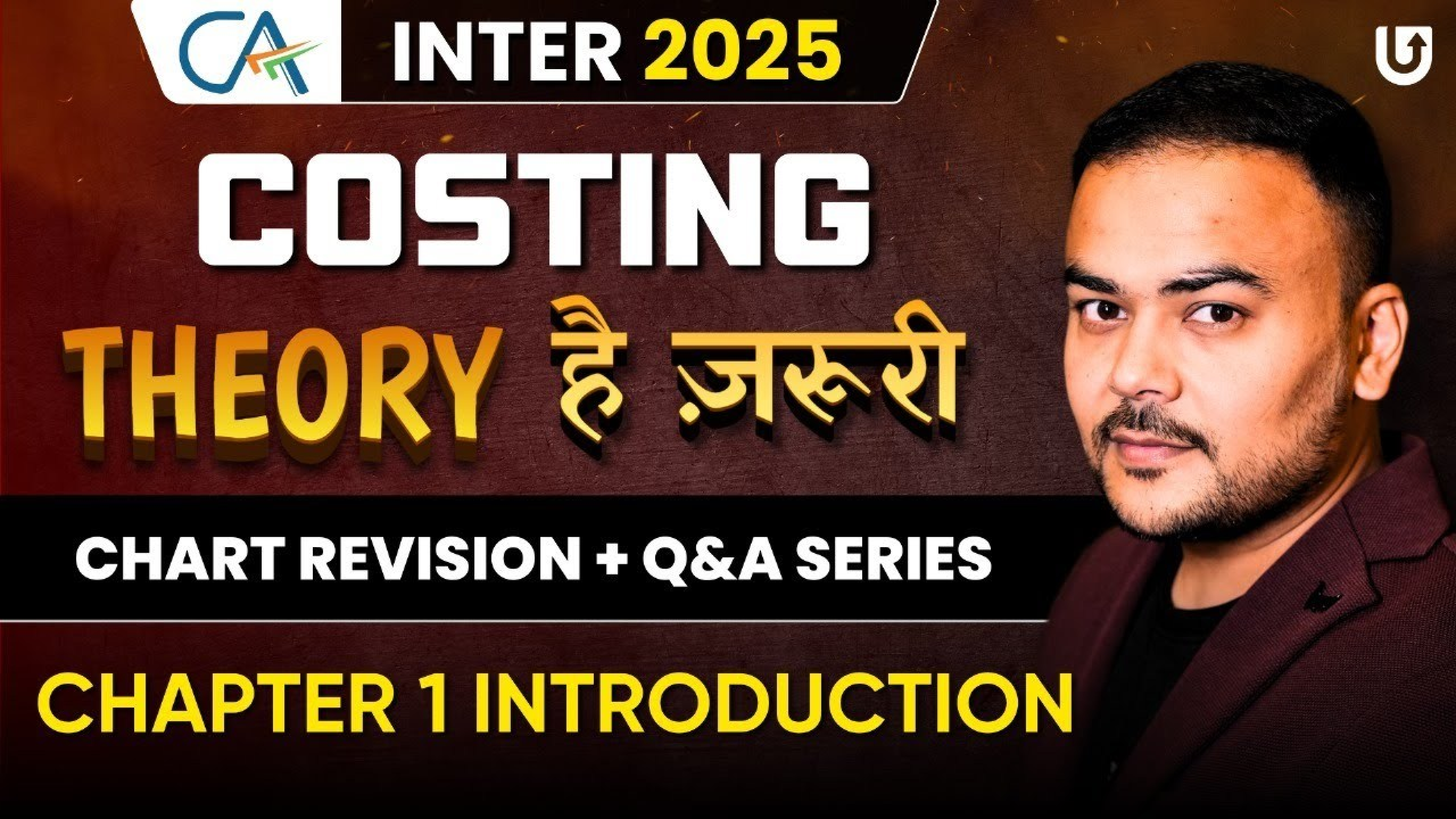
INTER 2025
COSTING
THEORY है ज़रूरी
CHART REVISION + Q&A SERIES
CHAPTER 1 INTRODUCTION

Theory Chart

Chp1 Introduction to Cost & Mgt. Acc

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INTRODUCTION

Theory of Generic Competitive Strategies

- To be competitive we need to fit in any of three
  - Cost Leadership
  - Product differentiation
  - Focus or Niche
- cost leadership = lowest cost + maintaining quality
- Achieve it by robust Cost & Mgt. Acc. System

Meaning and Definition of Important Terms

- **Cost:** resource given up in exchange of some goods or services. (Noun)
- **Costing:** the technique and process of ascertaining costs (Verb)
- **Costing System:** Internal Financial Information System, helps to plan and control activities and decision making
- **Cost Accountancy**: the application of costing and cost accounting principles, methods and techniques
- **Mgt. Accounting:** use of Cost and FM to create, protect, preserve and increase value for stakeholders. Assists Management in planning, organising, controlling, decision making
- **Cost Mgt:** It is an application of management accounting concepts to provide the information needed to plan, monitor and control costs.

