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Cost Accounting: Nature and Scope

Cost accounting is the art or process of recording analysing and classifying of expenditure for the purpose of product costing or service costing, ascertain of profitability, operation planning and cost controlling.

Needs of cost accounting:

1) No provision for material control
2) Non-availability of detailed particulars about labour cost
3) Classification of accounts in a general manner.
4) No classification of a account in general manner.
5) No classification of cost into direct and indirect.

6) Ascertainment of true cost of production not possible.
7) No provision for a system standard.

OR

1. The analysis of profitability of individual products, services or jobs.

2. The analysis of profitability of different departments or operations.

3. The analysis of cost behaviour of various items of expenditure in the organization. This will help in future cost estimation with reasonable accuracies.

4. It locates differences between actual results and expected results. Such differences can be also traced to the individual cost centres with the efficient cost system.

5. It will assist in setting the prices so as to cover costs and generate an acceptable level of profit.

6. The effect on profits of increase or decrease in output or shutdown of a product line or department can be analyzed with by adoption of efficient Cost Accounting System.

Definition of cost accountancy

Cost accountancy is the application of costing and cost accounting principles methods and techniques to the science, art, and practice of cost control and ascertaining of profitability.

Features of cost accountancy

1) Cost accountancy is a special branch of accountancy dealing with the ascertainment of cost of products and services.
2) Cost accountancy is both a science and an art.
3) It follows the same double entry system as in financial accounting.
4) It involves the processes of accumulation, classification, analysis,

recording and ascertainment of costs.

5) It determines the total and per unit cost of products and services.

6) It provides data for fixing the selling price of products and services and for determining the quotation price or tender price.

7) It provides data to the management for exercising effective control over costs.

8) It provides data to the management for use in forward planning and decision-making process.

Scope of cost accountancy

1) **Costing:** Costing refers to the techniques and processes of ascertaining costs.
2) **Cost accounting:** It is the process of accounting for which begins with recording of expenditure and ends with the preparation of statical data.
3) **Cost Control:** Cost control is the guidance and regulation, by executive action, of the costs of operating an undertaking. It guides the organisation to achieve the target of the undertaking for a given period.
4) **Budgetary Control:** Budgetary control is a system whereby the budgets are used as a means of planning and controlling costs

5) **Cost Audit:** Cost audit is the verification of the correctness of cost accounts and a check on the adherence to the cost accounting plan.

Objectives of Cost Accounting

1) Ascertain the cost per unit.
2) Provide a correct analysis of cost.
3) Control over wastage of material.
4) Provide requisite data.
5) Ascertain the profitability.
6) To exercise effective control of stock.
7) To advise management on future expansion policy proposed capital project.
8) To present an interpret data for management planning, evaluation of performance and control.
9) To help in the preparation of budget and implementation of budgetary control.
10) To guide management in the formation and implementation of incentive bonus plan based on productivity and cost savings.

Similarities Between Cost Accounting and Financial Accounting

1) Both cost accounts and financial accounts are maintained on the basis of Double Entry System of Accounting.
2) Recording of transactions, both under cost accounting system and financial accounting system, is made on the basis of common vouchers, invoices and documents.
3) Both cost accounts and financial accounts disclose the profit or loss of the business.
4) Both cost accounts and financial accounts involve the process of matching the costs and revenues of the related activity for the current period.

5) Both the accounting systems contain the record of direct costs and indirect costs.
6) Both the accounting systems enable the business concern to compare and reconcile the trading results.
7) Both the accounting systems assist the management in formulating the future business policy and making various managerial decisions.

Difference Between Cost accounting and financial accounting

1) Financial accounts are very comprehensive in nature and cover all business transactions while cost accounts cover only the transactions relating to manufacturing and sale of products and the services.
2) Financial accounts deal with all items of expenses, losses, income and gains but co accounts deal with only those items of expenses which enter into the cost of production.
3) Financial accounts do not contain analysis of expenditure but cost accounts record expenses by

elements, functions, variability, departments etc., to study them analytically

4) Financial accounts disclose the overall profitability of the business whereas con accounts deal with product-wise, job-wise, department-wise and process-wise profitability.
5) The maintenance of financial accounts is compulsory in a business, while cost accounts, need not be maintained compulsorily.
6) Financial accounts cannot be incorporated in cost accounts whereas cost accounts may be incorporated in financial accounts.

Advantages of Cost Accounting

A. Advantages to management:

1) Identification of profitability and unprofitability activities of organisation.
2) Calculation of quotation price and tender price.
3) Helping in formulating business policy.
4) Helps the management in decision making process.
5) It helps in making comparison.
6) Helping in controlling cost of production.
7) Helps in checking of goods material.

B. Advantages to employees

1) Better wages.

2) Distinction between efficient and inefficient workers.
3) Higher standards of living.
4) Social recognition of the worker.
5) Low labour turnover.
6) Elimination of strikes, lockout and disputes.
7) More bargaining power of the employees.

