DEPARTMENT OF COMMERCE AND FINANCIAL STUDIES
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MBA (Financial Management)

Course Code and Name: FMCC1/24-ACCOUNTING FOR DECISION MAKING

Unit –II / Topic: COST ACCOUNTING

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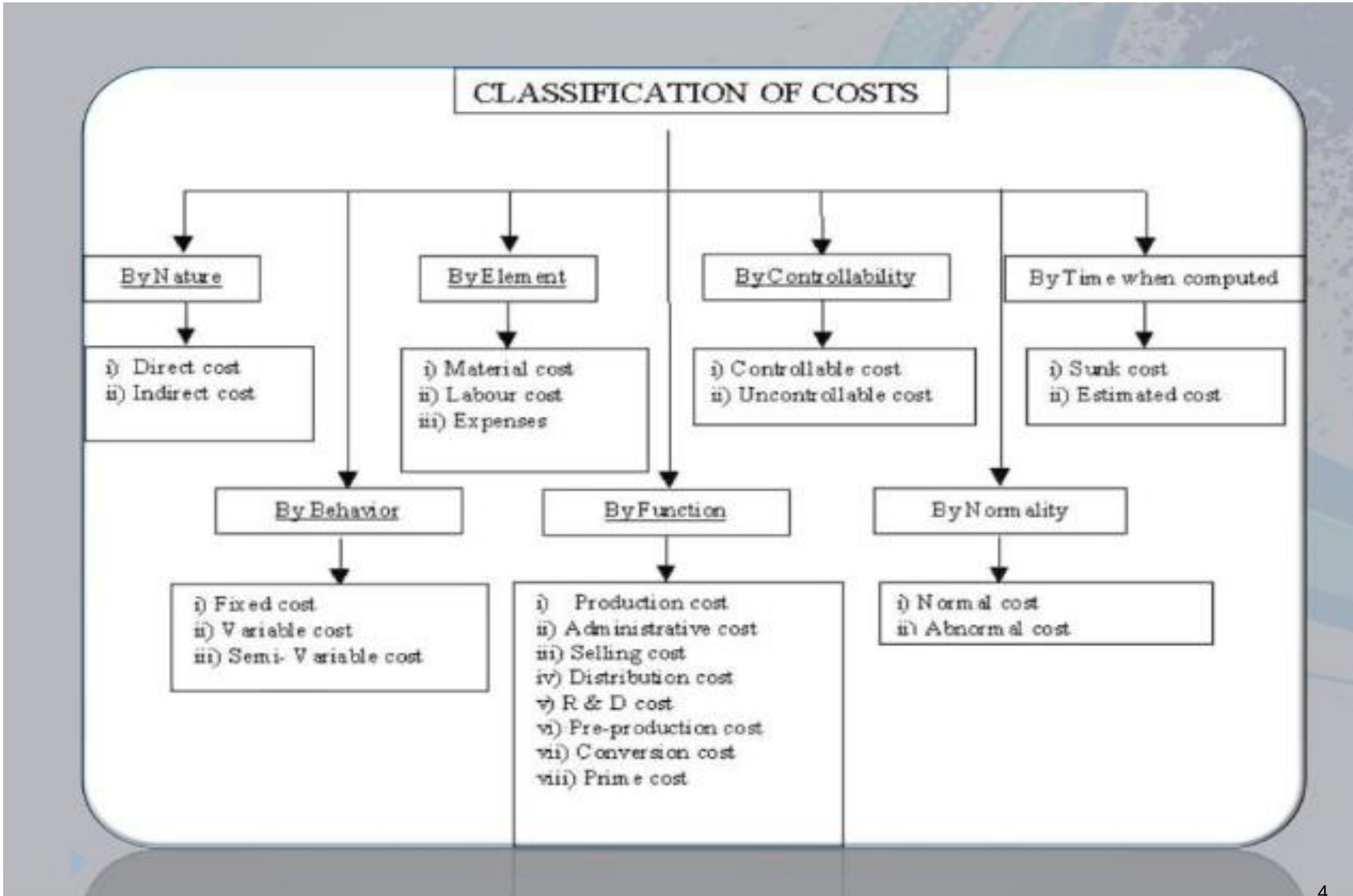
Cost Accounting (Content)

- Definitions
- Scope
- Significance and Limitations of cost accounting
- Cost Classification
- Cost Sheet
- Methods of Costing
- Process Costing
- Job Costing

Cost Accounting

Cost accounting may be defined as “the classifying, recording and appropriate classification of expenditure for the determination of the costs of products and services, and for the presentation of suitably arranged data for purposes of control and guidance of management”.

