



# COST ACCOUNTING

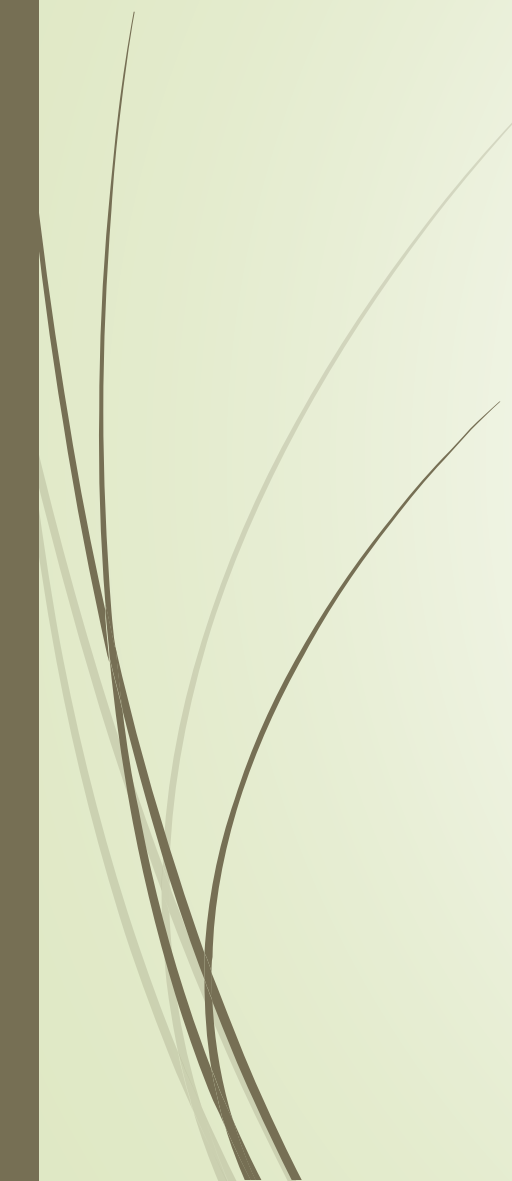
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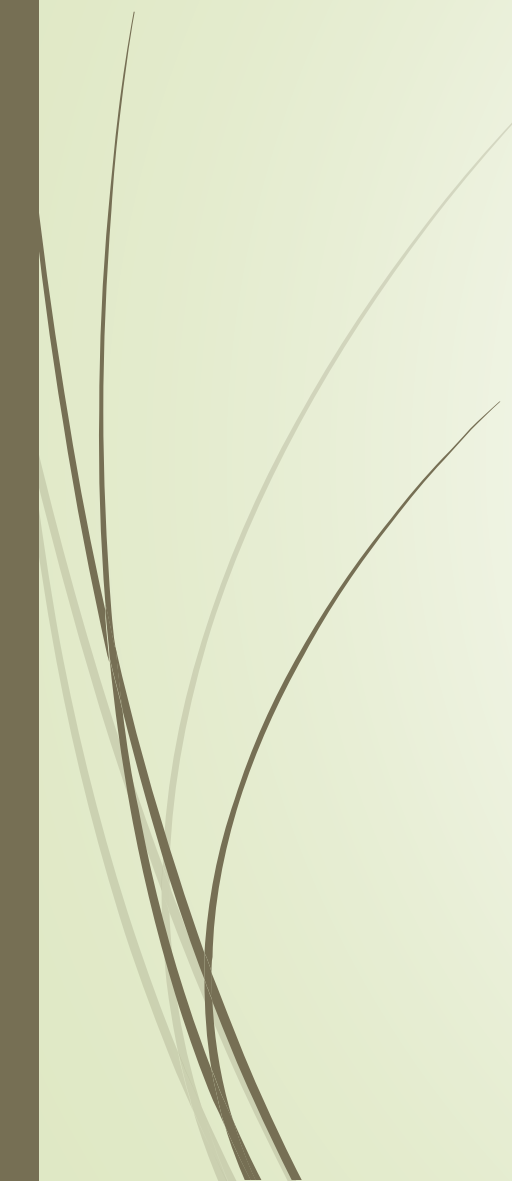


# MEANING

- Cost accounting is a branch of accounting which deals with the collection, classification, recording, analysis, interpretation, reporting and control current and prospective costs.
  - The technique and process of ascertaining costs.
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# NATURE OF COST ACCOUNTING

- A BRANCH OF ACCOUNTING
  - TOOLS AND TECHNIQUES
  - COST ACCOUNTING IS SCIENCE AND AN ART
  - COST ACCOUNTING IS A PROFESSION
  - A PROCESS IN NATURE
  - INTERNAL ACCOUNTING (NOT BINDED BY LAWS)
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# SCOPE OF COST ACCOUNTING

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- ➡ 1. Ascertainment of Cost
  - ➡ 2. Cost Accounting
  - ➡ 3. Controlling Cost




# Objectives of Cost Accounting

- To ascertain Cost
  - Cost Control
  - Determination of Prices
  - Ascertainment of Profitability
  - Provides a Base for Setting Business Policies
  - Inter-firm Comparison
  - Internal Audit System
- 



# Need of Cost Accounting

- Financial Decision Making
  - Profit Analysis:
  - Pricing Strategy
  - Performance Evaluation
  - Budgeting and Forecasting
  - Inventory Management
  - Regulatory Compliance and Reporting
- 



# Difference Between Financial Accounting and Cost Accounting

# Cost Accounting Vs Financial Accounting

## Financial Accounting

➡ Financial Accounting is an accounting system that captures the records of financial information about the business to show the correct financial position of the company at a particular date.

## Cost Accounting

➡ Cost Accounting is an accounting system, through which an organization keeps the track of various costs incurred in the business in production activities.





# Difference Between Financial Accounting and Cost Accounting

## Financial Accounting

### ➤ Purpose

- To tell about Profit and Loss and financial position of the business to the owners and outside parties like creditors, bankers, tax authorities

## Cost Accounting

### ➤ Purpose

- To provide detailed information of cost to the management for the purpose of proper planning operation and decision making



# Difference Between Financial Accounting and Cost Accounting

## Financial Accounting

### ➤ Period

- Financial accounts are prepared at the end of the year,

## Cost Accounting

### ➤ Period

- Cost accounts can be prepared daily, weekly, monthly or yearly as per the requirement of the management.



