SYLLABUS

B.B.A. III SEM

Subject – Business Costing

UNIT – I	Basics of Costing: Meaning and definition of Cost Accounting, Concepts of Cost ,Cost Object, Cost Center and Profit Center, Cost Control and Cost Reduction Classification of Costs, Overview of Cost Accounting Standards.

Unit – 1

Concept

Broadly speaking, the term 'Cost Accounting is a combination of two words, i.e., 'COST' AND 'ACCOUNTING'

In simple words, cost may be defined as the amount of resources sacrificed or given up to achieve specific objectives, which may be the acquisition of goods or services. In other words, Cost means the amount of expenditure (actual or national) incurred on, attributable to a thing.

On the other hand, Accounting is an important service activity in business and is concerned with the collecting, recording, evaluating and communicating the results of the past events. The history of accounting development reflects its changing role in response to the changing business and social needs. It can be perceived as an information system, which has its inputs, processing methods and outputs. The usefulness of accounting lies in its capacity to provide information to various shareholders, in business so that they could arrive at the correct decisions. Though accounting has been variously defined, its commonly accepted definition as given by the American institute of certified public manner and in terms of money, transaction and events which are, in part at least, of a financial character and interpreting the results thereof."

Meaning of Cost Accounting

The industrial revolution in England presented a challenge to the development of accounting as a tool of industrial management. Costing techniques were developed as guides to management actions. The increasing awareness on the part of entrepreneurs and industrial managers for using scientific principles of a management in the wake of scientific management movement led to the development of cost accounting. Cost accounting deals with the controlling them and evaluating productivity of the enterprise.

Cost accounting either to focused mainly on ascertainment of cost but with the advent of globalization, entry of multinationals and increase in competition and cost accountants are concentrating on cost of reduction through adopting stringent measures of cost control. Cost accounting thus has come serve the twin objectives of, (i) Cost ascertainment and (ii) Cost reduction. It is playing both service and advisory and economic decisions.

1. Ascertainment of Costs – It refers to the collection and analysis of cost and the linking up of production with the expenses at different stages of operations.
2. Controlling the costs – cost control aims at guiding the actual towards the targets, regulating the actual if they vary from the targets; and this is done through executive action. It is exercised through techniques such as standard costing, budgetary control etc.

Thus, cost accounting is a formal system of accounting for costs by means of which costs of products or services are ascertained and controlled. According to Sir Wheldon, cost accounting is "the application of accounting and costing principals, methods and techniques in the ascertainment of costs and analysis of saving or excesses as compared with previous experience of standards."

Definitions of cost Accounting

Important definitions of the term cost accounting are as under –

1. According to R.N. Carter, cost accounting is defined as, "a system of recording in accounts the materials used and labour employed in the manufacture of a certain commodity or on a particular job."
2. According to kohler, "Cost Accounting is the branch of accounting dealing with the classification, recording, allocation, summarization and reporting of current and prospective purpose."

3. According to Nichola, "Cost Accounting is a system of cost accumulating and classification for product costing and managerial planning, control and decision-making purposes."
4. According to Sickle, "Cost Accounting is a science of recording and presenting business transactions pertaining to the production of goods and services, whereby these records become a method of measurement and a means of control."
5. According to W.W. Bigg, "Cost Accounting is the provision of such analysis and classification of expenditure as will enable the total cost of any particular unit of production to be ascertained with reasonable degree of accuracy and at the same time to disclose exactly how such total cost is constituted.

