

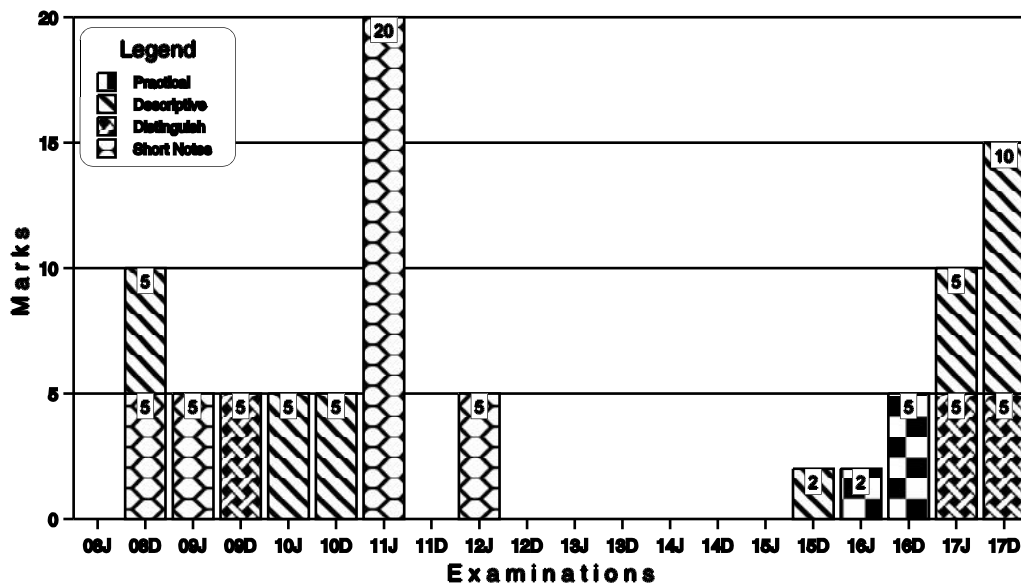
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INTRODUCTION TO COST ACCOUNTING

THIS CHAPTER INCLUDES

- Definition of Cost Accounting
- Scope
- Objectives
- Significance
- Cost Objects
- Cost Centres
- Cost Units
- Classification of Costs

Marks of Short Notes, Distinguish Between, Descriptive & Practical Questions



CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	Meaning	<ol style="list-style-type: none"> 1. Cost: Cost refers to the expenditure incurred in producing a product or in rendering a service. It is expressed from the producer or manufacturer's viewpoint. (not that of consumer/ end user.) Cost ascertainment is based on uniform principles and techniques. 2. Costing: The technique and process of ascertaining cost. 3. Cost Accounting: The process of accounting for cost which begins with recording of income and expenditure or the bases on which they are calculated and ends with the preparation of periodical statements and reports for ascertaining and controlling costs. 4. Cost Accountancy: 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 for the purpose of managerial decision-making.
2.	Objectives of Cost Accounting	Ascertainment of Cost: <ol style="list-style-type: none"> 1. Determination of selling price 2. Cost Control and Cost Reduction 3. Ascertaining the profit of each activity 4. Assisting management in decision-making
3.	Advantages of a	<ol style="list-style-type: none"> 1. Profit Measurement and Analysis

	Cost Accounting System	<ol style="list-style-type: none"> 2. Cost Reduction 3. Cost Comparison and Cost Control 4. Identification of losses and inefficiencies 5. Financial Decision Making 6. Price Determination
4.	Features of a Good Cost Accounting System	<ol style="list-style-type: none"> 1. Accuracy of data 2. Relevance of data 3. Simple and easy to operate 4. Participative Roll of executives 5. Cost - Effective 6. Management's Role 7. Smooth implementation
5.	Factors for Installing a Cost Accounting System	<ol style="list-style-type: none"> 1. Scope of Coverage 2. Objective 3. Technical aspects 4. Organisational Set-up 5. Impact of expansion on cost 6. Psycho-social aspects 7. Impact on Accounting System 8. Information requirements
6.	Classification of Cost	<ol style="list-style-type: none"> 1. On the basis of Time Period <ol style="list-style-type: none"> (a) Historical Cost (b) Current Cost (c) Pre-determined Cost 2. On the basis of Behaviour/Nature/Variability <ol style="list-style-type: none"> (a) Variable Cost (b) Fixed Cost (c) Semi – variable Cost 3. On the basis of Elements <ol style="list-style-type: none"> (a) Materials