# Difference Between Financial Accounting and Cost Accounting

## Financial Accounting

### ➤ Control

- Greater control is kept on cash movement i.e. receipt and payment of cash

## Cost Accounting

### ➤ Control

- To control the cost of different cost elements like materials, labour and Overheads, so that total cost of production can be minimised



# Difference Between Financial Accounting and Cost Accounting

## Financial Accounting

### ➤ Information

- In Financial accounting the information is provided only in monetary terms.

## Cost Accounting

### ➤ Information

- The information is both monetary as well as non-monetary (i.e. units, jobs, contract etc.).



# Difference Between Financial Accounting and Cost Accounting

## Financial Accounting

- **Fixing of selling price**
  - Financial accounts provides its results at the end of the year that why it is not helpful for the price fixation

## Cost Accounting

- **Fixing of selling price**
  - Cost accounts provides sufficient information before and after the production of goods and services under various market condition.

# Difference Between Financial Accounting and Cost Accounting

## Financial Accounting

### ➤ Reporting of cost

- Under financial accounts, cost of production is reported in aggregate and that too at the end of the year.

## Cost Accounting

### ➤ Reporting of cost

- Cost of production is reported per unit as well as of each job, process, batch or contract as per the component of cost.

# Difference Between Financial Accounting and Cost Accounting

## Financial Accounting

### ➤ Analysis of profit

- Financial accounts disclose the gross profit or Net Profit for the whole business at the end of the year.

## Cost Accounting

### ➤ Analysis of profit

- Cost accounts disclose the profit or loss for each unit, job, process.
- Moreover profit can be estimated before production on the basis of predetermined overhead rates.





# Difference Between Financial Accounting and Cost Accounting

## Financial Accounting

### ➤ **Mandatory**

- Maintenance of financial accounts is compulsory under law in case of companies and other businesses

## Cost Accounting

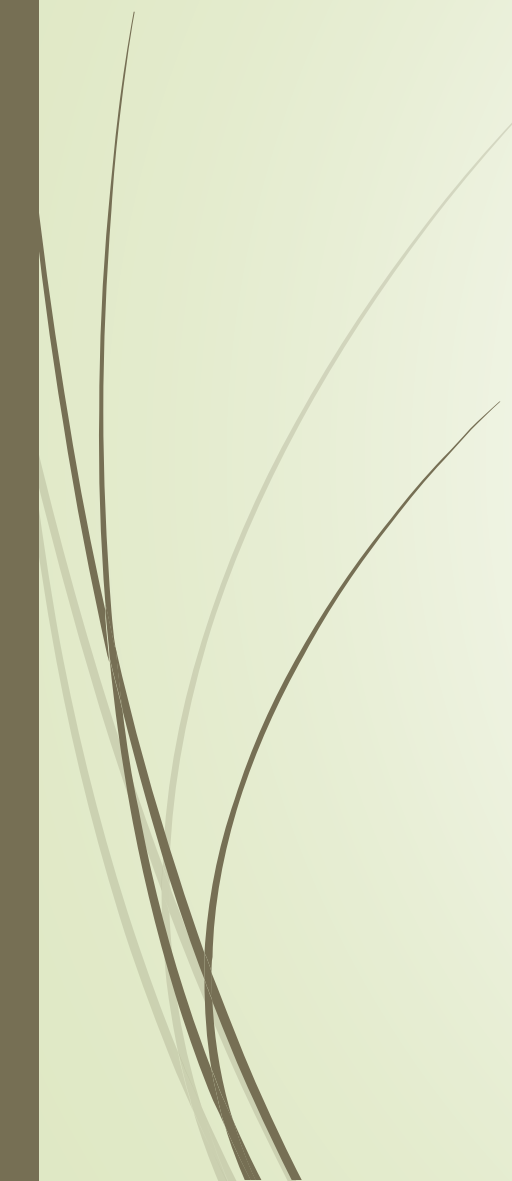
### ➤ **Optional**

- Maintenance of cost accounting is voluntary.





# CONCEPT OF COST

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- According to the Chartered Institute of Management Accountants, cost is **“the amount of expenditure (actual or notional) incurred on or attributable to a specified thing or activity.”** Similarly, according to Anthony and Wilsch **“cost is a measurement in monetary terms of the amount of resources used for some purposes.”**