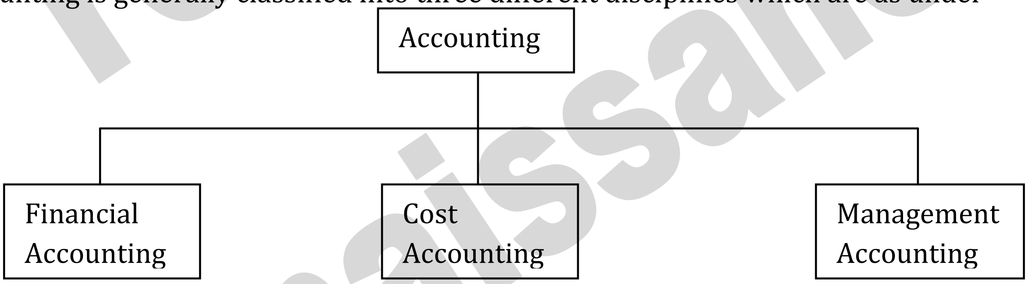
Scope of Cost Accounting

The scope of cost accounting is very wide and includes the following –

1. Costing – It refers to the techniques and processes of ascertaining costs. It involves systems, methods and techniques to accumulation, analysis and appropriate allocation of expenditure incurred in respect of a product or service.
2. Accounting – It is the science which records and determines scientifically the cost of manufacturing goods or rendering service per unit control and guide the persons involved in the organization. It helps thus, cost accounting in the formal mechanism by which cost data are provided for ascertaining and controlling the costs of products or services.
3. Cost Control – Cost control involves the setting up of targets for expenses and production, measurement of performance through, comparison of actual with targets, to ascertain merit of the variances, analysis of variances and inctialing corrective action to eliminate redundancies.
4. Budgetary Control – It is a system where by the budgets are used as a means of planning and controlling costs. Budgetary control is the establishment of budgets relating to the responsibilities of executives to the requirement of a policy and the continuous comparison of actual with budgeted results, either to secure by individual action the objective of that policy or to provide a basis for its revision. It involves the establishment of budget for each section of the organization, measurement of the actual performance with reference to the budgeted performance the ascertainment of deviations and taking suitable actions to remedy the defects, if any.
5. Cost audit – It is the verification of the correctness of cost accounts and to ensure adherence to the cost accounting plan. The purposes of the cost audit is to endure that he figures as shown by cost accounts are correct and that cost accounts, cost centres and cost units have been properly defined and charged.

Classification of Accounting

The accounting is generally classified into three different disciplines which are as under –



1. Financial Accounting – IT deals with preparation of Trial Balance, Profit and Loss account and Balance sheet. It shows the amount of profit earned or loss suffered during a particular period.
2. Cost Accounting – It shows classification and analysis of costs on the basis of functions, processes, products, centres etc. It also deals with cost computations, cost savings, cost reduction etc.

3. Management Accounting – It deals with the processing of data generated in financial accounting and cost accounting of managerial decision-making. It also deals with application of managerial economics concepts for decision-making.

Distinction between cost Accounting and Management Accounting

The term "Cost accounting" and "management accounting" have sometimes been used synonymously by any accounts in recent years. But these two systems of accounting are not one and the same thing. Although over the years, the subject matter of cost accounting has broadened, it is, concerned mainly with the techniques of product costing procedures and related information processing. It helps the management in planning and controlling costs related to both production and distribution activities.

By nature, management accounting refers to the reporting system designed to cater to the decisional and executional needs of management. The accounting statements and reports in management accounting are situation-specific and are prepared with respect to a specific problem, situation or decision.

The points of difference between Cost Accounting and Management Accounting are under –

1. Origin and Development – Cost Accounting owes its origin to Industrial Revolution. Financial accounting proved inadequate to satisfy the information needs (about costs) of the management. Cost accounting was evolved as a necessary adjunct of financial accounting. On the other hand management accounting owes its origin to the management consciousness of mid-twentieth century. Thus management accounting is of a more recent origin on the other hand.
2. Object – The main object of cost accounting is to determine the cost of product or a service. However, in modern times, cost control and price fixation have also come to be recognized, as important objective of management accounting is to provide meaningful information to the management for decision-making and control.
3. Nature – Cost accounting includes both presents and future. Whereas management accounting is mainly future-oriented. It primarily concerns itself with the projection of figures for future.
4. Scope – The scope of cost accounting is limited to cost ascertainment and control. It deals with cost data only. The scope of management accounting is much wider than cost accounting. It includes financial accounting, cost accounting, and tax planning a decisional accounting.
5. Utility – Cost accounting is useful both for external parties and internal management. On the other hand management accounting is meant for the internal consumption or for internal use of the management.
6. Types of Data Used – Cost accounting deals with the monetary cost of products and services. It covers only quantitative aspects. On the other hand management accounting makes use of both quantitative and qualitative data, i.e. monetary as well as non-monetary figures.
7. Principles and Format – Cost accounting follows a definite format and principles. On the other hand management accounting follows to set format and principles for reporting. The format and procedure will differ from concern to concern. In fact, the method of presentation of information depends the informational needs of the individual concern and the skill of the management accountant.

