Introduction: Cost and Cost Accounting

Meaning:

Cost accounting is the classifying, recording and appropriate allocation of expenditure for the determination of the costs of products or services, and for the presentation of suitably arranged data for purposes of control and guidance of management. It includes the ascertainment of the cost of every order, job, contract, process, service or unit as may be appropriate. It deals with the cost of production, selling and distribution.

It is thus the provision of such analysis and classification of expenditure as will enable the total cost of any particular unit of production or service to be ascertained with reasonable degree of accuracy and at the same time to disclose exactly how such total cost is constituted (i.e. the value of material used, the amount of labour and other expenses incurred) so as to control and reduce its cost.

According to Wheldon, “Cost accounting is the application of accounting and costing principles, methods and techniques in the ascertainment of costs and the analysis of saving/or excess cost incurred as compared with previous experience or with standards”. Thus, cost accounting relates to the collection, classification, ascertainment of cost and its accounting and control relating to the various elements of cost.

It establishes budgets and standard costs and actual cost of operations, processes, departments or products and the analysis of variances, profitability and social use of funds.

Thus, cost accounting has the following features:

1. It is a process of accounting for costs.

2. 2. It records income and expenditure relating to production of goods and services.

3. 3. It provides statistical data on the basis of which future estimates are prepared and quotations are submitted.

4. 4. It is concerned with cost ascertainment, cost control and cost reduction.

5. 5. It establishes budgets and standards so that actual cost may be compared to find out deviations or variances.

6. 6. It involves the presentation of right information to the right person at the right time so that it may be helpful to management for planning, evaluation of performance, control and decision making.

7. ***Difference between Costing and Cost Accounting:***

8. **Main differences between costing and cost accounting are given as under:**

Basis of Distinction	Costing	Cost Accounting
1. Nature	It is a technique and process of ascertaining costs.	It is regarded as a specialised branch of accounting.
2. Scope	The costing techniques include principles and rules which govern the procedure of ascertaining the cost of products/services.	It involves classification, accumulation, assignment and control of costs.
3. Process	The process of costing consists of routines of ascertaining costs by historical or conventional costing, standard costing or marginal costing.	It involves establishment of budgets, standard costs or actual costs of operations, classification, recording and appropriate allocation of expenditure.

9.

10. Objectives of Cost Accounting:

11. Objectives of cost accounting are ascertainment of cost, fixation of selling price, proper recording and presentation of cost data to management for measuring efficiency and for cost control and cost reduction, ascertaining the profit of each activity, assisting management in decision making and determination of break-even point.

12. The aim is to know the methods by which expenditure on materials, wages and overheads is recorded, classified and allocated so that the cost of products and services may be accurately ascertained; these costs may be related to sales and profitability may be determined. Yet with the development of business and industry, its objectives are changing day by day.

Following are the main objectives of cost accounting:

1. To ascertain the cost per unit of the different products manufactured by a business concern;

2. To provide a correct analysis of cost both by process or operations and by different elements of cost;

3. To disclose sources of wastage whether of material, time or expense or in the use of machinery, equipment and tools and to prepare such reports which may be necessary to control such wastage;

4. To provide requisite data and serve as a guide for fixing prices of products manufactured or services rendered;

5. To ascertain the profitability of each of the products and advise management as to how these profits can be maximised;

6. To exercise effective control if stocks of raw materials, work-in-progress, consumable stores and finished goods in order to minimise the capital locked up in these stocks;

7. To reveal sources of economy by installing and implementing a system of cost control for materials, labour and overheads;

8. To advise management on future expansion policies and proposed capital projects;

9. To present and interpret data for management planning, evaluation of performance and control;

10. To help in the preparation of budgets and implementation of budgetary control;

11. To organise an effective information system so that different levels of management may get the required information at the right time in right form for carrying out their individual responsibilities in an efficient manner;

12. To guide management in the formulation and implementation of incentive bonus plans based on productivity and cost savings;

13. To supply useful data to management for taking various financial decisions such as introduction of new products, replacement of labour by machine etc.;

14. To help in supervising the working of punched card accounting or data processing through computers;

15. To organise the internal audit system to ensure effective working of different departments;

16. **.** To organise cost reduction programmes with the help of different departmental managers;

17. To provide specialised services of cost audit in order to prevent the errors and frauds and to facilitate prompt and reliable information to management; and

18. To find out costing profit or loss by identifying with revenues the costs of those products or services by selling which the revenues have resulted.

Broadly speaking, the above objectives can be re-grouped under the following three heads:

(1) Ascertainment and analysis of cost and income by product, function and responsibility.

(2) Accumulation and utilisation of cost data for control purposes to have the minimum possible cost consistent with maintenance of quality. This objective is achieved through fixation of targets, ascertainment of actuals, comparison of actuals with targets, analysis of reasons of deviations between actuals and targets and reporting deviations to management for taking corrective action.

(3) Providing useful data to management for taking decisions.

Objections Against Cost Accounting:

A number of objections are generally raised against the introduction of costing on various grounds.

Following are some of the important objections usually raised:

1. Want of Necessity:

It has been argued that costing is of recent origin and that industries prospered in the past and are still prospering without the aid of costing and, therefore, expenditure incurred in installing a costing system would be an unnecessary expenditure.