Cost Reduction

- **Definition**: real and permanent reduction in unit cost without reducing quality
- **Approach:** It is believed that cost of an object always have a scope of further reduction and no cost is termed as lowest.
- **Value Chain Analysis:** seggregate value and non-value added activities, eliminate non-value added activities to save cost.

OBJECTIVES OF COST ACCOUNTING

Ascertainment of Cost

- Costs are accumulated, assigned, and ascertained for each cost object.
- **Accumulate:** all costs from records like financial accounts, invoices, other documents etc.
- **Assign:** to respective heads based on nature, normality etc.
- **Ascertain:** cost using arithmetical calculations in a defined format

Determination of Selling Price and Profitability

- Helps in determination of selling price and thus profitability of a cost object.
- In a competitive business environment price fixation is done by market so cost is used as basis of rate negotiation.

Cost Control

- Ensuring expenditures are within set standards is cost control
- Steps of Cost Control:
  - **Set Standards:** These are desired cost or result that needs to be achieved and set before period starts
  - **Measure Actuals**: actual performance measurement in a way comparable with standards
  - **Compare both:** find variance and report it
  - **Analyze Action:** find reasons for variance and take further action, modify standards in future if needed

Assisting Management in Decision Making

- By providing information that helps in planning, implementing, measuring, controlling and evaluation of various activities.

SCOPE OF COST ACCOUNTING

Costing

- It is the technique and process of ascertaining costs of products or services.
- Procedure is governed by some principles and rules
- Cost is ascertained using historical costs, standard costs, process cost, operation cost etc.

Cost Accounting

- It begins with the recording of expenditure & ends with preparation of cost sheets, budgets etc.
- It is a formal mechanism of cost ascertainment.

Cost Analysis

- Process of finding out the factors responsible for variance in actual costs from the budgeted costs and accordingly fixation of responsibility for cost differences.
- It helps in taking better cost management and strategic decisions.

Cost Comparisions

- Comparisons of cost involved in alternative courses of action such as use of different technology for production, cost of making different products and activities, and cost of same product/ service over a period of time.

Cost Control and Reduction

- Cost is analyzed to know whether cost is not exceeding its budgeted cost and whether further cost reduction is possible or not.

Cost Reports

- These reports are primarily prepared for use by the management at different levels.
- Cost Reports helps in planning and control, performance appraisal and managerial decision making.

Statutory Compliances

- Maintaining cost accounting records as per the rules prescribed by the statute to maintain cost records
- In India, Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 mandates to maintain cost records for for companies crossing specified limit.

COST CONTROL VS COST REDUCTION

• It aims at maintaining the costs as per standards. • It seeks to attain lowest cost at existing conditions • Emphasis on past and present • It's a preventive function • It ends when targets are achieved	• It challenges all given standards & believe in exploring all options to minimize cost • Here no condition is taken as permanent and every change can that result in cost reduction are taken • Emphasis on present and future • It's a corrective function • It has no visible end & starts when cost control is achieved

RELATIONSHIP OF COST AND MANAGEMENT ACCOUNTING WITH OTHER DISCIPLINES

Cost Accounting vs Management Accounting

Basis	Cost Accounting	Management Accounting
Nature	Records quantitative aspect only.	It records both qualitative and quantitative aspect.
Objective	It records the cost of producing a product and providing service	It provides information to management for planning and co-ordination.
Area	It only deals with cost ascertainment.	It is wider in scope as it includes financial acc., budgeting, taxation, etc.
Recording of data	It uses both past and present figures.	Focus is on projection of figures for future.
Development	Related to industrial revolution.	Related to the need of modern business world.
Rules and Regulation	It follows certain principles & procedures	It does not follow any specific rules and regulations.