		<ul style="list-style-type: none"> (b) Labour (c) Expenses
		<p>4. On the basis of Relationship</p> <ul style="list-style-type: none"> (a) Direct Cost (b) Indirect Cost <p>5. On the basis of Controllability</p> <p>(a) Controllable Costs</p> <ul style="list-style-type: none"> (i) Time (ii) Location (iii) Product / Output <p>(b) Non-Controllable Cost</p> <p>6. On the basis of Normality</p> <ul style="list-style-type: none"> (a) Normal cost (b) Abnormal Cost <p>7. On the basis of Functions</p> <ul style="list-style-type: none"> (a) Production Costs (b) Administration Costs (c) Selling Cost (d) Distribution Cost (e) Research Cost (f) Development Costs (g) Pre-Production Cost (h) Conversion Cost <p>8. On the basis of Attributability to the Product</p> <ul style="list-style-type: none"> (a) Period cost (b) Product Cost <ul style="list-style-type: none"> (i) Preparation of Financial Statements (ii) Product pricing (iii) Cost-plus-Contract with Government Agencies <p>9. On the basis of Relevance to decision making</p>

		<ul style="list-style-type: none"> (a) Relevant Cost <ul style="list-style-type: none"> (i) Marginal Cost (ii) Differential Cost (iii) Opportunity Cost (iv) Out-of-pocket Cost (v) Replacement Cost (vi) Imputed Cost (vii) Discretionary Cost (b) Irrelevant Costs <ul style="list-style-type: none"> (i) Sunk Cost (ii) Committed Cost (iii) Absorbed Fixed Cost
7.	Other Costs	<ol style="list-style-type: none"> 1. Explicit Cost: This is also known as out of pocket cost. It refer to cost involving immediate payment of cash. Salaries, wages, postage and telegram. 2. Implicit Cost: This cost do not involve any immediate cash payment. It is not recorded in the books of account. It is also known as economic cost or imputed cost. 3. Estimated cost: Estimated cost are prospective cost since they refer to prediction of cost. 4. Shut down cost: In other words, all fixed cost which cannot be avoided during the temporary closure of a plant will be known as shut down cost. 5. Absolute cost: It refers to the cost of any product, process or unit in its totality. Here the cost depicted in absolute amount may be called absolute cost and are base cost on which further analysis and decisions are based.
8.	Cost Sheet	Meaning: A Cost Sheet is a statement which shows the break-up and build-up of costs. It is

		<p>a document which provides for the assembly of the detailed cost of a cost centre of a cost unit.</p> <p>Uses: The following are the uses of the Cost Sheet.</p> <ol style="list-style-type: none"> 1. Presentation of Cost information. 2. Determination of Selling Price. 3. Ascertainment of Selling Price. 4. Product-wise and Location-wise Cost Analysis. 5. Inter-firm and Intra-firm Cost Comparison. 6. Preparation of Cost Estimates for submitting tenders / quotations.
9.	Cost Period	<p>The period to which the Cost relates is called Cost period. It is also called the control period since cost ascertainment is for the purpose of control. Generally, the cost period is shorter than the financial period used for reporting purposes.</p>

Cost Unit

It is a unit of production, service or time or combination of these, in relation to which costs may be ascertained or expressed. Cost units differ from one business to the other. They are usually units of physical measurement like number, weight, area, volume, time, length and value. Illustrations are as under:

Industry or Product	Cost Unit	Industry or Product	Cost Unit
Paints	Litres	Automobiles	Number
Cement	Tonne	Gas	Cubic metre
Power	Kilo-watt hour	Brickworks	Thousands
Transport	Tonne - kilometre or Passenger- kilometre	Interior Decoration	Each Contract

Responsibility Centre

It is an activity centre of a business organisation entrusted with a special task.

It is a unit of function of a business organisation headed by an executive

responsible for its performance.

