CHP-01 BASIC CONCEPTS OF COST

(Q.1) Explain the meaning of cost, costing and cost accounting?

Answer: Cost: Amt of expenditure incurred in producing a product or providing a service.

Costing: Procedure of ascertaining cost of product being manufactured or service being rendered.

Cost Accounting: Process beginning with recording of income & expenditure and ending with preparation of periodical statements and reports for controlling costs.

(Q.2) Define Cost Units and provide some examples?

Answer: Unit of product, service or/and time in relation to which costs is expressed e.g. cost per passenger km.

(Q.3) Define Cost Centres and describe its types?

Answer: It is dept. product or job for which cost is ascertained. Cost Centres are of two types

1. Personal Cost Centre: It consists of a person or group of persons e.g. machine operator.
2. Impersonal Cost Centre: It consists of a location or an equipment e.g. location of

factory Cost Centre in a manufacturing concern: 2 Types

1. Production Cost Centre: where raw material is converted into finished product.
2. Service Cost Centre: It is a cost centre which provide service to a Production cost centre.

(Q.4) Write Short note on Cost Objects?

Answer: Cost object is anything for which a separate measurement of cost is required. Cost object may be a product (Computer, TV) a service (Transport service) a project, a customer (Metro rail project) etc.

(Q.5) Describe objectives of Cost Accounting?

Answer: 1. Ascertainment of Cost: To determine cost for a job, process or Product.

2. Determination of Selling Price: Aims at earning profit so good mark-up on cost.

3. Cost Control: Actual cost incurred in producing a product does not exceed its standard cost.

4. Cost Reduction: Reducing cost further from standard cost level.

5.Ascertaining the profit of each activity: Match cost with the revenue & determine costing P&L.
6.Assisting management in decision making: Help Selection a course of action out of two or more alternative courses.

(Q.6) State difference between Cost Control and Cost Reduction?

Answer:

Cost Control	Cost Reduction
1. Actual cost should not exceed Standard cost If it exceeds, investigation is needed.	1. Reducing cost further from standard Cost level without impairing product quality.
2. Main objective - Control cost so as not to exceed the standard limits.	2. Main objective - Achieve real and Permanent reduction in cost p.u. of Goods Manufactured.
3. Standards are treated as milestone.	3. Standards are assumed to have much extra cost.
4. Preventive function	4. Corrective function.
5. Emphasis on past and present.	5. Emphasis on present and future.

(Q.7) Describe advantages of Cost Accounting System?

Answer: 1. Cost Determination: To determine total cost and unit cost of a product or service.
2. Helping in Cost Reduction: Find new methods of mfd. and reduce cost per unit of product.
3. Product Profitability Analysis: To eliminate unprofitable products and identify exact causes decrease or increase in the profit/loss of the business.
4. Determination of selling price: Good mark up for profit earning.
5. Cost Control and Variance Analysis: check adverse variance and avoid in future.
6. Cost Comparison and Benchmarking: Cost comparison helps in cost control. Uniform costing & inter-firm comparison methods are used for comparison between same industry firms.

(Q.8) Describe Limitations of Cost Accounting?

Answer: 1. Expensive: Detailed analysis in allocation & absorption of overheads need additional work& hence additional salary.
2. Requirement of Reconciliation: Profit as per cost & financial records is different.
3. Duplication Work: Maintain two sets of accounts i.e. Financial Account and Cost Account.
4. Inefficiency: Costing system itself does not control costs but its usage does.

(Q.9) State difference between Financial Accounting and Cost Accounting.

Answer:

Basis	Financial Accounting	Cost Accounting
Objective	1. To provide information about financial performance.	1. To provide information of ascertainment of cost for the of cost control and decision making.
Nature	2. Records all expenses as direct or Indirect.	2. Records all expenses as material, labour and OH cost.
Recording Of Data	3. Records Historical data.	3. Use of both historical costs & pre-determined costs.
Users of information	4. Users are shareholders, Creditor financial analysts and government and its agencies etc.	4. User is only internal mgt
Analysis of costs and profits	5. Shows total profit or loss of Company.	5. Shows profit or loss of each product.
Time Period	6. Financial statements are Prepare.	6. Its reports and statements are prepared as and when required.