Financial Accounting vs Cost Accounting

Basis	Financial Accounting	Cost Accounting
Objective	Information about the financial performance of an entity.	Ascertainment of cost for the purpose of cost control and decision making.
Nature	It classifies records, present and interprets transactions in monetary terms.	It classifies, costs records, present, and interprets it in a significant manner.
Recording of data	It records Historical data.	Uses both historical and pre-determined costs.
Users of Information	shareholders, creditors, financial analysts and government and its agencies, etc.	Internal management most of the time and sometimes regulatory authority
Analysis of Cost & Profit	For the organization either segment wise or as a whole.	For each cost object i.e. product, process, job, operation, contracts etc.
Time period	Financial Statements are usually for a year.	Cost Reports are prepared as and when required.
Presentation / Format	A set format is used for financial information	In general, no set formats for cost information

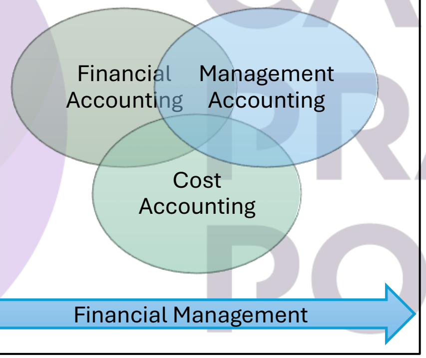
ROLE AND FUNCTIONS OF COST AND MANAGEMENT ACCOUNTING

Special Note

- Though the term Cost Accounting and Management Accounting is used by various authors synonymously but in actual practice, Cost Accounting is concerned with accumulation and allocation of costs to different cost objects, whereas, Management Accounting concerned with provision of information to internal users for decision making.

Cost & Management Accounting with Financial Management

- Cost and Management Accounting is an application of Financial Management for decision making purposes.
- For Relationship refer diagram below



Role

- Provide relevant information to management for decision making
- Assist management for planning, measurement, evaluation and controlling of business activities,
- Help in allocation of cost to products and inventories for both external and internal users.

Functions

- Collection and accumulation of cost for each element of cost
- Assigning costs to cost objects to ascertain cost.
- Setting up budget and standards for a particular period or activity beforehand and these are compared with the assigned and ascertained cost. Any deviation from the set standards are analysed and reported. All this exercise is done to control costs.
- Providing relevant information to the management for decision making by setting up MIS.
- To gather data like time taken, wastages, process idleness etc., analyse the data, prepare reports and take necessary actions.

MIS

- An Information system environment is set up which is popularly known as Management Information System
- The MIS provides relevant and timely information related to both internal and external to the organisation to enable management at all levels to take decisions.
- Decisions include cost optimisation, price fixation, implementation of any plan related with product, process, marketing etc.

USERS OF COST AND MGT ACCOUNTING

Internal Users

- **Policy Makers**: formulate strategies to achieved long term/ short term goal, positioning in competitive market, design organisation structure
- **Managers:** to ascertain cost, find prices, evaluate performances, profitability, evaluate options etc.
- **Operational level staff**: supervisors, foreman, team leaders need information to know objective and goals, to know product/ service specifications, divisional responsibility
- **Employees:** are concerned for information related to time and attendance, incentives, performance parameters etc.

External Users

- **Regulatory Authorities:** for tariff determination, providing subsidies, rate fixation etc. Data is asked in particular format, reported periodically
- **Auditors**: for financial audit, cost audit, special audits
- **Shareholders**: need information affecting their investment, this is done through annual reports covering information like new orders received, product expansion, market share for products etc.
- **Creditors and Lenders**: to know information which affects an entity's ability to serve lenders or creditors. Example: monthly stock reports by bank

ESSENTIAL FEATURES OF GOOD COST ACCOUNTING SYSTEM

- **Informative and Simple:** it should be tailor made, practical and capable of meeting business requirements. Unnecessary details should be avoided.
- **Accurate and authentic:** otherwise it will distort output and wrong decision may be taken
- **Uniformity and consistency:** in classification, treatment and reporting. It helps in benchmarking and comparison.
- **Integrated and inclusive:** with financial accounting, taxation, statistics and operational research etc. to get complete overview and clarity in results
- **Flexible and adaptive:** enough to make necessary amendment and modifications in line with technological, reporting, regulatory and other requirements
- **Trust on the system:** and its output by management for decision making. This can be done by their active role while development of system.