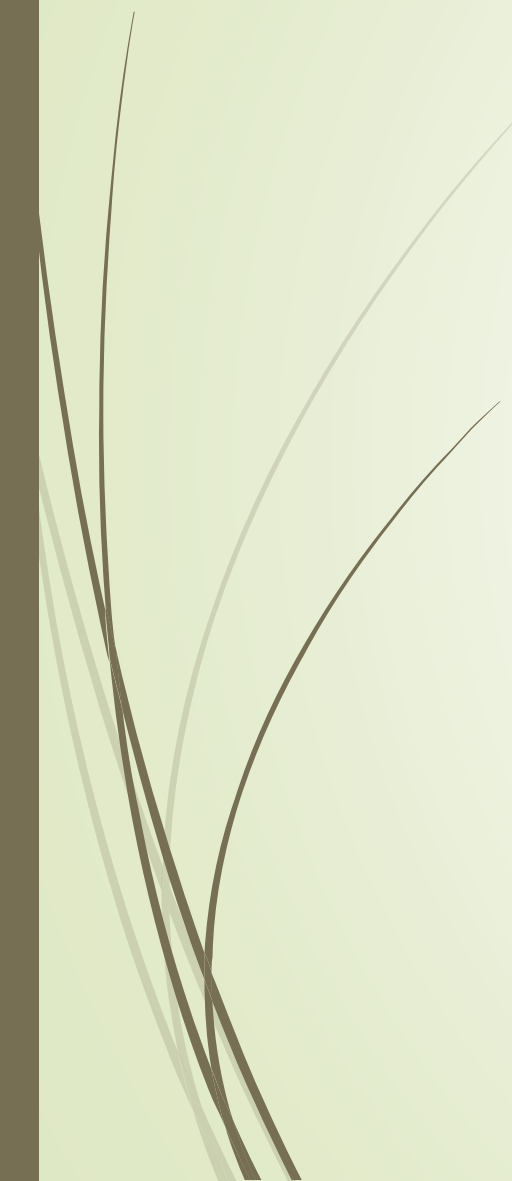


# ELEMENTS OF COST

- MATERIAL
  - LABOUR
  - EXPENSES
- 



# CLASSIFICATION OF COST

- ACCORDING TO ELEMENT
  - ACCORDING TO VARIABILITY
  - ON THE BASIS OF NORMALITY
  - ON THE BASIS OF TRACEABILITY
  - ACCORDING TO PLANNING AND CONTROL
  - ON THE BASIS OF FUNCTION
  - ACCORDING TO CONTROLABILITY
  - ACCORDING TO TIME
  - ACCORDING TO MANAGEMENT-DECISION
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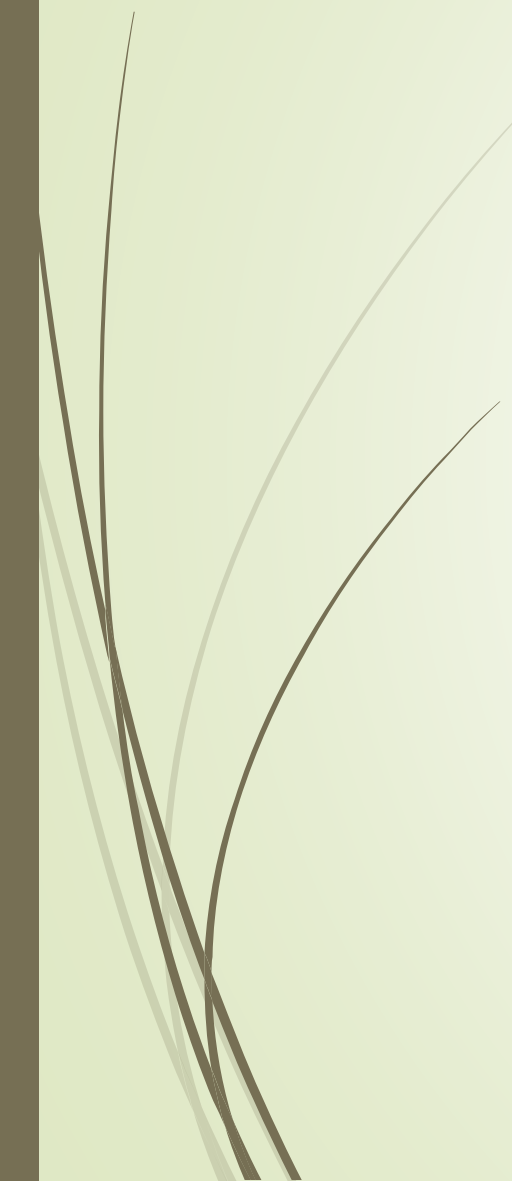


# ACCORDING TO ELEMENT

- MATERIAL COST
  - LABOUR COST
  - EXPENSES
- 



# ACCORDING TO VARIABILITY

- ➡ **FIXED COST** (Example: Land and building)
  - ➡ **VARIABLE COST** (Example: material, labour)
  - ➡ **SEMI-VARIABLE COST** (example Electricity bill)
- 

# ACCORDING TO NORMALITY

## ➤ **NORMAL COST**

Normal Cost are the normal or regular costs which are incurred in the normal conditions during the normal operations of the organization.

## ➤ **ABNORMAL COST:**

Abnormal costs are the costs that are uncommon, irregular, or sporadic which are not brought about because of unusual circumstances of the activities or production. For example, obliteration because of fire, shut down of hardware



# ACCORDING TO TRACEABILITY

## ➡ **DIRECT COST:**

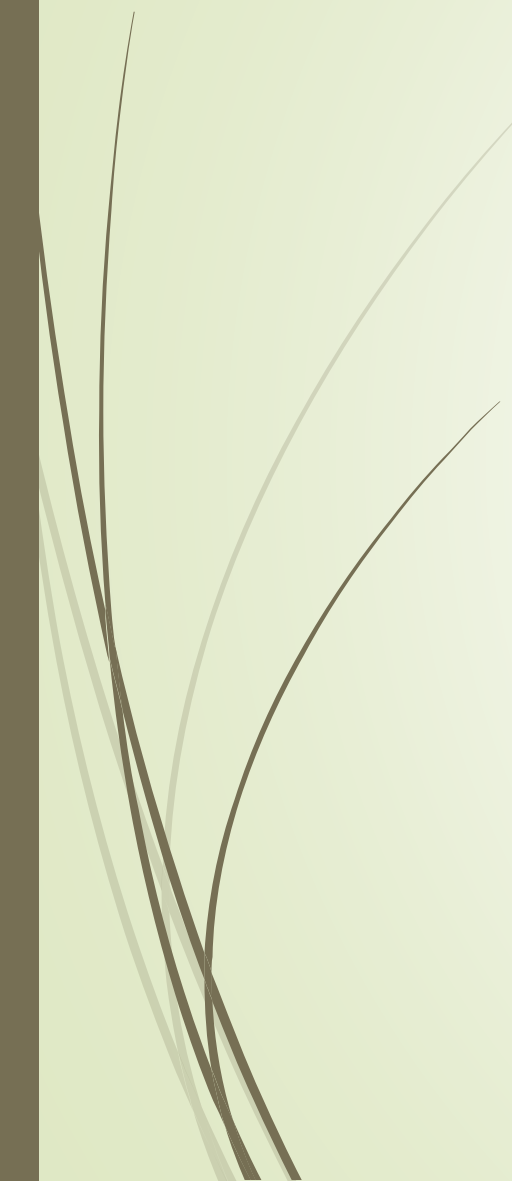
Direct costs are expenses associated with production and sales. The cost of raw material and labor required to manufacture a product would be categorized as direct costs.

## ➡ **INDIRECT COST:**

Indirect costs are fixed expenses a business incurs to keep the company running no matter the activity level.



