where the process of manufacture is divided into two or more processes. The objective is to find out the total cost of the process and the unit cost of the process for each and every process. Usually the industries where process costing used are textile, oil industries, cement, pharmaceutical etc.

**Features of Process Costing**:

(a) Production is done having a continuous flow of products having a continuous flow of identical products except where plant and machinery is shut down for repairs etc.

(b) Clearly defined process cost centres and the accumulation of all costs by the cost centres.

(c) The maintenance of accurate records of units and part units produced and cost incurred by each process.

(d) The finished product of one process becomes the raw material of the next process or operation and so on until the final product is obtained.

(e) Avoidable and unavoidable losses usually arise at different stages of manufacture for various reasons.

(f) In order to obtain accurate average costs, it is necessary to measure the production at various stages of manufacture as all the input units may not be converted into finished goods.

(g) Different products with or without by-products are simultaneously produced at one or more stages or processes of manufacture. The valuation of by-products and apportionment of joint cost before joint of separation is an important aspect of this method of costing.

(h) Output is uniform and all units are exactly identical during one or more processes. So the cost per unit of production can be ascertained only by averaging the expenditure incurred during a particular period.

**Applications of Process Costing**: The industries in which process costs may be used are many. In fact a process costing system can usually be devised in all industries except where job, batch or unit or operation costing is necessary. In particular, the following are examples of industries where process costing is applied:

Chemical works Textile,

weaving,

spinning etc.

Soap making Food products

Box making

Canning factory

Distillation process

Coke works

Paper mills Paint,

ink and varnishing etc.

Biscuit work

Meat products factory

Oil refining

Milk dairy

**Normal Process Loss**: The normal loss is the unavoidable loss of units in a processing department that occurs majorly due to the nature of production operation or the nature of raw materials being processed. ... The normal loss is not presented as a separate cost element on the cost of production report (CPR) of the concerned department.

**Abnormal Process Loss:**  An abnormal loss occurs when expected output exceeds actual output. The scrap value of an abnormal loss is credited to the process account. The allocated cost of an abnormal gain is credited to the process account. The inputs to a process less the normal loss is the expected output.

**Abnormal gain:** Abnormal gain is the amount of gain in respect of excess units produced when the units of actual wastage are less than the normal or expected wastage in the process of production. ... The amount of abnormal gain should not be allowed to influence the cost per unit of the production.

**OPERATING OR SERVICE COSTING**

Operating Costing is a method of ascertaining the costs of providing or operating a service. This method of costing is applied by those undertakings which provide services rather than the production of goods. ... Welfare services: Canteens, hospitals, libraries. Utility suppliers: Gas, Electricity, water. The next step is to collect and identify various costs under different headings.

The headings used are,

(a) Fixed or standing charges

(b) Semi-fixed or maintenance charges

(c) Variable or running charges.

One of the important features of operating costing is that mostly such costs are fixed in nature. For example, in case of passenger transport organization, most of the costs are fixed while few costs like diesel and oil are variable and dependent on the kilometres run. The method of computing costs in various service organisations.

**Transport Organisation**:

Costing in a transport industry consists of determining the operating cost of each vehicle and applying this cost to find out the cost per unit of service rendered by a vehicle. The cost unit is selected with proper care keeping in view the needs of each concern, the weight, bulk, volume and type of goods carried and distance covered in each trip. Transport undertakings include goods transport organizations as well as passenger transport organizations. The cost unit is either ton kilometre or passenger kilometre. The meaning is cost of carrying one ton over a distance of one kilometre or cost of carrying one passenger for a distance of one kilometre.

**Collection of Costs**: A log book is maintained for each vehicle to record details of trips made by the vehicle during a specified period of time. Log book is maintained usually on a daily basis. The details shown in the log book enables the management to make suitable allocation of vehicles, to avoid the duplicate trips, or to avoid idle running capacity. The log book also provides the information relating to the fuel consumed, distance travelled, no of hours travelled, chargeable kilo meters. The log book provide the data for proper allocation of cost and in this respect these may be compared with the production details available in a manufacturing concern.

**Classification of Costs**:

The costs of a transport organisation can be classified and accumulated under the following heads: -

(a) *Fixed or stand-by costs*: These costs which include garage charges, insurance, taxes, license, depreciation, wages of drivers, cleaner’s salary, establishment cost of workshop and office. Out of the above some of the costs are directly identifiable for each vehicle such as license fee and some are apportioned such as office expenses

(b) *Maintenance Charges*: These costs are in the nature of semi-variable nature includes expenditure on maintenance, repairs, tyres, tubes and other charges.

(c) *Operating and Running costs*: These costs are variable in nature, includes fuel, lubricating oil, wages of drivers / cleaners (if paid on per trip / kilometer). These costs can be easily identifiable with each of the vehicle.

**Significance of Operating or Running Costs:**

(i) Control of operating and running cost and avoidance of waste of fuel and other consumable material.

(ii) Cost of running own vehicles may compared with the hired or other forms of transport.

(iii) Facilitates quotation of hiring rates to outside parties who ask for the transport service.

(iv) If transport service is treated as a separate department or service cost center, the costs to be charged to the requesting department may be easily determined.

(v) Suitable information is obtained for efficient routing of vehicles.

(vi) Cost of idle vehicles and lost running time is easily obtained.