INSTALLATION OF COSTING SYSTEM

- **Objective:** to be clear if it is for price fixation or cost control or both
- **Nature of Business or Industry:** costing methods to be followed accordingly
- **Organisational Hierarchy:** System to fulfill information needs of – Top Mgt. (Corporate Strategy), Strategic Level Mgt. (marketing, diversification, pricing), Operational Level Mgt. (Standard Quantity, Idle Time etc.)
- **Knowing the product:** costing system depends on nature of product, check by products, perishable products, etc.
- **Knowing the production process:** it helps in doing apportionment appropriately and to identify resource requirements
- **Information synchronization:** costing info to be in sync with other depts. like stock statement to bank, details given to tax authorities etc.
- **Method of maintenance of cost records:** Integrate or Non-Integrated and reconciliation if needed
- **Statutory compliances & audit:** compliance of standards and reporting of statutory requirements
- **Information Attributes:** Information should be complete, accurate, timely, relevant to have an effective MIS.

Benefits of Digital Costing System

With the help of AI and Machine Learning for analysis of Big Data, following benefits can be achieved:

- Accurate cost ascertainment
- Analysis of time date to fix incentives
- Analyse resource consumption to plan and schedule procurement and find possibilities of zero wastage & JIT
- Measurement of variances in real time
- Analyse customer data to predict demand

COST ACCOUNTING WITH THE USE OF INFORMATION TECHNOLOGY

Industrial Revolution

- Due to digital innovation (Industry 4.0) system is automated and improved
- More emphasis is on digitization & automation of business process to have better cost control and mantain market competitiveness

Impact of IT in Cost Accounting

- **Single Entry and Automatic Reports**: one entry for multiple purposes and custom made reports, easy reconciliation etc.
- **Paperless Environment**: bill of material, GRN, etc. not required in multiple copies, concerned departments can get e-copy as required.
- **Resource Procurement & Mobilisation**: Material Requisition, PO issue, etc. can be done in no time using internet/ extranet.
- **Accurate and Customized Info**: by use of codification of cost centres, cost information can be customized, manager can get job-wise, batch-wise, process-wise, cost centre wise reports
- **Uniformity:** in report, budgets and standards
- **Real Time Reports:** Cost and revenue variance reports are generated in real time basis enabling management to take immediate measures
- **Value Chain Analyses made easy:** monitoring and analysing each process closely to eliminate non-value activities

Digital Costing System

- Purpose of System is same to collect, classify, account the date and use it for decisions
- but difference is in method of collection, medium of storage, forms of analysis and reporting
- It links different business functions internally and also connect externally with suppliers, customers etc.
- **Information Outputs:** Date on time spent, resource consumed, current market prices, lead time, stock availability, demand trend etc.

RESPONSIBILITY CENTRES

Responsibility Centres

- Management delegates its responsibility and authority to various departments or people to have better control over the organization. These departments or people are known as responsibility centres
- Performance of these responsibility centres are measured against some set standards

Types

- **Cost Centres**: The responsibility centre which is held accountable (answerable) for incurrence of costs which are under its control. Example: Material Mgt. Dept
- **Revenue Centres:** The responsibility centres which are accountable for generation of revenue for the entity. Example: Ticket Counter for Indian Railways
- **Profit Centres:** Responsibility Centres which are accountable for both costs as well as revenue, profitability is the basis for measurement of their performance, hence they are profit centres. Example: Commercial Vehicle Business Unit for Tata Motors
- **Investment Centres:** Responsibility centres where performance is measured on the basis of Return on Investment (ROI) along with profit. They may also have authority to do capex. Example. PSU for Central Govt.

Types of Cost Centres

- **Standard Cost Centres**: Cost Centre where input-output ratio is clearly identifiable. The actual cost for inputs is compared with the standard cost [cost that should be incurred for the given output]. Example: Raw Material cost in Production department.
- **Discretionary Cost Centres:** The cost centre whose output cannot be measured in financial terms, thus input-output ratio cannot be defined. The cost of input is compared with allocated budget for the activity. Example: R&D department, Advertisement department

LIMITATIONS OF COST ACCOUNTING

- **Expensive:** as analysis, allocation and absorption of overheads requires considerable amount of additional work, and hence additional money.
- **Requirement of reconciliation**: as cost results differ from financial
- **Duplication of work**: as two sets of accounts need to be maintained

COSTING TERMS USED IN MANAGERIAL DECISION MAKING

- **Pre-determined Cost:** cost computed in advance before production or operation starts
- **Standard Cost:** a predetermined cost based on management's expected standard of efficient operation. It may be used as a basis for price fixation and cost control through variance analysis.
- **Marginal Cost**: Change in total costs if the there is a increase or decrease by one unit
- **Estimated Cost**: prediction of cost computed on the basis of information available in advance of actual production or purchase
- **Differential Cost**: It represents the change in total cost due to change in activity level, technology, process or production method etc.
- **Imputed Costs**: Notional costs which do not involve any cash outlay. Example: Interest on capital, Notional Rent etc.
- **Capitalized Costs**: These are costs which are initially recorded as assets and subsequently treated as expenses. Example, installation expenses on the erection of a machine
- **Opportunity Cost:** This cost refers to the value of sacrifice made or benefit of opportunity foregone in accepting an alternative course of action. For example, loss of interest on the bank deposit is the opportunity cost for carrying out the expansion plan where funds are used
- **Out-of-pocket Cost:** Portion of cost which actually involves cash outflow, it is considered in decisions relating to fixation of SP, make or buy etc.