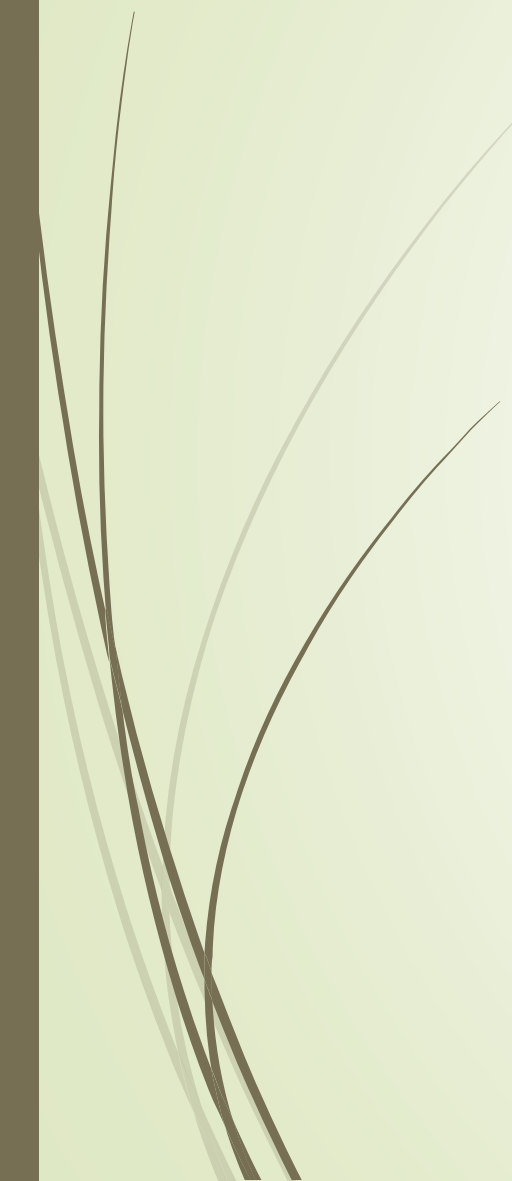
# ACCORDING TO PLANNING AND CONTROL

- ➡ **BUDGETED COST:** Budgeted cost refers to costs in total given a certain level of activity.
  - ➡ **STANDARD COST:** The term standard cost refers to a specific cost per unit.
- 





# ACCORDING TO FUNCTIONS

- MANUFACTURING/ Prime/ PRODUCTION COST
  - ADMINISTRATIVE COST
  - SELLING COST
  - DISTRIBUTION COST
  - RESEARCH AND DEVELOPMENT COST
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# ACCORDING TO CONTROLLABILITY

## ➤ CONTROLLABLE COST

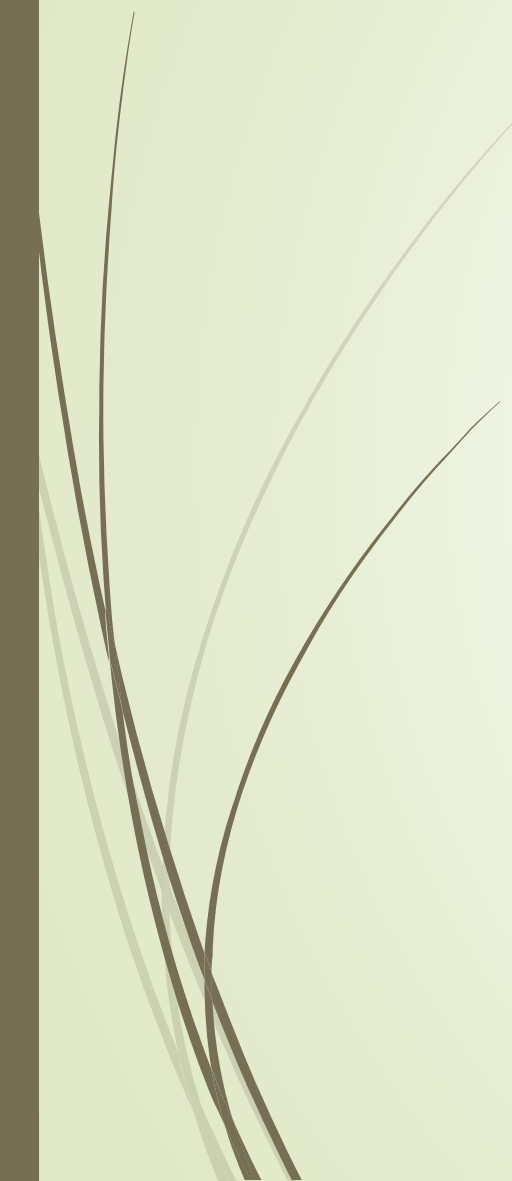
Controllable costs include such items as marketing budgets and labor costs, over which the company has full authority.

## ➤ UNCONTROLLABLE COST

Non-controllable costs include things like rent and insurance, which a company cannot change.