Analysis and Classification of elements of cost

To understand the actual interpretation of the term 'COST' it is very important to understand the basic concept of elements of cost. There are three element of costing, which are as under –

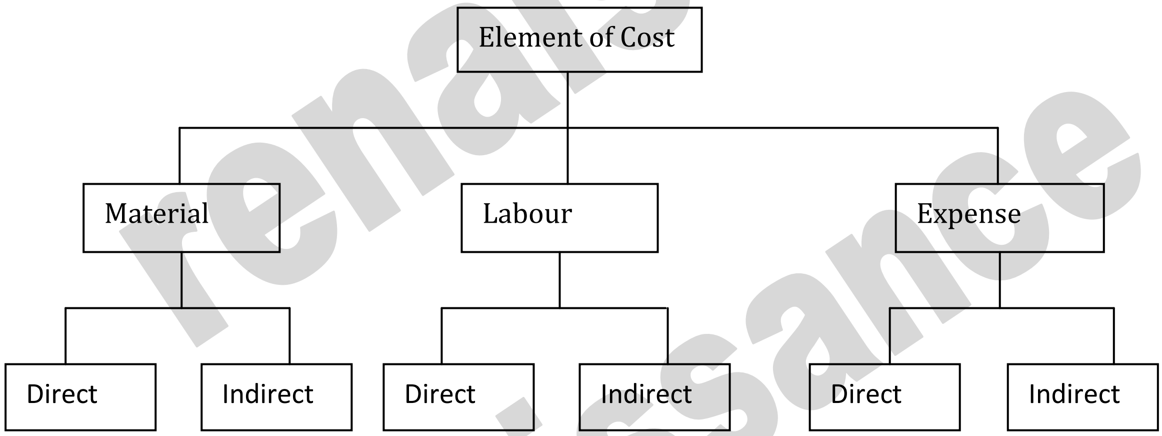
1. Material – The substance from which the product is made is called 'Material'. It may be in the form of raw or a manufactures state. It can be direct as well as indirect. It may be further sub-divided as under –

a. Direct Material – In simple words, material which becomes an integral part of the finished product and which can be conveniently assigned to specific physical units is termed as 'Direct Material'. Its examples are as under.
   1. Components specifically purchases, produced or requisitioned from stores.
   2. Primary packing material such as carton, boxes and wrapping material etc.

b. Indirect Material – Material which is used or applied for the purpose of ancillary to the business and which cannot conveniently be assigned to specific physical units, is termed as 'indirect Material' such as – Printing and Stationery material, oil and wastage, consumable stores etc.

2. Labour – To convert material into finished goods, human effort are required and such efforts of human beings are known as 'Labour'. It may be further sub divided as –
   a. Direct Labour – Any type of labour which is directly related to the production of a particular commodity is known as direct labour. It is thereof, specifically and conveniently traceable to specific products.
   b. Indirect Labour – Indirect labour refers to the labour employed for the purposes of carrying out tasks incidental to goods produced or services provided is indirect labour. Such type of labour does not alter the construction composition or condition of the product. It cannot be practically traced to specific units o output. Such as wages of storekeepers, timekeepers, directors fees, salaries of salesman etc.
3. Expenses – It refers to the amount/expenditure/expenses directly or indirectly required for the production of a product. It may be of two types –
   a. Direct Expenses – It refers to the expenses directly conveniently and wholly allocated to specific cost centre sot cost unit. Such as Costly of defective work incurred in connection with a particular job or contract, hiring of special type machinery for the complete particular product.
   b. Indirect Expenses – It refers to the expenses, which cannot be directly, conveniently and wholly allocated to cost centres or cost units, such as

Elements of Cost with the help of a chart



Various statements of Unit costing

1. Units or Output Costing – costing information is presented in the form of a statement known as cost sheet or cost statement. Sometimes production account may also be prepared.
2. Cost sheet – Cost sheet is a periodical statement, which is prepared in tabular form on weekly, fortnight, monthly or quarterly basis. It is defined by I.C.M.A., London as, "A statement, which provides for the assembly of the detailed cost of a centre a cost unit."
3. Statement of Cost and Profit – Usually in a statement of cost, cost per unit is not shown. In some statements of cost, the proportion of each elements to total cost is shown in a separate column, in addition to total cost.

4. Production Account – When a cost sheet is prepared in the form of account, it is known as production account. It is based on double Entry system of financial accounting.

Unit or Output Costing -
This method is also known as single costing. Under this method, no separate set of book is generally required. Costing information is presented in the form of a statement known as cost sheet or cost statement. Sometimes production account may also be prepared. The cost of the production per unit is arrived at by dividing the total cost of production during a given period by the total number of units produced. The cost of production includes direct materials, direct labour, direct expenses, factory overheads and office and administrative overheads. The total cost per units is arrived at by dividing the cost of sales (or total cost) during a given period by the total number of units is arrived by adding the selling and distribution overheads to cost of goods sold.

Suitability of Unit costing – This method is applied where there are only one or few products, which are identical and capable of being expressed in simple quantitative units. For example, radios, cameras, bricks, pens, cement, mines, quarries, etc.