(Q.10) Classify Costs on the basis of Functions?

Answer: 1. Prime Cost = Direct material cost + Direct Labour Cost + Direct Expenses.

2. Factory Cost or Works Cost = Prime Cost + factory overheads + opening WIP – closing WIP

3. Cost of Production = works costs + Administrative overheads

4. Cost of Goods Sold = Cost of production + opening stock of FG – closing stock of FG.

5. Cost of Sales= Cost of goods sold + selling and distribution expenses.

(Q.11) Classify Costs on the basis of Controllability?

Answer: 1. Controllable Costs: Costs which can be controlled by management e.g. cost of raw materials.

2. Uncontrollable Costs: Costs which cannot be controlled by management e.g. Rent of factory.

(Q.12) **Classify Costs on the basis of Normality?**

Answer: (a) Normal Cost - Cost which is normally incurred at a given level of output. It is treated as part of cost of production e.g. cost of materials and labour.

(b) Abnormal Cost - Cost which is not normally incurred at a given level of output. It is Charged to Costing Profit and loss Account e.g. cost of abnormal material losses.

(Q.13) Classify Costs on the basis of Management Decision Making?

Answer: 1. Pre-determined Cost - Cost which is computed in advance before production start on some some scientific basis of all factors e.g. standard cost of material. May be std cost or estimated cost.

2. Standard Cost - A pre-determined cost, which is calculated from managements 'expected standard of efficient operation' e.g. cost of standard material to be consumed.

3. Marginal Cost –It is sum of direct material, direct labour, direct expenses and variable overhead.

4. Estimated Cost – A pre-determined cost which is computed in advance Before the production start on some scientific basis of past actual costs adjusted with anticipated future changes.

5. Differential Cost - Increase or decrease in total cost (variable as well as fixed) due to change in activity level, technology, process or method of production.

6. Imputed Costs - Notional costs which do not involve any cash outlay. Interest on own capital.

7. Capitalised Costs - Costs which are initially recorded as assets &subsequently treated as Exp.

8. Product Costs –Costs which are charged to products or services. Variable manufacturing cost under marginal costing technique and manufacturing costs (variable and fixed) under absorption costing technique are products costs.

9. Opportunity Cost –Cost of next best alternative. This cost refers to the value of sacrifice made or benefit of opportunity foregone in accepting an alternative course of action.

10. Out-of-pocket Cost - Cost which involves cash outflow e.g. wages of workers.

11. Shut down Costs - Costs which continue to be incurred even when a plant is temporarily Shutdown.
e.g. rent of building.

12. Sunk Costs - Historical costs incurred in the past are known as sunk costs. They play no role in decision making in the current period.

13. Discretionary Costs – Costs which can be avoided /reduced by managerial decisions e.g. advertising, research and development etc.

14. Period Costs - Costs which are not charged to the products but are charged as expenses against the revenue of the period in which they are incurred.

15. Explicit Costs - Costs which require immediate cash payment e.g. when materials are purchased, labour are employed. These are required to be paid instantly in cash.

16. Implicit Costs - Costs do not involve any immediate cash payment e.g. depreciation of Machine.

(Q.14) Describe various methods of Costing?

Answer: 1. Job Costing: Cost of each job is ascertained separately e.g. customer order in printing Press.

2. Batch Costing: Extension of job costing. A batch may represent a number of small orders passed through the factory in batch.