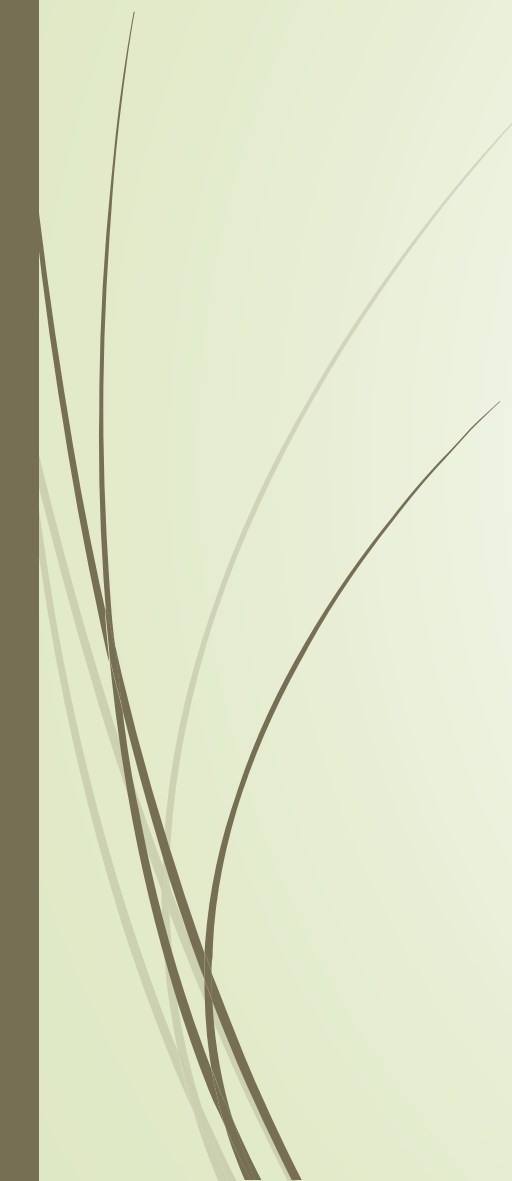


# ACCORDING TO MANAGENENT DECISIONS

- MARGINAL COST
  - OPPORTUNITY COST
  - REPLACEMENT COST
  - SUNK COST
  - DIFFERENTIAL COST
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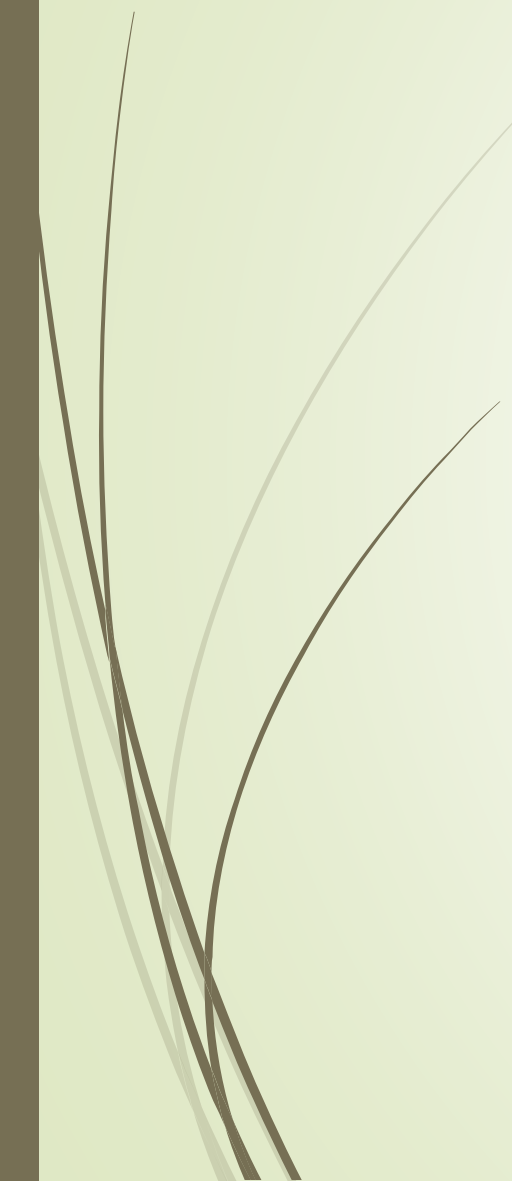


# DIFFERENTIAL COST

- ➡ Differential cost refers to **the difference in costs between two or more business decisions**. Specifically, a differential cost arises when there are multiple similar options and it's necessary to select one at the forfeiture of others.
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# REPLACEMENT COST

- Replacement cost is a term referring to the amount of money a business must currently spend to replace an essential asset like a real estate property, an investment security, or another item, with one of the same or higher value.
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# SUNK COST

➤ A sunk cost, sometimes called a retrospective cost, refers to **an investment already incurred that can't be recovered**. Examples of sunk costs in business include marketing, research, new software installation or equipment, salaries and benefits, or facilities expenses.



# ELEMENTS OF COST



# ELEMENTS OF COST

- MATERIAL COST
  - LABOUR COST
  - OTHER EXPENSES
- 



# MATERIAL & MATERIAL COST

- Materials may be defined as the item (substance) from which products are manufactured.
- **I.C.M.A.** “The material cost is the cost of commodities supplied to an undertaking.”
- Material can be in raw shape and in manufactured state e.g. cotton is raw material for yarn factory and cloth is a raw material for ready-made garment factory.

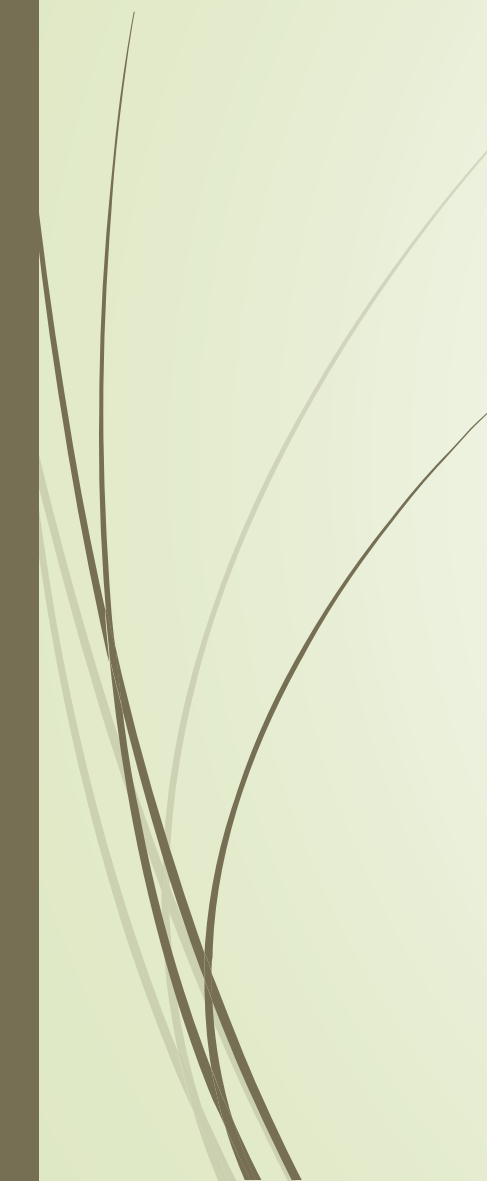


# Types of Materials

- ➡ Direct Material
  - ➡ Indirect Material
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# Direct Material

- ➡ Direct material are those material which are either purchased specially for the production of product or which are visible in the finished product as leather in the shoes, wood in furniture, cloth in dress, paper in the book.
  - ➡ **I.C.M.A defines** direct material as, “ Material cost which can be identified with and allocated to cost centre or cost unit.”
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# Indirect Material

- These material do not form part of the product. Indirect material is not visible in the final product as lubricant in the machine, adhesive in the furniture making etc.
- **I.C.M.A** defines indirect material, “The Material cost which cannot be allocated but which can be apportioned to or absorbed by cost centre or cost unit.”