COSTING TERMS USED IN MANAGERIAL DECISION MAKING

- **Shut down Costs:** Costs which continue to be, incurred even when a plant is temporarily shutdown e.g. rent, rates, depreciation, etc. These costs cannot be eliminated with the closure of the plant.
- **Sunk Costs:** Historical costs incurred in the past are known as sunk costs, they are irrelevant in decision making.
- **Absolute Cost**: These costs refer to the cost of any product, process or unit in its totality, these are base costs on which further analysis and decisions are made
- **Discretionary Costs:** Such costs are not tied to a clear cause and effect relationship between inputs and outputs. Examples include advertising, public relations, executive training etc.
- **Period Costs:** These are the costs, which are not linked to the production but are charged for the period in which they are incurred. It includes fixed manufacturing cost and non-manufacturing cost
- **Engineered Costs:** These are costs that result specifically from a clear cause and effect relationship between inputs and outputs. Example: direct material, direct wages etc.
- **Explicit Costs:** These costs are also known as out-of-pocket costs and refer to costs involving immediate payment of cash. Example: Salaries, Rents etc.
- **Implicit** Costs: These costs do not involve any immediate cash payment. They are also known as economic costs.

METHODS OF COSTING

- **Single or Output Costing:** Under this method, similar units of a single products are produced by single process. Example bricks, coals, etc.
- **Job Costing:** Under this method of costing, cost of each job is ascertained separately as every job is unique. It is suitable order based work like a printing press, motor workshop, etc.
- **Batch Costing:** Batch is a group of units that are processed together. Here, cost of each batch is calculated separately and then cost pu is calculated by dividing from number of units.
- **Contract Costing**: It is like a big job involving large duration and size. It is suitable for firms engaged in the construction of bridges, roads, buildings etc.
- **Process Costing:** In this method, the cost of completing each stage of work is ascertained, like cost of crushing, filtering in sugar mfg. etc. separately. It is also called as operation costing.
- **Service Costing**: It is used in the case of firms rendering services like transport, hotels etc. It is also called as operating costing
- **Multiple Costing:** It is a combination of two or more methods of costing outlined above. Example: Bicycle production where cost parts is ascertained by batch costing and assembling cost by single costing.

TECHNIQUES OF COSTING

- **Uniform Costing:** when number of firms in an industry follow the same system of costing in details, adopting common terminology for various items and processes they are said to follow a system of uniform costing. Example: Government may want all petroleum companies to follow same costing system which help them in making policies regarding pricing or tax relief.
- **Marginal Costing:** is defined as the ascertainment of costs by differentiating between fixed and variable costs to evaluate the effect of changes in volume, costs and pricings on profit.
- **Standard Costing and Variance Analysis:** here standard costs are pre-determined and subsequently compared with the recorded actual costs. It is more suitable when manufacturing method involves production of standardized goods of repetitive nature
- **Historical Costing:** ascertainment of costs after they have been incurred. It has two types: Post Costing: cost ascertainment after production is complete, Continuous Costing: Cost ascertainment as soon as job is completed or when it is under process.
- **Absorption Costing**: It is the practice of charging all costs, both variable and fixed to operations, processes or products. This differs from marginal costing where fixed costs are excluded from products.

IMPORTANT TERMS OF COSTING

Cost Object

- Cost object is anything for which a separate measurement of cost is required. It may be a product, a service, a project, a customer, a brand
- It is important in classifying direct or indirect costs as traceability is checked in terms of cost object
- **Direct Costs:** Direct costs are costs that are readily identified and are traceable to a particular cost object
- **Indirect Costs:** Indirect costs are costs that are not traceable to a particular cost object.

Cost Units

- It is a unit of measurement of product, service or time (or combination of these) in relation to which costs may be ascertained or expressed.
- Cost units are usually the units of physical measurement like number, weight, area, volume, length, time and value.

Cost Driver

- A Cost driver is a factor or variable of activity which effect level of cost.
- Example: the number of purchase orders would be a cost driver for procurement cost