TYPES OF RESPONSIBILITY CENTRES

Particulars	Cost Centres	Revenue Centres	Profit Centres	Investment Centres
Meaning	A centre for which a standard amount of cost is predetermined and used for control.	A center devoted to raising revenue (no responsibility for production)	A centre whose performance is measured in terms of income earned and cost incurred (profit earning)	A centre responsible for earning profits and also for asset utilisation.
Primary responsibility	Cost reduction and cost control	Generation of sale revenue.	Profit earning	Earning return of investments
Performance evaluation	Standard cost less actual cost	Budgeted revenue less actual revenue	Budgeted profits less actual profits	Budgeted ROI less actual ROI.

METHODS OF COSTING

1. Job Costing	The cost of each job is ascertained separately. It implies that the direct cost of each job is traceable and identifiable. It is suitable in all cases where work is undertaken on receiving a customer's order/ assignment. Some examples are printing press, motor workshop, etc.
2. Batch Costing	It is used where the output under a particular work order consists of similar units. It may not be economically feasible to ascertain cost per unit. Hence a collection or a lot of units called a batch is taken for cost ascertainment purposes. Each batch is treated as a unit of cost and thus separately costed. Here cost per unit is determined by dividing the cost of the batch by the number of units produced in the batch.

3.	Contract Costing	A larger job is called a contract. Generally, execution of work is distributed over two or more financial years. Hence, the cost of each contract is ascertained separately. It is suitable for firms engaged in the construction of bridges, roads, buildings etc.
4.	Single or Output Costing	Cost is ascertained for a product, the product being the only one produced like bricks, coals, etc.
5.	Process Costing and Operation Costing	The cost completing each stage of work is ascertained, like cost of making pulp and cost of making paper from pulp. In mechanical operations, the cost of each operation may be ascertained separately, the name given is operation costing.
6.	Operating or Services Costing	Ascertainment of cost of rendering or operating a service is called Service Costing or Operating Costing. It is used in the case of concerns rendering services like transport, cinema, hotels, etc. where there is no identifiable tangible cost unit.
7.	Multiple Costing	It represents a combination of two or more methods of costing outlined above. For example, if a firm manufactures bicycles including its components; the parts will be costed by batch costing system but the cost of assembling the bicycle will be computed by the Single or output costing method. The whole system of costing is known as multiple costing.

FOR ASCERTAINING COST, FOLLOWING TYPES OF COSTING ARE USUALLY USED

1. Uniform Costing
2. Marginal Costing
3. Absorption Costing
4. Direct Costing
5. Standard Costing
6. Historical Costing

SHORT NOTES

2008 - Dec [8] Write a short note on the following :

(d) Uniform Costing

(5 marks) [CMAIG - II]

Answer :

Uniform Costing:	<ul style="list-style-type: none">• It is the practice of using the same costing principles and/or practices by a number of firms in the same industry.• It helps in inter firm comparison, fixation of price, cost control and cost reduction and in seeking tax relief or protection from Government.• For better perception and judgment of performance of individual units/undertakings by a comparative study, the performance/achievement must be expressed in the same denomination so that like is compared with like.
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2009 - June [8] Write a short note on the following:

(c) Profit Centre

(5 marks) [CMAIG - II]

8.10 ■ **Solved Scanner CMA Inter Gr. I Paper 8 (New Syllabus)**

Answer :

Profit Centre :	<ul style="list-style-type: none">• A centre whose performance is measured in terms of both, the expenses it incurs and revenue it earns is called as profit center.• Thus the profit centre is that segment of the activity of a business with which both the revenues and expenses are identified and profit or loss made by that particular segment of activity is ascertained.• Profit centre is a responsibility centre for which both costs and revenues are accumulated.• As defined by CIMA London, profit centre is “a part of business accountable for costs and revenues” It may be called a Business Unit or Strategic Business Unit.• The object of profit centre is to maximize the centre’s profit i.e. difference between revenues and expenses.
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2011 - June [4] (a) Write a brief note on Management Accounting.