# Labour Cost

- The term labour may be defined as the human efforts by which materials are converted into finished products.
- **I.C.M.A defines** labour cost as, “The cost of remuneration (wages, salaries, bonus, commission etc.) of the employees of an organisation.”




# Types of Labour

- Direct Labour
  - Indirect Labour
- 



# Direct Labour

- Direct Labour is the labour which is personally engaged in the production of goods, running of machine, jobs or processes or the production operations.
  - **I.C.M.A.** defines direct Labour, “wages which can be identified with and allocated to cost centre or cost unit.”
- 



# Indirect Labour

- Those workers who are not directly engaged in the production or running the machines but providing services or help to those who are operating the machines as storekeepers, inspectors, watchman, cleaner, waterman, chowkidar, Gardner etc.
- **I.C.M.A.** defines indirect Labour, “The wages or labour charges which cannot be allocated but which can be apportioned to or absorbed by cost centre or cost unit.”



# Other Expenses

- The expenses are incurred for producing a product or providing a service in addition to material and wages as rent of factory, insurance, depreciation, telephone bill etc.
- **I.C.M.A.** defines expenses as. “the cost of services provided to an undertaking and notional cost of the use of owner’s assets.



# Types of Expenses

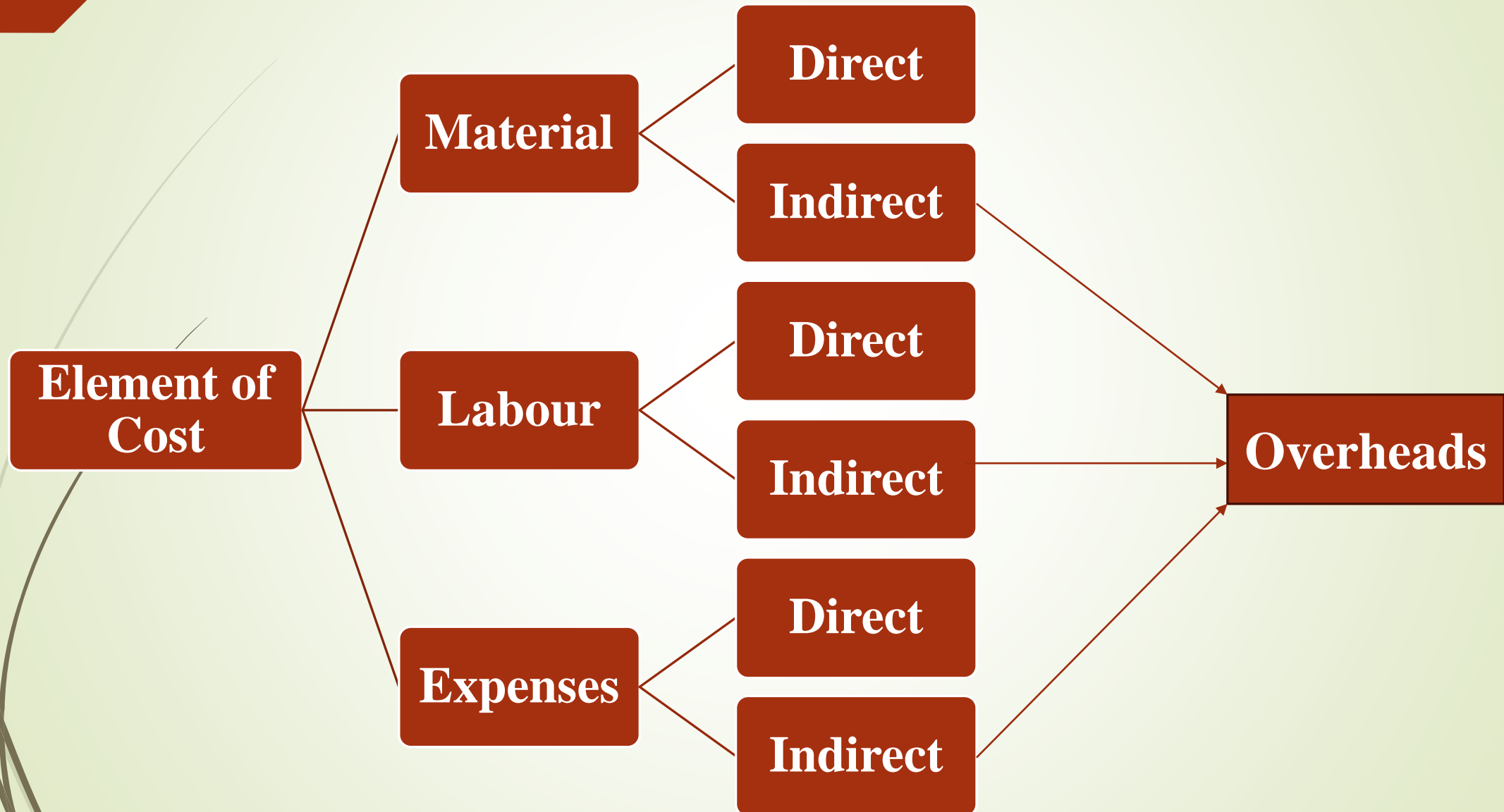
- Direct Expenses
  - Indirect Expenses
- 

# Direct Expenses

- Direct Expenses or chargeable expenses are those expenses which are directly identified with a particular job, process, Product or operation. These are specially incurred for a job and directly allocated to the job for which incurred. E.g. cost of special moulds, designs and pattern for a specific job etc.
- **I.C.M.A. defines** expenses direct as, “Expenses which can be identified with and allocated to cost centre and cost unit.”

# Indirect Expenses

- Indirect expenses are those which cannot be identified with a specific job, order, or process but which are common and these are apportioned to all jobs on some appropriate basis. E g. rent and utility- electricity, water, and heating
- **I.C.M.A. defines** it as, “Expenses other than direct expenses.”
- Indirect expenses broadly can be divided into:
  - Factory Expenses
  - Office Expenses
  - Selling and Distribution Expenses



# Overheads

- Overheads can be aggregate of indirect materials, indirect labour and indirect expenses.
- **ICMA defines** overheads, “The aggregate of all indirect materials cost, indirect labour cost and indirect expenses.”
- Overheads can be classified into the following:
  - Factory Overheads
  - Office Overheads
  - Selling and Distribution Overheads.



