

SEBI GRADE A

Costing

Introduction to Cost Accounting



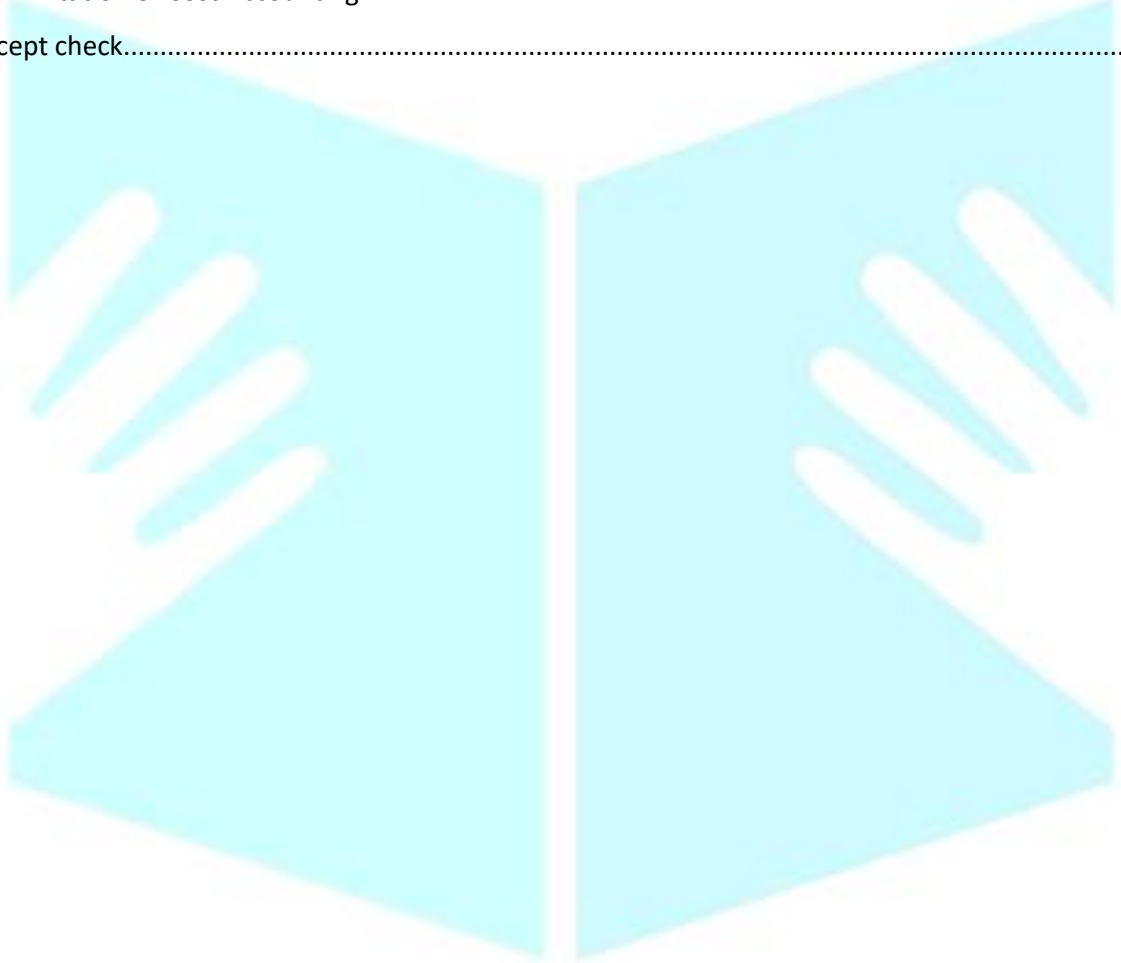
 www.edutap.co.in

 +91 8146207241

 hello@edutap.co.in

Contents

1	Introduction to Cost Accounting	2
1.1	Meaning.....	2
1.2	Objectives of Cost Accounting.....	3
1.3	Scope of Cost Accountancy	3
1.4	Difference between Financial, Cost and Management Accounting	4
1.5	Importance of Cost Accounting.....	4
1.6	Limitation of Cost Accounting	5
2	Concept check.....	6



EduTap

1 Introduction to Cost Accounting

Introduction to Cost Accounting



Way back to 15th Century, no accounting system was there, and it was the barter system prevailed. It was in the last years of 15th century Luca Pacioli, an Italian found out the double entry system of accounting in the year 1494. Later it was developed in England and all over the world upto 20th Century.