(5 marks) [CMAIG - II]

Answer :

Management Accounting :	<ul style="list-style-type: none">• Management accounting is concerned with accounting information which is useful for the management.• It is “the presentation of accounting information in such a way as to assist the management in the creation of policy and day to day operation of the undertaking”.• It includes the methods and concepts necessary for effective planning, for choosing between alternative business actions and for control through the evaluation and interpretation of performance.• It embraces within its fold several subjects and cost accounting is one of them.
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2011 - June [5] (b) Write a note on Chargeable Expenses.

(5 marks) [CMAIG - II]

Answer :

Chargeable Expenses:

- These are also called direct expenses.
- These expenses are directly charged to product or cost unit.
- These are treated as a part of prime costs.
- They are directly identifiable.
- e.g. Cost of patent rights, hire charges of special plant, experimental costs, Royalty paid in mining, costs of special layouts and designs, etc.

2011 - June [8] Write short notes on the following :

- (a) Profit Centre, (5 marks)
(c) Cost Control and Cost Reduction, (5 marks) [CMAIG - II]

Answer :

(a) Please refer 2009 - June [8] (c) on page no. 19

(c) Cost Control & Cost Reduction : Cost control and cost reduction are two different concepts. Cost control has the objective to achieve cost targets while cost reduction is directed to explore the possibility of improving the targets themselves.

Cost reduction is a continuous process and has no visible end while cost control ends when targets are achieved.

- Cost control aims at maintaining the costs in accordance with established standards.
- Cost control seeks to attain lowest possible cost under existing conditions.
- Cost control is a preventive function.
- Cost reduction is concerned with reducing costs.
- Cost reduction recognizes no condition as permanent ,since a change will result in a lower cost.
- Cost reduction is a corrective function.

2012 - June [8] Write short notes on the following :

- (b) Cost Control and Cost Reduction; (5 marks) [CMAIG - II]

Answer :

Please refer 2011 - June [8] (c) on page no. 21

DISTINGUISH BETWEEN

2009 - Dec [5] (a) Distinguish between Cost control and Cost reduction.

(5 marks) [CMAIG - II]

Answer :

Difference between Cost Control and Cost Reduction can be summarized in the following table:

Cost control	Cost reduction
<p>1. The word 'control' indicates an exercise in restraint. When expenses are controlled, they are restrained from growing larger than they should grow. Cost control is cost management. It is meeting the budgeted targets set.</p>	<p>1. Cost reduction involves target of cost reduction. It believes in the premise that there is always scope for further improvement. There is a concern for reducing the expenses that are too high.</p>
<p>2. It is an organized and intentional effort to limit the growth of cost within limits.</p>	<p>2. It is an organized and intentional one time or continuous initiative taken with the goal to reduce cost from current level to a lower level.</p>
<p>3. It is a reactive measure to stem cost growth to stay within budget. It is an effort to limit the growth of cost.</p>	<p>3. It is a proactive effort to actually reduce costs from baseline.</p>
<p>4. In business practices, Cost control is a much better plan of action. It involves creation of responsibility centres with clearly defined authorities and responsibilities.</p>	<p>4. It is an initiative taken with the goal to reduce costs from the current level to a desired lower level on a permanent basis. It is a reaction to a problem.</p>

<p>5. Motivating and encouraging employees to accomplish budgetary goals is one of the essential aspects of cost control.</p>	<p>5. The goal of cost reduction can be achieved in two ways. First-reduce the cost/unit and second-increase productivity. Reducing wastages, improving efficiency, searching for alternatives, etc., can effect cost reduction.</p>
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2017 - June [8] Answer the following question:

(c) Differentiate between Financial Accounting and Management Accounting. **(5 marks)**

Answer:

The main differences between Financial Accounting and Management Accounting are as follows:

	Financial Accounting	Management Accounting
(a)	Provides general business information like P&L account, Balance Sheet	Specific information relating to specific problems and decision making.
(b)	Information for owners and outside parties	Information is for management for optimizing decisions.
(c)	Importance is on recording rather than control	Emphasis is on control like using details of materials, labour, etc for standard costing, budgetary control.
(d)	All commercial transactions between the business and external parties are recorded.	Concerned with Internal transaction not involving payment or receipt
(e)	Only those transactions that can be measured in monetary terms are recorded.	Other parameters like cost units, apportioning bases are also recorded.
(f)	Efficiency of resource utilization - men/materials or machine is not available	Available for corrective action.
(g)	Stocks are valued at cost or	Always valued at cost.