Overheads are classified according to functions into the following:

- (i) Factory overheads
- (ii) Office overheads
- (iii) Selling and Distribution overheads

**(i) Factory Overheads:** Factory overheads are those expenses which are incurred at the place of production or work or where the products are manufactured. It is because of this these are also known as production overheads or works overheads or manufacturing overheads. Factory overheads may include the following:

- (a) Rent, Rates, Taxes of factory building
- (b) Factory telephone charges
- (c) Factory repair and maintenance
- (d) Heating and lighting expenses in factory
- (e) Salary to factory manager, foremen, supervisor, Inspectors etc. Powerhouse Expenses

- (f) Insurance of factory building, factory machinery, factory workers, etc.
  - (g) Power and fuel
  - (h) Workers, canteen and welfare expenses
  - (i) Subscription to technical journal
  - (j) Bonus, overtime and leave wages to factory workers and other factory related staff
  - (k) Wages to chokidar, sweepers, waterman etc.
  - (l) Salary, fees to factory directors
  - (m) Contribution to provident fund, ESI, etc., to factory employees
  - (n) Drawing office salary (drawing office is the office where maps, designs and patterns are prepared) related to product
  - (o) Salary to storekeeper
  - (p) Expenses on consumeable store like oil, grease, lubricants, cotton waste, thread, etc.
  - (q) Small tools used in factory and their depreciation
  - (r) Factory printing, stationery etc.
  - (s) Water charges in the factory
  - (t) Cost of rectifying defective work
  - (u) Cost of training of new employees
  - (v) Purchase office expenses/Buying expenses
  - (w) Gas, steam, coal, charges
  - (x) Cleaning charges in factory
  - (y) Haulages charges in the factory. (big repair or overhauling of the machinery etc.)
  - (z) Indirect material, nut, bolts, screws, nails, rags, thread and other lubricants etc.
- related to the expenses incurred in running the



- (z) Indirect material, nut, bolts, screws, nails, rags, thread and other lubricants etc.)

**(ii) Office Overheads:** Office overheads are related to the expenses incurred in running the administration, work and office work of the factory. Office is a place where policies are formulated, decisions are taken and directions are issued to implement those decisions and various records are kept. It is a place from where direction and control is made on the activities going on in the organisation. The expenses of office relate to management and administration of business. These may also be named as administrative overheads or establishment overheads.

These can be:

- (a) Office salaries
- (b) Directors fees
- (c) Office rent, rates, taxes, lighting etc.
- (d) Office cleaning charges
- (e) Office insurance (building, staff, appliances etc.)
- (f) Printing, stationery, postage and stamp charges in the office
- (g) Office telephone, telegrams, fax charges, mobile charges, photostat etc.
- (h) Legal charges
- (i) Public Relation expenses
- (j) Trade subscription/subscription of trade journal
- (k) Bank charges

- (l) Office heating and lighting
- (m) Repair and maintenance of office building, office appliances and office furniture
- (n) Depreciation on office building, office appliances and office furniture
- (o) Audit fees
- (p) Counting house salary
- (q) Cost of dusters, brushes
- (r) Travelling expenses of office staff
- (s) General expenses
- (t) Hire charges of office machinery.

**(iii) Selling and Distribution Overheads:** Those expenses incurred either to increase the sale or to maintain the sales and also the expenses incurred to place the goods from producer's place to the place of the consumer. So these overheads are called selling and distribution overheads.




**(iii) Selling and Distribution Overheads:** Those expenses incurred either to increase the sale or to maintain the sales and also the expenses incurred to place the goods from producer's place to the place of the consumer. So these overheads are also known as marketing overheads as these are related to creating demand, securing orders, dispatching goods and collecting payments for goods sold. These may be:

- (a) Travelling expenses, salesmen's salary and commission to salesmen
- (b) Trade discount, cash discount allowed, brokerage, commission etc.
- (c) Sample expenses, branch expenses
- (d) Expenses for catalogues and price list
- (e) Printing and stationery, postage used in selling and distribution department
- (f) Material used in packing of the product for transportation and for display of the product
- (g) Delivery van expenses
- (h) Salary, commission and wages of delivery van operators
- (i) Rent, taxes on godown and warehouse
- (j) Insurance of godown, warehouse, finished goods, workers working in sales and distribution deptt.
- (k) Window dressing expenses and showroom expenses.
- (l) Carriage outward and loading and unloading charges of the finished goods
- (m) Advertisement expenses
- (n) Bad debts
- (o) Trade expenses, exhibitions and trade fairs expenses
- (p) Salary of sales manager and other staff related to sales deptt.
- (q) After sales service expenses
- (r) Repair and maintenance of delivery van
- (s) Depreciation of warehouse, delivery van
- (t) Subscription to sales journals
- (u) Free gifts
- (v) Loss by fire and loss in transit of finished goods
- (w) Collection charges.



# Components of Total Cost

1. Prime Cost
  2. Factory Cost
  3. Office Cost or Total Cost of Production
  4. Total Cost or Cost of Sale/ Selling Cost
- 

# 1. Prime Cost

Prime cost is the sum total of Direct Material cost, Direct Labour cost and Direct Expenses. It is also known as direct cost.

**Prime Cost = Direct Material Cost + Direct Labour Cost + Direct Expenses**

## 2. Factory Cost

Factory Cost is the sum total of Prime cost and factory Overheads. It is also known as work cost or manufacturing cost or production cost.

**Factory Cost = Prime cost + factory Overheads**



### 3. Office Cost

**Office Cost** is the sum total of Factory Cost and Office Overheads. It is also known as total cost of production.

**Office Cost = Factory cost + Office Overheads**

## 4. Cost of sale / Selling Cost

**Selling Cost** is the sum total of Office Cost and Selling and Distribution Overheads.

**Office Cost = Factory cost + Selling and Distribution Overheads**



## 5. Selling Price or Sale

If Profit is added to the Selling Cost or cost of sale the resulting amount will be sale price.