This argument overlooks the fact that modern industries are running under highly competitive conditions and that every manufacturer should know the actual cost of production to decide how far he can reduce the selling price. Many industrial failure.' in the past may be attributed to the lack of knowledge on the part of manufacturer of actual cost of production and, therefore, selling products below cost.

2. Inapplicability:

It is argued that modern methods of costing are inapplicable to many types of industries. It is true that costing cannot be applied with advantage to trading concerns and concerns of small size. But in many cases some methods of costing can always be devised to suit the requirements of the business.

It should be clearly understood that there is no stereotyped system of costing which can be applied to all types of industries. The system of costing should be so devised as to suit the business but not the business to suit the system.

3. Failure in Many Cases:

It is argued that the adoption of costing system failed to produce the desired results in many cases and, therefore, the system is defective. The failure of a system may be due to several causes such as apathy or indifference of management, lack of adequate facilities, non-co-operation or opposition from the employees. So it is hasty to find fault with the system, if it fails to produce the desired results.

4. Mere Matter of Forms and Rulings:

It is argued that after some time, a costing system degenerates into a matter of forms and rulings. This is not the fault of the system. It is the fault of the way in which the system is maintained. Forms and rulings are essential for a costing system but they must be revised and brought up-to-date in the light of altered conditions. If this is not done, the system is bound to degenerate into a mere matter of forms and rulings.

5. Expensive:

It is said that the cost involved in installing and working a cost system is out of all proportions to the benefits derived therefrom. It may be stated in this connection that a costing system must be a profitable investment and should produce benefits commensurate with the expenditure incurred on the system. If care is taken to devise a costing system to suit the requirements of the industry and avoid unnecessary elaboration, expenditure incurred in installing and operating the system will be a profitable investment and will bring adequate return.

General Principles of Cost Accounting:

Following are the main principles of Cost Accounting:

1. Cause-Effect Relationship:

Cause-effect relationship should be established for each item of cost. Each item of cost should be related to its cause as minutely as possible and the effect of the same on the various departments should be ascertained. A cost should be shared only by those units which pass through the departments for which such cost has been incurred.

2. Charge of Cost Only after its Incurrence:

Unit cost should include only those costs which have been actually incurred. For example unit cost should not be charged with selling cost while it is still in factory.

3. Past Costs Should not Form Part of Future Costs:

Past costs (which could not be recovered in past) should not be recovered from future costs as it will not only affect the true results of future period but will also distort other statements.

4. Exclusion of Abnormal Costs from Cost Accounts:

All costs incurred because of abnormal reasons (like theft, negligence) should not be taken into consideration while computing the unit cost. If done so, it will distort the cost figures and mislead management resulting in wrong decisions.

5. Principles of Double Entry Should be Followed Preferably:

To lessen the chances of any mistake or error, cost ledgers and cost control accounts, as far as possible, should be maintained on double entry principles. This will ensure the correctness of cost sheets and cost statements which are prepared for cost ascertainment and cost control.

Evolution and Development of Cost Accounting:

Widespread growth of industrialisation in the western world during the last half of the 19th century gave rise to the development of cost accounting. With the advent of the factory system, necessity for accurate cost information was felt to bring efficiency in production. In spite of this, there was slow development of cost accounting during the 19th century.

To quote Eldon S. Hendriksen, “Not until the last 20 years of the 19th century was there much literature on the subject of cost accounting in England and even then very little was to be found in the United States. Most of the literature until this time emphasized the procedures for the calculation of prime costs only.”

Several reasons for the late development of cost accounting can be attributed as given below:

1. Overheads (i.e. indirect costs) constituted a small part of total cost in the early period of the factory system as costly machinery was uncommon during those days. Necessity of cost accounting is felt more if overheads form a significant portion of total cost as we will see in t he course of our discussion in the book.

2. A tendency among the cost accountants to keep their costing methods strictly secret was also responsible for slow development of cost accounting.

3. Until the late 19th and early 20th centuries, manufacturing processes were simple and firms were producing a small variety of products. Because of these facts also, development, cost accounting was slow.

The most rapid development in cost accounting took place after 1914 with the growth of heavy industry and mass production methods when costs (i.e., overheads) other than materials and labour constituted a significant portion of the total cost of production. The scientific management movement led by Taylor gave impetus to the development of cost accounting because it contributed to the use of standard costs in planning manufacturing operations and in evaluating performance.

The development of cost accounting in India is of recent origin and it started gaining importance after the independence of the country when the Indian Government started laying emphasis on the industrial development of the country. Further, provision of cost audit under section 233 B of the Companies Act has given impetus to the development of cost accounting in India.

The Vivian Bose Enquiry Commission brought to light the various malpractices prevalent in the manufacturing establishments and it was thought that the financial audit for the audit of financial accounts at the end of the year was insufficient to judge the real efficiency of working of manufacturing organisations.

As a result, the concept of cost audit emerged to get the best utilisation of the resources of the country which are used in the manufacturing organisations and the Government was given the power for ordering cost audit under section 233 B of the Companies Act, 1956.

The Government may appoint a cost auditor to conduct cost audit where it is necessary:

(a) So to do in the opinion of the Government under section 233 B of the Companies Act, 1956;

(b) To ascertain correct cost of certain units when Government is approached for protection or financial help;

(c) To ascertain correct cost of contract given to private firms under ‘cost plus’ basis;

(d) Fix reasonable prices of certain items of production so as to prevent undue profiteering.