3. Contract Costing: Cost of each contract is ascertained separately e.g. construction of bridges.

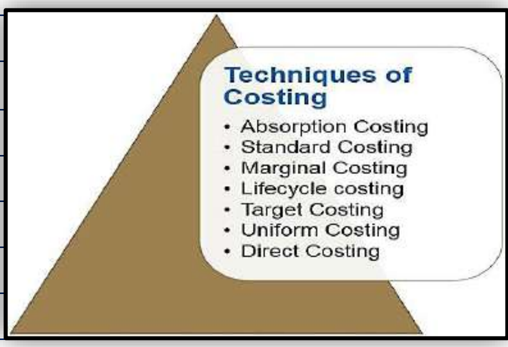
4. Single or Output Costing: Cost of a product is ascertained e.g. only one produce like bricks.

5. Process Costing: Cost of each stage of work is ascertained e.g. cost of making paper from pulp.

6. Operating Costing: Used by concerns rendering services like transport or hospital.

7. Multiple Costing: Combination of two or more methods of costing outlined above. Suppose a firm manufactures bicycles including its components; the parts will be costed by the system of job or batch costing 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.

(Q.15) Describe various techniques of Costing?



Answer: 1. Uniform Costing: When a number of firms in an industry agree among themselves to follow the same system of costing and to adopt common terminology for various items and processes then they are said to. follow a system of uniform costing

2. Marginal Costing: Ascertainment of marginal cost by differentiating between fixed and variable costs. It is used to ascertain effect of changes in

3. Standard Costing and variance analysis: It involves Fixation of standards for each element of costs, Comparison of actual costs with standard costs to ascertain the variances and take action for adverse variances.

4. Historical Costing: Actual costs are ascertained after they are incurred.

5. Direct Costing: Practice of charging all direct costs to operations, processes or products and writing off all indirect costs against profits in which they arise.

6. Absorption Costing: Practice of charging all variable manufacturing costs and fixed production overheads to operations, processes or products and writing off all administrative, selling and distribution overheads against profits in the period in which they arise.

(Q.16) Explain the following:

Answer: 1. Pre-production Costs: These are the costs which are incurred in making a trial production Run preliminary to formal production. These costs are incurred when a new factory is in the process of establishment or a new project is undertaken or new production taken up.

2. Research and Development Costs: Research costs are the costs incurred for the original and planned investigation undertaken with a prospect of gaining new technical knowledge and understanding.

Development costs are the cost incurred in applying research findings to a plan or design for The production of new or substantially improved products, processes, or services prior to the commencement of commercial production.

3.Training Costs: Costs which are incurred in relation to providing training to the workers, apprentices, executives etc. Training cost consists of wages and salaries paid to new trainees, f Paid to trainers, cost of materials and properties used to train the trainees and costs associated with training centre etc. The total cost of training section is thereafter apportioned to production centers.

4. Conversion cost: It is the cost incurred to convert raw materials into finished goods. It is the sum of direct wages, direct expenses and manufacturing overheads.

(Q.17) You have been asked to install a costing system in a manufacturing company. What practical difficulties will you expect and how will you propose to overcome the same?

Answer: 1. Lack of top management support: Installation of a costing system does not receive the adequate support of top management. They consider it as interference in their work. They believe that such, a system will involve additional paperwork.

They also have a misconception in their minds that the system is meant for keeping a check on their activities.

2. Resistance from cost accounting departmental staff: The staff resists because of fear of loosing their jobs and importance after the implementation of the new system.

3. Non co-operation from user departments: The foremen, supervisor and other staff members may not co- operate in providing requisite data because this would increase their responsibilities and will increase paper work.

4. Shortage of trained staff: Since cost accounting system's installation involves specialised work, there may be a shortage of trained staff.

To overcome these practical difficulties, necessary steps required are:

- To convince to top management regarding utility of the system.
- Resistance and non-co-operation can be overcome by behavioural approach.
- Proper training should be given to the staff at each level

- Regular meetings should be held with the cost accounting staff, user departments, staff An top management to clarify their doubts.

(Q.18) Define Explicit costs. How is it different from implicit costs?

Answer: Explicit costs: These costs are also known as out of pocket costs. They refer to those costs which involves, immediate payment of cash. Salaries, wages postage and telegram, interest on loan etc. are some examples of explicit costs because they involve immediate cash payment.