Classification of Costs



1. Nature of Expense: By nature of expenses, costs are classified into material, labor and expenses.
2. Relation to Cost Object – Traceability: This classification is based on the relation of cost element with the cost object. The classification is done into direct and indirect costs. The basis is cause and effect relationship between cost element and cost object or traceability of costs to its cost object.
3. Functions / Activities: Costs can also be classified into various functions / activities. Common functional classification of costs are done into following:

- Production
- Quality Check etc.

4. The behavior of Costs: The behavior of costs is seen with respect to the change in volume. On this basis, costs are classified into Fixed Costs, Variable Costs, and Semi-variable Costs. Fixed costs do not change with the small change in volume, variable costs do change. Semi-variable costs have characteristics of both fixed and variable costs.

5. The purpose of Decision Making by Management: For decision-making purpose of management, costs can be classified into various types such as opportunity cost, marginal cost, differential cost, relevant cost, imputed cost, replacement cost, sunk cost, normal/ abnormal cost, avoidable/ unavoidable costs,

6.Production Process: It’s an important classification for cost accounting of different manufacturing industries. Based on the production process of the industry, costs can be classified into following:

- Batch Cost
- Process Cost
- Operation Cost
- Operating Cost
- Contract Cost
- Joint Cost

7. Time Period: Based on a time period of assessment or any other specific purpose, costs can be classified into historical cost, pre-determined cost, standard cost, and estimated cost.

Methods of Costing

The following are the important costing method:

1.Job costing

2.Contract costing

3.Batch costing

4.Process costing

5.Unit costing

6.Operating costing

7.Multiple costing

8.Activity based costing

9.Target costing

10.Kaizen costing and

11.Life cycle costing

Methods of Costing

- **Job costing** is the form of specific order costing which applies where the work is undertaken as an identifiable unit. Costs are collected and accumulated for each job.

- **Contract costing** is the form of specific order costing in the case of construction activities generally.

- **Batch costing** is a form of specific order costing. Under this method, the cost per unit is obtained by dividing the total cost of a batch by no. of items produced in that batch.

- **Process costing** is that form of operation costing which is used to ascertain the cost of the product at each process or stage of manufacture.

Methods of Costing

- **Unit costing** is used in costing of products that are expressed in identical units and suitable for products that are manufactured by continuous activity.
- **Service or operating costing** is the method used for the costing of operating a service such as Public Bus, Railways, Nursing home. It is used to ascertain the cost of a particular service.
- **Multiple costing** is when the output comprises different assembled parts like in televisions, cars or electronic gadgets, cost has to be ascertained for the component as well as the finished product. Such costing may involve different / multiple methods of costing.
- **Activity-based costing (ABC)** is a secondary / somewhat complementary method to the two traditional costing techniques.

Methods of Costing

- **Target costing** is an approach to determine a product's life cycle cost, which should be sufficient to develop specified functionality and quality, while ensuring its desired profit. It involves setting a target cost by subtracting a desired profit margin from a competitive market price.
- **Kaizen costing** is a cost reduction system. It is the maintenance of present cost levels for products currently being manufactured via systematic efforts to achieve the desired cost level.
- **Life cycle costing** refers to the total cost of ownership over the life of an asset. Costs considered include the financial cost which is relatively simple to calculate and also the environmental and social costs which are more difficult to quantify and assign numerical values.

Objectives of Cost Accounting

Scope of cost accountancy.

The scope of cost accountancy is very wide and includes the following:- 1.Cost ascertainment 2.Cost Accounting 3.Cost control

Objectives of cost accounting?

The objectives of cost accounting are:-

1.To ascertain the cost per unit of the different products

2.To provide a correct analysis of cost

3.To disclose the sources of wastages

4.To serve as a guide for fixing the price

5.To help for cost control and cost reduction

6.To exercise effective control on raw materials

7.To fix wage structure/ bonus plans

8.To help in budgetary control

Advantages/Limitations of Cost Accounting

Advantages:-

(a) Measuring efficiency

(b) cost control and cost reduction

(c) guide in reducing prices

(d) Action against unprofitable activities

(e) Improves efficiency

(f) establishes standards

(g) prevents fraud

(h) helps in decision making

(i) check on accuracy

(j) sound wage policy

(k) Higher bonus plans

Limitations:

(a)Highly expensive

(b)Not mandatory except in some industries

(c)Unnecessary paper work

(d)Not reliable

(e)Failure of costing system

Cost Sheet - Advantages

- A cost sheet is a statement showing the costs of production of a product or service at different levels.
- “A cost sheet is a document which provides for the assembly of the detailed cost of a cost centre or cost unit.
- It is a statement showing the details of the total cost of a job, operation or an order. It is a memorandum statement.

Advantages of cost sheet:-

1. Discloses the total cost and the cost per unit of the units produced
2. Enables a manufacturer to keep a close watch and control on cost of production
3. Helps to fix sale price
4. Helps to submit quotations/ tenders/
5. acts as a guide to the manufacturer and helps him to formulate a definite production policy.

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