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	market value, whichever is lower.	
(h)	Records are maintained as per Companies Act and as per Income Tax Act.	Records are maintained as per Companies Act only in certain cases, that too as per Cost Accounting requirements, but mainly to suit the management for efficiency and control.

2017 - Dec [8] (b) Differentiate between Operation Cost and Operating Cost.
(5 marks)

DESCRIPTIVE QUESTIONS

2008 - Dec [4] (a) "Costs may be classified in a variety of ways according to their nature and the information needs of the management"-Explain.

(5 marks) [CMAIG - II]

Answer :

- Cost classification is the process of grouping costs according to their characteristics. Costs are classified or grouped according to their common characteristics. Costs may be classified according to elements, according to functions or operations, according to their behaviour, according to controllability or according to normality.
- The breakup of the aggregate costs into relevant types, is an essential pre-requisite of decision making as well as of controlling costs. Classification of costs on different basis is thus necessary for various purposes.
- For the purpose of decision-making and control, costs are distinguished on the basis of their relevance to different type of decisions and control functions.
- The importance of distinguishing costs as direct or indirect lies in the fact that direct costs of a product or an activity can be accurately allocated while indirect costs have to be apportioned on the basis of certain assumptions.
- This is so because direct costs are controllable at the operational level whereas indirect costs are not amenable to such control.

2010 - June [3] (a) What is meant by 'Relevant Cost'? Explain with the help

of illustration.

(5 marks) [CMAIG - II]

Answer :

Relevant costs are those costs which are appropriate to a specific management decision. These are represented by future cash flows whose magnitude will vary depending upon the outcome of the management decision made.	
(a) Relevant costs are the future costs	A decision is about the future; it cannot alter what has been done already. A cost that has been incurred in the past is totally irrelevant to any decision that is being made now. Costs that have been incurred include not only costs that have already been paid, but also costs that are subject of legally binding contracts.
(b) Relevant costs are cash flows	Only cash flow information is required. This means that costs or charges which do not reflect additional costs, should be ignored for the purpose of decision-making.
(c) Relevant costs are incremental costs	Only costs which will differ under some or all the available opportunities should be considered.
Illustration: For example, if an employee is expected to have no other work to do during next week, but will be paid his basic wages (of, say ₹1,000 per week) for attending work and doing nothing. His manager might decide to give him a job which earns only ₹ 400 and it will be incurred anyway whether the employee is given work or not.	

2010 - Dec [2] (b) Explain 'Cost Centre' and 'Cost Unit'.

(5 marks) [CMAIG - II]

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Answer :

Cost centre	<p>(a) It is defined as “a location, person or an item of equipment (or group of these) for which cost may be ascertained.”</p> <p>(b) A cost centre is the smallest organizational sub-unit for which separate cost allocation can be done.</p> <p>(c) It is used for controlling costs.</p>												
<div style="text-align: center;"> <p>Types of cost centre</p> <pre> graph TD A[Types of cost centre] --> B[Personal cost centre] A --> C[Impersonal cost centre] B --> D[It consists of a person or group of persons] C --> E[It consists of location or an item of equipment] </pre> </div>													
Cost unit	<p>It is an unit of production, service time or a combination of these, in relation to which costs may be ascertained or expressed. A cost unit is an unit of product or unit of service to which costs are ascertained by means of allocation, apportionment and absorption.</p> <table border="0" style="width: 100%;"> <thead> <tr> <th style="text-align: left;">Industry or Product</th> <th style="text-align: left;">Cost unit</th> </tr> </thead> <tbody> <tr> <td>Construction</td> <td>each contract</td> </tr> <tr> <td>Nuts & bolts</td> <td>gross</td> </tr> <tr> <td>Power</td> <td>KWH</td> </tr> <tr> <td>Chemicals</td> <td>litre, Gallon, Kg, etc.</td> </tr> <tr> <td>Transport</td> <td>passenger-Km, etc.</td> </tr> </tbody> </table>	Industry or Product	Cost unit	Construction	each contract	Nuts & bolts	gross	Power	KWH	Chemicals	litre, Gallon, Kg, etc.	Transport	passenger-Km, etc.
Industry or Product	Cost unit												
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Transport	passenger-Km, etc.												