These payments are recorded in the books of account and can be easily measured.

Main points of difference: The following are the main points of difference between Explicit and Implicit costs.

Main points of difference: The following are the main points of difference between Explicit and Implicit costs.

1. Implicit costs do not involve any immediate cash payment. They are also known as imputed costs or economic costs.

2. Implicit costs are not recorded in the books of account but yet they are important for certain types of managerial decisions such as relative profitability under two alternative courses of action.

(Q.19) Distinguish between Marginal Costing and Differential Costing?

Answer: Marginal Costing It is defined as the ascertainment of marginal cost by differentiating Between fixed and variable costs. It is used to ascertain effect of changes in volume on profit.

Differential Costing is a technique of costing which uses differential costs and differential Revenue for ascertaining the acceptability of an alternative.

The technique is termed as incremental costing when the difference between costs is increase in costs. The technique is termed as decremental costing when the difference Between costs is decrease in costs.

The main points of distinction between marginal costing and differential costing are as below:

1. The technique of marginal costing requires a clear distinction between variable costs and fixed costs whereas no such distinction is made in the case of differential costing.

2. In marginal costing, contribution ratio is the main yard stick for performance evaluation o and for decision making whereas under differential costing, differential costs are compared with the incremental or decremental revenue for choosing an alternative.

3. Differential cost analysis is possible in both absorption costing and marginal costing Whereas marginal costing in itself is a different technique.

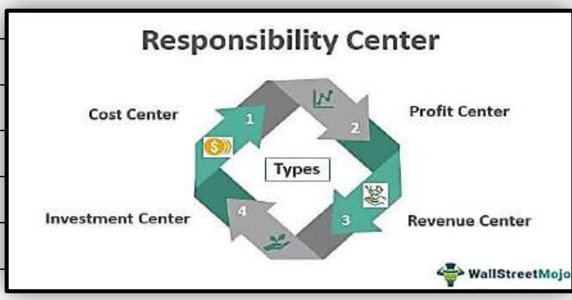
4. Marginal costs are incorporated in the cost accounting whereas differential costs are worked out separately.

(Q.20) Explain Profit centres and investment centres?

OR

Define Responsibility centre?

Answer: Responsibility Centre: it is a unit of function of the organisation under the control of a manager who has direct responsibility for its performance. Responsibility centre are classified into following 5 categories:



1. Cost centre: it is a responsibility centre for which costs are accumulated. The main Objective of cost. centre is to minimise the costs of centre

2. Revenue Centre: it is a responsibility centre for. which revenues are accumulated The main objective of of revenue centre is to maximise revenue the centre.

3. Profit centre: it is a responsibility centre for which both revenues and costs are. Accumulated. The main objective of this centre is to maximise profit of the centre.

4. Contribution Centre: it is a responsibility centre for which both revenues and variable costs accumulated. The main objective of this centre is to maximise contribution of the centre.

5. Investment centre: it is a responsibility centre for which costs, revenues and investment in assets are accumulated. The main objective of this centre is to maximise return on capital employed or return on investment of the centre.

(Q.21) Discuss briefly the relevant costs with examples?

Answer: A cost is relevant when it satisfies two conditions i.e. it should occur in future & it should be different among alternative courses of action. Relevant costs affect decision taken by management e.g. while considering a proposal for plant replacement by discarding the existing plant, the original cost of the old plant are irrelevant.

(Q.22) State the method of costing and the suggestive unit of cost for the following industries.