Cost sheet
Cost sheet is a periodical statement, which is prepared in tabular form on weekly, fortnightly, monthly or quarterly basis. it is defined by I.C.M.A, London as, "A statement, which provides for the assemble of the detailed cost of a centre a cost unit." The total cost is analyzed into prime cost, factory cost, office cost (or cost of production) and total cost (or cost or sales). The cost sheet generally shows the total cost per unit of the product manufactured during the period. Cost sheet, being a memorandum statement, does not form part of the double entry cost accounting records.

The cost sheet may be prepared on the basis of actual data (Historical cost sheet) or estimated data (Estimated Cost Sheet). Usually, a cost sheet contains the following –
1. Value of raw materials consumed – Cost of raw materials consumed is ascertained after making adjustments for the opening stock and closing stock of raw materials. The expenses incurred on purchase of material are asses to the coast of materials.
2. Cost of direct labour – Direct labour employed in production should be identified separately. This can be easily done with the help of time and job cards.
3. Direct expenses – Direct expenses should be separately identified, as they are part of prime cost.
4. Prime cost – It consists of costs of direct material, direct labour, and direct expenses. It is also known as direct cost. Basis cost, first stage cost or flat cost.
5. Factory cost – It comprises prime cost and in addition works or factory overheads which includes cost of indirect material, indirect labour and indirect expenses relating to production or factory. This cost is also known as works costs of manufacturing cost.
6. Cost of production – It comprises of factory cost and office and administration overheads. This is also termed as cost of production.
7. Total cost – It comprises of cost of production and selling and distribution overheads. It is also termed as cost of sales/cost of goods sold.

Objectives of Preparing Cost sheet –
Cost sheet is prepared for the use of management. Basic objectives for preparing cost sheet are –
1. To ascertain the cost of production and each component, in total as well as per unit
2. To compare the costs for any two periods and
3. To fix the selling price of the product.

Specimen of Cost sheet – There is no fixed from of cost sheet, but in order to make it more useful, it is generally presented in a tabular form. Usually there are columns in the cost sheet – first column for the particular second for the total cost and third for the cost per unit for the current period. Cost sheet may also have to additional columns showing total cost and per unit cost for a preceding period.

A specimen of a cost sheet is given below –

M/S ____________ABC Co. Ltd.____________
Cost sheet /Cost Statement
For the period ending ____________________
(Output ______________Units)

Particulars	Detail Rs.	Total Rs.	Per Unit Rs.
Opening Stock of Raw Material	+		
Add: Purchases of Raw Material	+		
	?		
Less: Closing Stock of Raw Material	-		
	?		
Add: Direct Expenses/ Labour	+		
	?		
Prime Cost			
Add: Factory Overheads:			
Works Costs			
Add: Office and Administrative Overheads:			
Cost of Production			
Add: Office and Distribution Overheads:			
Cost of Sales			
	Profit		
Sales			

Items in the cost sheet

1. **Stock of raw materials –** Stocks of raw materials is used to calculate the cost of raw materials consumed. For computation of the raw material consumed, the value of opening stock of raw-materials added to and the value of closing stock of raw-materials is deducted from the value of materials purchased.
2. **Work-in-Progress –** Work-in-Progress means incomplete part of work or product. It is also known as semi-finished goods. Usually such goods bear proportionate share in factory overheads besides the cost of raw-materials consumed and direct wages. The treatment of stock of work-in-progress depends upon the basis of valuation of it. Thus it can be treated in any of the following ways –
   a. When it is valued at prime cost – The opening stock and closing stock of work in progress shall be adjusted in the cost sheet, while computing the prime cost.
   b. When it is valued at work cost – the opening stock and closing stock of work in progress are adjusted in the cost sheet, while computing the factory cost of goods manufactures during the accounting periods.
   c. When prime cost and factory overheads components are given separately – In this case prime cost components shall be adjusted while calculating prime cost and factory overhead components shall be adjusted while calculating factory cost.
   Usually the work-in-progress is valued ay works cost.
3. **Stock of Finished Goods –** In a cost sheet, the opening stock of finished goods is added to and closing stock of finished goods is deducted from the cost of production to find out the cost of goods sold.

4. **Treatment of the Cost of Rectifying the Defective Production –** Sometimes the production may not be, perfect as the saleable product but is capable of being rectified and brought to the required degree of perfection provided some additional expenditure is incurred. The defective production may be unavoidable (normal) or abnormal. The additional cost incurred rectify the normal defective production is treated as abnormal loss and charged to costing profit and loss account.
5. **Sale of Scrap –** It is an incidental residue from certain types of materials used in the production, usually of small amount and low value, recoverable without further processing. The realizable value (i.e.) saleable value) of scrap may be deducted from the works cost.