2015 - Dec [1] Answer the question:

(c) Narrate any two practical difficulties in installing a costing system.

(2 marks) [CMAIG - II]

Answer:

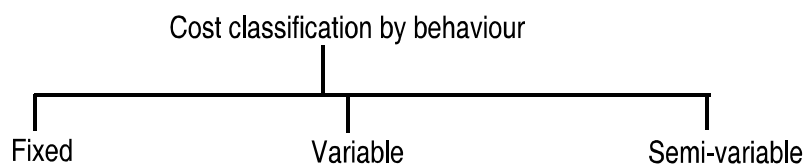
Practical difficulties in installing a costing system:	
(a) Lack of support from top management	In most cases, cost accounting system is introduced without the support of the top management in all the functional areas. Even the Managing Director or chairman often introduces the costing system without consulting the departmental heads. The departmental managers treat this as interference in their work. Thus, it creates a fear in the minds of the departmental managers.
(b) Resistance from the existing staff	Whenever a new system is introduced, resistance is natural as the existing staff may feel that they would lose their importance and may feel insecure of their position in the organization.

2017 - June [8] Answer the following question:

- (d) How would you classify costs based on behaviour? Give an example to explain each class. **(5 marks)**

Answer:

Classification based on Behaviour– Fixed, Semi-variable or Variable: Costs are classified based on behaviour as fixed cost, variable cost and semi-variable cost depending upon response to the changes in the activity levels.



Fixed Cost: Fixed cost is the cost which does not vary with the change in the volume of activity in the short run. These costs are not affected by temporary fluctuation in activity of an enterprise. These are also known as period costs.

Example: Rent, Depreciation etc.

Variable Cost: Variable cost is the cost of elements which tends to directly vary with the volume of activity. Variable cost has two parts (i) Variable direct cost (ii) Variable indirect costs. Variable indirect costs are termed as variable overheads.

Example: Direct labour, Outward Freight. etc.

Semi-Variable Costs: Semi variable costs contain both fixed and variable elements. They are partly affected by fluctuation in the level of activity. These are partly fixed and partly variable costs and *vice versa*.

Example: Factory supervision, Maintenance etc.

2017 - Dec [8] Answer the following questions:

- (a) "Cost Accounting and Management Accounting are inter-dependent." Do you agree, discuss,
 (d) What is Responsibility Accounting? Also state the Principles of Responsibility Accounting. **(5 marks each)**

PRACTICAL QUESTIONS

2016 - June [1] (g) A company has 1,000 units of obsolete items which are carried in inventory at the original purchase price of ₹ 36,000 although their market value as scrap is only ₹ 4,000. If the items are re-worked for ₹ 12,000, they can be sold for ₹ 22,000. Find the relevant cost for selling the items. **(2 marks) [CMAIG - II]**

Answer:

Relevant cost for selling the items

Particulars	Amount (₹)
Re-work cost	12,000
Add: Opportunity cost (scrap value)	4,000
	16,000

Note: If the obsolete items were sold as scrap in the market they would have realised ₹ 4,000 but now the items are re-worked and not sold as scrap. So, ₹ 4,000 has to be considered as opportunity cost.

2016 - Dec [3] (b) Classify the following costs according to function and under the appropriate element of cost in the context of a jute bag manufacturing unit:

- (i) Nuts and Bolts
- (ii) Commission on sales
- (iii) Printing and Stationery
- (iv) Product Catalogue
- (v) Secondary packing material used in the delivery van. **(5 marks)**

Answer:

Element	Function	Material	Labour	Expense
Production Overheads		Nuts and Bolts (i)		
Administration Overheads		Printing & Stationery (iii)		
Selling Overheads		Product Catalogue (iv)	Commission on Sales (ii)	
Distribution Overheads		Secondary Packing material item in delivery van (v)		

Repeatedly Asked Questions

No.	Question	Frequency
1	Write short notes on Profit Centre, 09 - June [8] (c), 11 - June [8] (a)	2 Times
2	Write short notes on the Cost Control and Cost Reduction 11 - June [8] (c), 12 - June [8] (b)	2 Times