Answer:

Sr. no.	Industry	Method of Costing	Method of Costing
1.	Transport	Operating Costing	Passenger k.m. or tonne k.m
2.	Power	Operating Costing	Kilo-watt (kw) hours
3.	Hotel	Operating Costing	Room day
4.	Hospital	Operating Costing	Patient-day
5.	Steel	Process Costing/ Single Cost	Tonne
6.	Coal	Single Costing	Tonne
7.	Bicycles	Multiple Costing	Number
8.	Bridge	Contract Costing	Project/ Unit

	Construction		
9.	Interior	Job Costing	Assignment
	Decoration		
10.	Advertising	Job Costing	Assignment
11.	Furniture	Job Costing	Number
12.	Brick Works	Single Costing	1000 units/ units
13.	Oil refining mill	Process Costing	Barrel/ Tonne/ Litre
14.	Sugar company	Process Costing	Tonne
	Having its own		
	sugarcane field		
15.	Toy Making	Batch Costing	Units
16	Cement	Single Costing	Tonne/ per bag
17	Radio assembling	Multiple Costing	Units
18.	Ship Building	Contract Costing	Project/ Unit

(Q.23) State the types of cost in the following cases:

Answer: 1. Interest paid on own capital not involving any cash outflow - Type of cost - Imputed cost

2. Withdrawing money from bank deposit for the purpose of purchasing new machine for expansion purpose –Type of cost - Opportunity cost.

3. Rent paid for the factory building which is temporarily closed – Type of cost - Shut down Cost.

4. Cost associated with the acquisition and conversion of material into finished product – product cost.

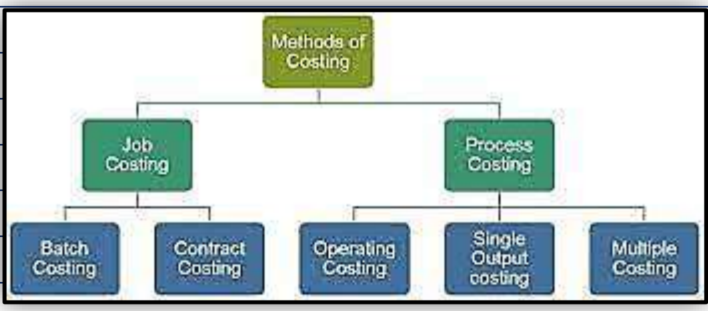
(Q.24) Identify the methods of costing for the following:

Answer: 1. Where all costs are directly charged to a specific job. – Job costing

2. Where all costs are directly charged to a group of products. - batch costing

3. Where cost is ascertained for a single product. – unit costing / single costing / output Costing.

4. Where the nature of the product is complex and method cannot be ascertain – multiple Costing.



(Q.25) State difference between Cost Accounting and Management Accounting?

Answer:

Basis	Cost Accounting	Management Accounting
Nature	1. It records the quantitative aspect only.	It records both qualitative and quantitative aspect.
Objective	It records the cost of producing a product and providing a service	It Provides information to management for planning and co-ordination.
Area	It only deals with cost Ascertain	It is wider in scope as it includes
		F.A., budgeting, Tax, planning.
Recording of data	It uses both past and present figures.	It is focused with the projection of figures for future.
Development	It's development is related to industrial revolution.	It develops in accordance to the need of modern business world.
Rules and Regulation	It follows certain principles and procedures for recording costs Of different product.	It does not follow any specific rules and regulations.

(Q.26) Describe importance of Cost Accounting?

Answer: 1. Control of Direct and Indirect cost: Control over material cost (avoid over stocking), labour cost (Avoid high labour turnover rate) & overheads cost (avoid unnecessary exp.)

2. Measuring efficiency & fixing responsibility: Compare actual with std and fix responsibility for any deviations.

3. Budgeting: Actual performance is compared with budgeted performance like sales budget.

4. Price determination: Good mark up for profit earning.

5. Curtailment of loss during off-season: Reduce overhead by utilising idle capacity during Season.

6. Expansion: Production estimation help in deciding future expansion.

7. Arriving at decisions: Decision need correct cost information otherwise without proper cost accounting decision would be like taking a jump in the dark.

(Q.27) Describe the factors to be considered before installation of Costing system?

Answer: 1. Objective: Whether to fix selling prices or control costs or both.