Cost Accounting has emerged as a specialized discipline from the initial years of 20th century.

1.1 Meaning

Cost Accountancy: Cost Accountancy is defined as ‘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 purposes of managerial decision making. Thus, Cost Accountancy is the science, art and practice of a Cost Accountant.

(a) It is a **science** because it is a systematic body of knowledge having certain principles which a cost accountant should possess for proper discharge of his responsibilities.

(b) It is **an art** as it requires the ability and skill with which a Cost Accountant is able to apply the principles of Cost Accountancy to various managerial problems.

(c) **Practice** includes the continuous efforts of a Cost Accountant in the field of Cost Accountancy

Costing

Costing is defined as the technique and process of ascertaining costs. The technique in costing consists of the body of principles and rules for ascertaining the costs of products and services. The technique is dynamic and changes with the change of time. The process of costing is the day-to-day routine of ascertaining costs. It is popularly known as an arithmetic process. For example, If the cost of producing a product say ` 200/-, then we must refer material, labour and expenses accounting and arrive the above cost as follows:

Material	₹	100
Labour	₹	40
Expenses	₹	60
Total	₹	200

Finding out the breakup of the total cost from the recorded data is a daily process. That is why it is called arithmetic process/daily routine. In this process we are classifying the recorded costs and summarizing at each element and total is called technique.

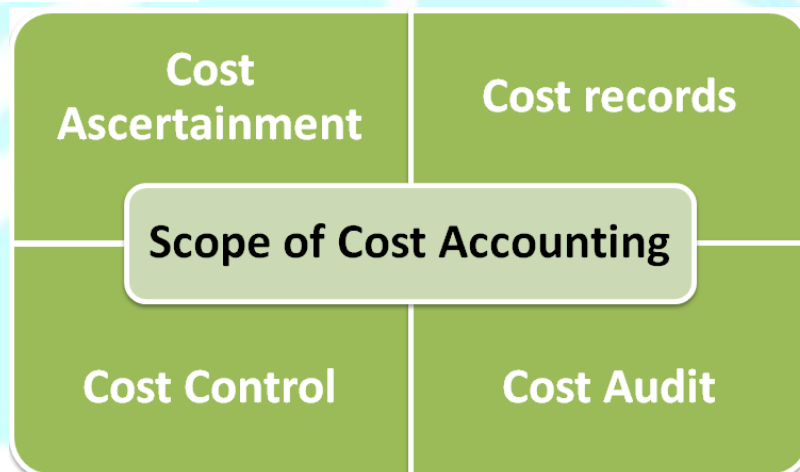
1.2 Objectives of Cost Accounting

Objectives of Cost Accounting

- To ascertain the Costs under different situations using different techniques and systems of costing
- To determine the selling prices under different circumstances
- To determine and control efficiency by setting standards for Materials, Labour and Overheads
- To determine the value of closing inventory for preparing financial statements of the concern
- To provide a basis for operating policies which may be determination of Cost Volume relationship, whether to close or operate at a loss, whether to manufacture or buy from market, whether to continue the existing method of production or to replace it by a more improved method of production.... etc.



1.3 Scope of Cost Accountancy



The scope of Cost Accountancy is very wide and includes the following: -

- Cost Ascertainment:** The main objective of Cost Accounting is to find out the Cost of product / services rendered with reasonable degree of accuracy.
- Cost Control:** It is the process of regulating the action so as to keep the element of cost within the set parameters.
- Cost Records:** This is the ultimate function of Cost Accounting. These records are primarily prepared for use by the management at different levels. Cost records helps in planning and control, performance appraisal and managerial decision making.
- Cost Audit:** Cost Audit is the verification of correctness of Cost Accounts and check on the adherence to the Cost Accounting plan. Its purpose is not only to ensure the arithmetic accuracy of cost records but also to see the principles and rules have been applied correctly.