C. Advantages to society

D. Advantages to nation

OR

1. Helps in controlling cost:

Cost accounting helps in controlling cost by applying some techniques such as standard costing and budgetary control.

2. Provides necessary cost information:

It provides necessary cost information to the management for planning, implements and controlling.

3. Ascertains the total per unit cost of production:

It ascertains the total and per unit cost of production of goods and services that helps to fix the selling prices as well.

4. Introduces cost reduction programs:

It helps to introduce and implement different cost reduction programs.

5. Discloses the profitable and non profitable activities:

It discloses the profitable and non profitable activities that enable management to decide to eliminate or control unprofitable activities and expand or develop the profitable activities.

6. Provides information for the comparison of cost:

It provides reliable data and information which enable the comparison of cost between periods, volume of output, determent and processes.

7. Checks the accuracy of financial accounts:

It helps checking the accuracy of financial accounts. This is done by preparing cost reconciliation statement.

8. Helps invests and financial institutions:

It is also advantageous to investment and financial institutions since it discloses the profitability and financial position in which they intend to invest.

9. Beneficial to workers:

It is beneficial to workers as well since it emphasizes the efficient utilization of labor and scientific systems of wages payment.

Limitations of Cost Accounting

1) Cost accounting is unnecessary.
2) Cost accounting system cannot be adopted by small business concerns.
3) Cost accounting system is very costly.
4) Costing result are misleading.
5) Practical difficulties in the installation of costing system:
    a) Lack of cooperation.
    b) Lack of interest.
    c) Improper and insufficient completion of forms and their submission as such to cost office.

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Ratio Analysis

It express the relationship between one figure with another figure. For eg.-3:2

In quantitative forms two numbers are needed to calculate the ratio. One number is part as the numerator and the other as the denominator.

Ratio refers to the relationship between two variables expressed either in percentage or in multiples or in periods.

Various forms of expressing ratio:

1) **Proportion form:** In this form relationship between two items is directly expressed in proportion. For eg. 4:1
2) **Times form:** In this form a quotient is obtained by dividing one figure by another figure is taken as unit of expression or how many times a figure is, in comparison to another figure. For eg.: 4 times
3) **Percentage form:** In this form a quotient is obtained by dividing one figure by another figure is multiplied by 100 and it becomes the percentage form. For eg.: 30%
4) **Fraction Form:** For eg.: net profit is 1/10 of sale.

Objectives or Importance of ratio analysis/Utility of Ratio

1) Help in simplifying financial data.
2) Helpful in determining trend.
3) Helpful in controlling.
4) Benefits to other parties interested.
5) Helpful in locating weak spot.
6) Helpful in comparative study.
7) Helpful in measuring operating efficiency.
8) Overall profitability.
9) Help the investor to evaluate their investment.
10) Help in analysing the long term solvency position.

Limitation of ratio analysis

1) Limited use of single ratio.
2) Wrong ratio based on wrong data.
3) Incorrect comparison.
4) Different meaning.
5) Difficulty in forecasting.
6) Lack of qualitative analysis.
7) Difficulty of priceable challenges.
8) Lack of proper standard.
9) Window addressing.

Classification of Ratio:

1) **Liquidity Ratios:** These Ratios are used to measure short term liquidity and solvency position of a firm. It measures the relationship between current assets and current liability.
2) **Leverage Ratios:** These Ratios are used to measure the ability of the firm to serve long-term debt holders with regard to their claims regarding interest and repayment of principle amount.
3) **Activity Ratios:** These Ratios are known as turnover Ratios and evaluate the use of total resources of business and measure how efficiently the firm uses the resources.
4) **Profitability Ratios:** These Ratios measures the relationship between operating profit to sales.

Current Ratio:

It express the relationship between current assets and current liabilities.

CR= Current assets / Current liabilities

Liquid Ratio:

It express the relationship between liquid assets and current liabilities.

Liquid ratio= Liquid assets / Current liabilities

Q. What is manufacturing account?

Ans. The manufacturing account is prepared to determine the total manufacturing or production cost of goods completed during the accounting period. The production cost includes all cost incurred in converting raw materials into finished good, *i.e. cost of raw materials, direct labour and direct expenses, and factory overhead expenses.*

Q. What is cost sheet?

Ans. Cost sheet is a statement, prepared at a given interval of time, which provides information regarding element of cost incurred in production.

It discloses the total cost as well as the cost per unit of product manufactured during the given period.

Q. What is marginal costing?

Ans. Marginal Cost has the amount at any given volume of output which aggregate cost change if the volume of the output is increased or decreased by 1 unit. This is measured by the variable cost attribute to one unit.

OR

The ascertainment by differentiating by differentiating b/w fixed cost and variable cost of marginal cost and of the effect on profit of changes on volume of type of output.

OR

Marginal costing is a technique of cost accounting which pays attention to the behaviour of cost with changes in the volume of output.