2. Nature of Business: The costing system, suitable to company, should be introduced.
3. Organisational Hierarchy: Instant information about Costs to different level of management.
4. Knowing the product: Nature of product determines the type of costing system to be implemented. In case of perishable or short self- life, marginal costing method is required to know the contribution and minimum selling price.
5. Knowing the production process: Prior complete knowledge of all production process is required. Cost apportionment can be done on the most appropriate and scientific basis.
6. Method of maintenance of cost records: Integrated accounts should be maintained so difference in profit of cost and financial accounts.
7. Statutory compliances and audit: Books & Accounts to comply with statutory requirements.

(Q.28) Explain Essential requirements of a Good costing System (GCS)?

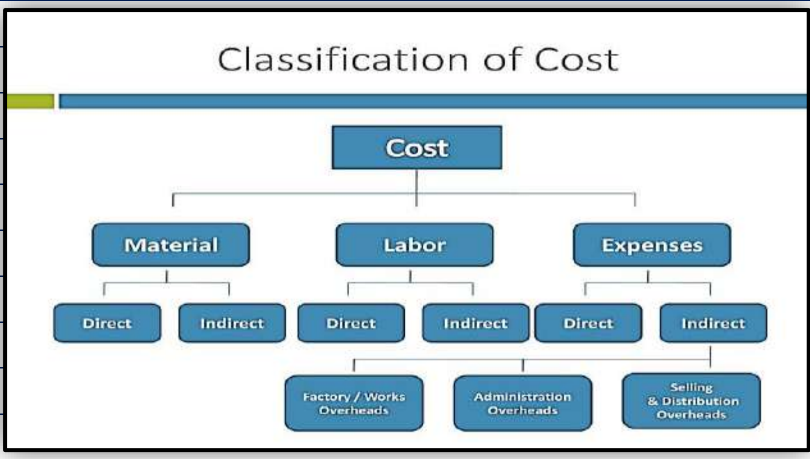
Answer: 1. Informative and Simple: GCS should be tailor-made, practical, simple& easy to operate.
2. Accuracy: Data provided by GCS should be accurate otherwise wrong decision may be taken.
3. Support from Management & subordinates: Necessary cooperation and participation of various depts of company is required.
4. Cost-Benefit: The Cost of installing and operating the system should justify the results.
5. Trust: Management should trust Costing System & provide a help in its development. & success.
6. Flexible: GCS should be flexible to adopt the changing requirements of the business.
7. Detail: It should provide information in detail and also avoid unnecessary details.

(Q.29) Classify Costs on the basis of nature or element?

Answer: 1. Direct Materials: Those materials which can be conveniently identified with and can be directly allocated to a particular product, job or process e.g. Refill in Pen, Milk in ice cream.
2. Direct Labour: Those labour which can be conveniently identified with and can be directly allocated to a particular product, job or process e.g. Halwai in confectionary.
3. Direct Expenses: All direct costs other than direct material cost and direct labour costs are termed as direct expenses e.g. royalty based on output produced.
4. Indirect Materials: Those materials which cannot be conveniently identified with and cannot be directly allocated to a particular product, job or process e.g. lubricant oils used in machine.
5. Indirect Labour: Those labour which cannot be conveniently identified with and cannot be directly allocated to a particular product, job or process e.g. labour employed in security Department.
6. Indirect Expenses: All indirect costs other than indirect material cost and indirect labour costs are termed as direct expenses e.g. rent of building.

7. Overheads: It is sum of indirect material costs, indirect labour costs and indirect expenses.

OH = Production OH + Admin OH + Selling OH and Distribution OH.



(Q.30) Classify Costs on the basis of Variability or Behaviour?

Answer: 1. Fixed costs – Those costs which remain same in totality and do not increase or decrease with volume of output but fixed cost per unit of output produced increases with a decrease in volume of production and vice-versa.

2. Variable Costs – Those costs which vary in direct proportion to volume of production. Direct material cost, direct labour cost and direct expenses are variable costs. Variable cost per unit remain same whether production volume is increased or decreased.