1.4 Difference between Financial, Cost and Management Accounting

To appreciate fully the objectives and scope of Cost Accounting, it would be useful to examine the position of Cost Accounting in the broader field of general accounting and other sciences. i.e Financial Accounting and Management accounting.

Financial Accounting	Cost Accounting	Management Accounting
Financial Accounting is used to keep the record of transactions and determine profit and loss and the financial status of the firm.	Cost Accounting is used to allocate, ascertain, accumulate and accounting for cost.	Management Accounting helps management in policy forming and decisions-making.
It is concerned with historical data.	It is concerned with past and present recorded data.	It deals with the estimation of data for the future.
Financial accounting is governed by GAAP.	Some principles in cost accounting are followed for keeping a record of costs.	There are no set principles followed in management accounting.
In financial accounting, qualitative data are not recorded.	In cost accounting, only quantitative aspects are recorded.	Management accounting uses both quantitative as well as qualitative aspects.

1.5 Importance of Cost Accounting

The limitation of financial accounting has made the management to realise the importance of cost accounting. The importance of cost accounting are as follows:

1. Importance to Management

Cost accounting provides invaluable help to management. The advantages are as follows :

- Cost accounting helps the management in the ascertainment of cost of process, product, Job, contract, activity, etc., by using different techniques such as Job costing and Process costing.
- By using demand and supply, activities of competitors, market condition to a great extent, also determine the price of product and cost to the producer does play an important role. The producer can take necessary help from his costing records.
- Cost can be reduced in the long run when cost reduction programme and improved methods are tried to reduce costs.
- As it is possible to know the cost of product at every stage, it becomes possible to check the forms of waste, such as time and expenses etc
- Cost accounting helps in checking the accuracy of financial account with the help of reconciliation of the profit as per financial accounts with the profit as per cost account.
- Helps in Inventory Control

2. Importance to Employees

Worker and employees have an interest in which they are employed. An efficient costing system benefits employees through incentives plan in their enterprise, etc. As a result, both the productivity and earning capacity increases.

3. Cost accounting and creditors

Suppliers, investor's financial institution and other moneylenders have a stake in the success of the business concern and therefore are benefited by installation of an efficient costing system. They can

base their judgement about the profitability and prospects of the enterprise upon the studies and reports submitted by the cost accountant.

4. Importance to National Economy

An efficient costing system benefits national economy by stepping up the government revenue by achieving higher production. The overall economic developments of a country take place due to efficiency of production.

5. Data Base for operating policy

Cost Accounting offers a thoroughly analysed cost data which forms the basis of formulating policy regarding day-to-day business, such as:

- (a) Whether to make or buy decisions from outside?
- (b) Whether to shut down or continue producing and selling at below cost?
- (c) Whether to repair an old plant or to replace it?

Advantages of Cost Accounting

1. It helps in cost reduction.
2. Ascertainment of cost.
3. Benefits of the National Economy.
4. Fixation of responsibility.
5. Price fixation.
6. Inventory controls.
7. Elimination of wastage.
8. It helps in checking the accuracy of the financial account.
9. Facilities cost comparison.
10. Helps in the estimate.



1.6 Limitation of Cost Accounting



2 Concept check

1. Basic objective of cost accounting is _____
- A. tax compliance.
 - B. financial audit.
 - C. cost ascertainment.
 - D. profit analysis.

Answer: Option C

2. Cost accounting started as a branch of
- A. financial accounting
 - B. Management accounting
 - C. corporate accounting
 - D. vedic accounting

Answer: Option A

3. In brief, _____ is the activity of finding out the cost of products and services.
- A. Financial accounting
 - B. Management accounting
 - C. Corporate accounting
 - D. Cost accounting

Answer: Option D

EduTap