**Selling Price/ Sales = Cost of Sales + Profit**

# Cost Sheet

- Cost Sheet is a statement which shows the output of a specific period along with the break up cost per unit as well as total.
- Data driven in cost sheet are collected from various records related to that job, order or production
- The cost sheet is prepared in columnar form, a column for particular, total cost and per unit cost is provided in the cost sheet.

# Advantages of Cost Sheet

- ➡ It disclose total cost and per unit cost of production of goods.
- ➡ It helps to keep control in the cost of production of products
- ➡ Comparative study of various elements of cost with past records.
- ➡ It helps in lay down the Production policies
- ➡ Helps in fix up the selling price.

**Specimen of Cost Sheet (Layout only)**

Particulars	Total Cost (₹)	Per Unit Cost (₹)
Opening stock of raw material	—	
<b>Add: Purchase of Raw Material</b>	—	
<b>Add: Carriage Inward or freight inward</b>	—	
<b>Add: other expenses on purchase like port duties, Insurance, etc.</b>	—	
<b>Less: Closing stock of raw material</b>	—	
<b>Cost of Material consumed</b>	—	
<b>Add: Direct Labour</b>	—	
<b>Add: Direct Expenses</b>	—	
<b>Prime Cost</b>	—	
<b>Add: Factory Overheads:</b>		
Power		
Dep. on Machinery		
Insurance of factory Machinery		
Foremen Salary		
Oil and Water charges		
Repairs to factory		
Factory lighting, etc.		
<b>Factory Cost</b>	—	
<b>Add: Opening work in progress</b>	—	
<b>Less: Closing work in Progress</b>	—	
<b>Factory Cost or works Cost</b>	—	
<b>Add: Office overheads:</b>		
Salary of office staff		
Printing and Stationery		
Postage		
Telephone		
Dep. of office Building and Office Appliances		
Lighting in office		
Bank charges		
Donations		
Rent of office Building		
Insurance of Office Staff		
Directors fees		
Legal charges		
Audit fees, etc.		
<b>Office Cost or Cost of Production</b>	—	
<b>Add: Opening stock of Finished Goods</b>	—	
<b>Less: Closing stock of finished goods</b>	—	
<b>Cost of goods sold</b>	—	
<b>Add: Selling and Distribution overheads:</b>		

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Cost Acc

Salesmen Salary  
Advertisement  
Bad Debts  
Rent of warehouse  
Delivery Van Expenses  
Sales office expenses  
Repair to warehouse  
Insurance charges etc.

**Cost of Sales**

**Add Profit**

**Sales**

—
—
—

**Items excluded from cost sheet or cost accounts or Items which are not taken i**





# **COST CENTRE, COST UNIT, PROFIT CENTRE, INVESTMENT CENTRE**

# Cost Centre

- A cost centre is the smallest segment of activity or area or responsibility for which cost are accumulated.
- Generally a department is a cost centre but department may have several cost centres.
- Cost centres are the sub-departments of an organization for which cost is collected for ascertainment and cost control.

# Definition of Cost Centre

- **I.C.M.A. London** defines cost centre as, “The location, person or item of equipment (or a group of group of these) for which cost may be ascertained and used for the purpose of cost control.”
- A cost centre can be a location (as an area of a department, store yard, or sales area) or an item of equipment (as lathe machine, van for delivery of goods, a cutting machine, a grinder etc.) or a person as salesman, foreman, operator, etc.)





# Classification of Cost Centre

**Personal and Impersonal Cost  
Centre**

**Operation and Process Cost Centre**

**Production and Services Cost  
Centre**



# 1. Personal and Impersonal Cost Centre

- (A) Personal Cost Centre:** Are those cost centres which consists of a person or a group of persons as a foreman, a salesman, or an operator, or a gang (group) working in an assembly line.
- (B) Impersonal Cost Centres:** are those cost centres which consist of a single machine or a group of machines in one area as an X-ray machine in a hospital, a lathe in factory, a cutter in a steel mill etc.

## 2. Operation and Process Cost Centre

- (A) Operation Cost Centres:** It is a cost centre which combines both persons as well as a machine doing the same type of work. As a boring machine being operated by a group of four workers at a time.
- (B) Process Cost Centres:** A process cost centre is a place of work (where men and machine both are working) for a specific process or a continuous sequence of operation as crushing, and finishing process in an oil mill.

### 3. Production and Services Cost Centre

**(A) Production Cost Centre:** A Cost Centre where actual work takes place is known as production cost centre. In this centre raw material is converted into finished goods. Machine shop, welding shop, boring shop, assembly shop, polishing shop can be the examples of the production cost centre.

### 3. Production and Services Cost Centre

**(B) Services Cost Centre:** A service cost centre means a centre which provides services to the production centre and other department of the organization. These services may be power supply, house repair shop, store department, telephone room etc. Sometime a centre may be performing both the functions, i.e. production as well as services.

# Profit Centre

- A profit centre refers to any unit of organization which is headed by an individual who is fully responsible for all cost revenues or profitability of its operations.
- Profit centre is a centre whose performance is measured both in term of expense incurred and revenues earned by it.
- A profit centre is to maximise the profit of the organisation.
- A profit centre is created to delegate responsibility to individuals and measure their performance.



# Meaning of Cost Unit

Cost is always calculated for something as the cost of pen, cost of a shoes, cost of a T.V. set, or cost of a car, cost of a house or cost of a shirt etc. A unit of that something is known as cost unit.

**I.C.M.A. London** defines cost unit as, “ A unit of quantity of product, service or time in relation to which cost may be ascertained or expressed.”

It is a unit of measurement of cost. In sugar factory cost per tonne or quintal is calculated, in paper mill cost per kilogram or per rim is calculated. Thus, a tonne, a quintal, a kg and a rim are the cost units.

# Investment Centre

- An investment center, in the context of cost accounting and managerial accounting, refers to a division, department, or segment of a company that is treated as a separate entity for the purpose of evaluating its financial performance and effectiveness in generating returns on the resources invested in it.
- Investment centers are often used as a way to assess the performance of different parts of an organization that have their own revenues, costs, and assets. They are evaluated based on both financial and non-financial measures to determine their contribution to the overall profitability and growth of the company.





**THANK YOU**