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B.Com Honours

Semester I

Calicut University

Essentials of Cost Accounting

Course Code: COM1MN104 • Module 1 Notes

1. Basics of Cost Accounting: Definition, Objectives, and Scope

In a highly competitive and dynamic commercial environment, organizations must understand the exact cost of their products or services to survive and maintain profitability. While financial accounting provides an overview of the company's overall financial position, it fails to provide detailed, product-level cost data. Cost accounting fills this critical gap. This module introduces the fundamental concepts of cost accounting, the key differences between financial and cost accounting, classification of costs, methods and techniques of costing, and the structural installation of a costing system.

Defining Key Terms

- **Cost:** The amount of expenditure (actual or notional) incurred on, or attributable to, a specified article, product, or activity.
- **Costing:** The technique and process of ascertaining costs, involving daily recording and analysis of expenditures.
- **Cost Accounting:** The process of accounting for cost from the point at which expenditures are incurred or committed to the establishment of its ultimate relationship with cost centers and cost units.
- **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 for managerial decision-making.

Objectives of Cost Accounting

The primary objectives of cost accounting include:

- **Ascertainment of Cost:** Calculating the total cost and unit cost of producing a product or rendering a service.
- **Control of Cost:** Using standard costing and budgetary control to minimize waste and inefficiency.
- **Determination of Selling Price:** Providing cost data to guide management in setting profitable prices.

- **Guiding Business Policy:** Supplying detailed cost analyses for decision-making (e.g., make-or-buy decisions, profitable product mix).

Differentiating Cost Accounting from Financial Accounting

Cost accounting and financial accounting serve different purposes and target different audiences:

Dimension	Financial Accounting	Cost Accounting
Primary Purpose	Provide financial status to external stakeholders (investors, creditors, tax authorities).	Provide detailed cost information to internal managers for planning and control.
Type of Data	Records historical transactions only.	Records both historical data and future projections.
Format & Rules	Strictly governed by GAAP, Accounting Standards, and statutory laws.	No statutory formats; structured based on internal management needs.
Level of Detail	Presents a consolidated view of the entire organization.	Presents detailed, segment-wise data (per product, per department).
Reporting Period	Prepared periodically (annually, quarterly).	Prepared continuously or as needed by management.

2. Classification of Costs

Cost classification is the process of grouping costs according to their common characteristics. Costs can be classified on several bases:

By Element & Function

- **Element:** Material (raw inputs), Labour (salaries/wages), and Expenses (power, rent).
- **Function:** Production cost (factory operations), Administration cost (office operations), and Selling & Distribution cost (promotions, shipping).

By Behavior

- **Fixed Costs:** Remain constant in total regardless of output level (e.g., office rent, salaries).
- **Variable Costs:** Change in direct proportion to the volume of output (e.g., raw materials, direct labor).
- **Semi-Variable Costs:** Contain both fixed and variable elements (e.g., telephone bill with fixed rental and usage charge).

By Relevance & Traceability

- **Direct Costs:** Easily traced to a specific cost unit (e.g., leather in shoe manufacturing).
- **Indirect Costs (Overheads):** Cannot be directly traced to a cost unit; allocated on a rational basis (e.g., factory lighting).
- **Product Costs:** Incurred to manufacture a product (inventoriable).
- **Period Costs:** Charged to P&L of the period (non-inventoriable, e.g., selling costs).

3. Methods and Techniques of Costing

The choice of costing method depends on the nature of the industry and its manufacturing processes:

Costing Methods

- **Job Costing:** Used where work is executed against specific customer orders, and each job is unique (e.g., printing press, repair shops).
- **Process Costing:** Used in industries where production is continuous, and raw materials pass through distinct stages/processes (e.g., chemical plants, oil refineries, textile mills).

- **Contract Costing:** A form of job costing applied to large-scale, long-duration construction projects (e.g., building bridges, roads).
- **Unit (Single) Costing:** Used where production is uniform, continuous, and consists of a single product (e.g., brick kilns, collieries).

Costing Techniques

- **Marginal Costing:** A technique that classifies costs into fixed and variable, focusing on contribution (Sales - Variable Cost) for short-term decisions.
- **Standard Costing:** Pre-determining standard costs and comparing them with actual costs to identify variances for corrective action.
- **Activity-Based Costing (ABC):** Allocating overheads to products based on the activities that consume resources, providing high precision.

Cost Centre and Cost Unit

Cost Centre: A location, person, or item of equipment (or group of these) for which costs may be ascertained and used for cost control. E.g., a specific department or machine.

Cost Unit: A quantitative unit of product or service in relation to which costs are ascertained. E.g., per ton of cement, per passenger-kilometer for transport, per bed for a hospital.

Installation of Costing System

Setting up a costing system in an organization involves studying the production layout, selecting appropriate costing methods, defining cost centers, designing forms for recording material/labor usage, training staff, and ensuring compliance with ****Cost Accounting Standards (CAS)**** issued by the Institute of Cost Accountants of India (ICAI).

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