3. Semi-variable costs –Those costs which varies with the volume of output but not in same proportion in which output is increased e.g. telephone expenses.

(Q.31) What are the Objectives of Cost Accounting

Answer: It is reiterated that the very basic objective of Cost Accounting is preparation and presentation of cost information.

The details of the very basic objective are summarized in the following lines:

1. To ascertain the cost of production on per unit basis, for example, cost per kg, cost per meter, cost per litre, cost per ton etc.

2. Cost accounting helps in the fixation of selling price. Cost accounting enables to determine the cost of production which helps to fix the selling price.

3. Cost accounting helps in cost control and cost reduction.

4. Ascertainment of division wise, activity wise and unit wise profitability is analysed through cost accounting.

5. Cost accounting also helps in locating wastages, inefficiencies and other gaps in the production processes/services offered.

6. Cost accounting helps in presentation of relevant data to the management which helps in decision making. Decision making is the most important functions of Management which has specific linkages to the strategic success/failure of an organisation.

(Q.32) Define the following terms:

Answer: 1. Cost Accounting Standard:

The Institute of Cost Accountants of India, recognizing the need for structured approach to the measurement bodies, regulators, research agencies and academic institutions to achieve uniformity and consistency in classification, measurement and assignment of cost to product and services, has constituted Cost Accounting Standards Board (CASB) with the objective of formulating the Cost Accounting Standards. Till date, the Board has issued 24 Cost Accounting Standards, Generally Accepted Cost Accounting Principles, 11 Guidance Notes29.

2. Cost Apportionment:

When items of cost cannot be directly charged to or accurately identifiable with any cost centres, they are prorated or distributed amongst the cost centres on some predetermined basis. This method is known as cost apportionment. Thus, items of indirect costs residual to the process of cost allocation are covered by cost apportionment. The predetermination of suitable basis of apportionment is very important and usually.

3. Cost Allocation:

When items of cost are identifiable directly with some products or departments such costs are charged to such cost centres. This process is known as cost allocation. Wages paid to workers of service department can be allocated to the particular department. Indirect materials used by a particular department can also be allocated to the department. Cost allocation calls for two basic factors –

a. Concerned department/product should have caused the cost to be incurred, and
b. Exact amount of cost should be computable.

4. Cost Absorption

Ultimately the indirect costs or overhead as they are commonly known, will have to be distributed over the final products so that the charge is complete. This process is known as cost absorption, meaning thereby that the costs absorbed by the production during the period. Usually any of the following methods are adopted for cost absorption:

1. Percentage of direct material cost
2. Percentage of direct labour cost
3. Percentage of prime cost
4. Direct labour hour rate
5. Machine hour rate.

The basis should be selected after careful observation to ensure maximum accuracy of cost distribution to various production units. The basis should be reviewed periodically and corrective action whatever needed should be taken for improving upon the accuracy of the absorption.

CIMA official terminology defines overhead absorption rate (OAR) as a means of attributing overhead to a product or service, based for example on direct labour hours, direct labour cost or machine hours.

(Q.33) Discuss about the factors that should taken care of while installation of costing system.

Answer: 1. Size of the firm - Size of the firm is an extremely important factor in designing a cost accounting system. As the size of the firm and its business grows, the volume and complexity of the cost data also grows.

2. Manufacturing Process - Process of manufacturer changes from industry to industry. In some industries, here may be a continuous process of production while in some batch or job type of production may be in operation. A cost accounting system should be such that the manufacturing process is taken into consideration and cost data is collected accordingly.

3. Nature and Number of Products - If a single product is produced, all costs like material, labour and indirect expenses can be directly allocated to that product. But if more than one product is manufactured, the question of allocation and apportionment as well as absorption of indirect expenses (Overheads) arises and hence the cost accounting system should be designed accordingly as more complex data will be required.

4. Organisation Structure - The structure of the organisation also plays a vital role in designing a costing system. The system should correspond to the hierarchy of the organisation.