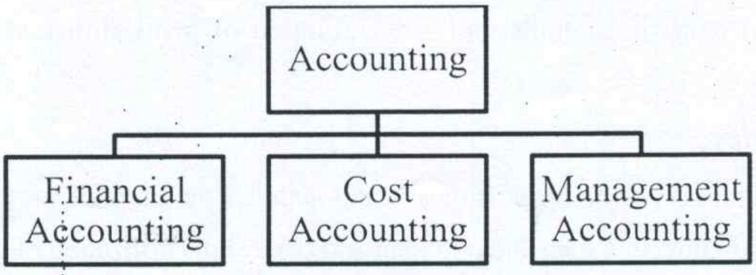
COST ACCOUNTING

1. Introduction to Cost Accounting

Introduction

Accounting serves the purpose of providing financial information relating to activities of a business. Such information is provided to shareholders, managers, creditors, debenture holders, bankers, tax authorities and others. Broadly speaking, on the basis of type of accounting information and the purpose for which such information is used, accounting may be divided into three categories:



- **Financial accounting** is mainly concerned with recording business transactions in the books of account and prepare Profit and Loss Account showing the net profit or loss during the year and Balance Sheet showing the financial position of the company at a point of time.
- **Cost accounting** is a branch of accounting which specializes in the ascertainment of cost of products and services. It is for use by management.
- **Management accounting** is the modern concept of accounts as a tool of management. it is concerned with all such accounting information that is useful to management.

Cost

Cost is the amount of expenditure (actual or notional) incurred or attributable to a given thing.

Costing

2M The Chartered Institute of Management Accountants (CIMA) of UK has defined costing as, **"the techniques and processes of ascertaining costs".**

Wheldon has defined costing as, **"the classifying, recording and appropriate allocation of expenditure for the determination of costs, the relation of these costs to sales value and the ascertainment of profitability."**

Thus, costing simply means cost finding by any process or technique. It consists of principles and rules which are used for determining:

- The cost of manufacturing a product; e.g., motor car, furniture, chemical, steel, paper, etc.
- The cost of providing a service; e.g., electricity, transport, education, etc.

Cost Accounting

Cost accounting is a formal system of accounting for costs in the books of account by means of which costs of products and services are ascertained and controlled.

2M According to CIMA of UK, **"Cost accounting is the process of accounting for costs from the point at which expenditure is incurred or committed to the establishment of its ultimate relationship with cost centres and cost units. In its widest usage, it embraces the preparation of statistical data, the application of cost control methods and ascertainment of profitability of activities carried out or planned."**

Cost Accountancy

Cost accountancy is a very wide term. It means and includes the principles, conventions, techniques and systems which are employed in a business to plan and control the utilization of its resources.

2M It is defined by CIMA of UK, as **"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 therefrom for the purposes of managerial decision-making."**

Cost accountancy is thus the science, art and practice of a cost accountant

Differences between Cost Accounting and Financial Accounting

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Basis of difference	Cost Accounting	Financial Accounting
Purpose	The main purpose of Cost Accounting is to provide detailed cost information to management, i.e. internal users.	The main purpose of financial accounting is to prepare profit and loss Account and Balance Sheet for reporting to owners or shareholders and other outside agencies i.e. external users.
Statutory requirements	Maintenance of these accounts is voluntary except in certain industries where it has been made obligatory to keep cost records under companies Act.	These accounts are obligatory to be prepared according to the legal requirements of companies Act and Income Act.
Analysis of cost and profit	Cost accounts show the detailed cost and profit data for each product line, department, process etc.	Financial accounts reveal the profit or loss of the business as a whole for a particular period. It does not show the figures of cost and profit for individual products, departments and processes.

Periodicity of reporting	Cost reporting is a continuous process and may be on daily, weekly, monthly basis etc.	Financial reports (Profit and Loss Account and Balance Sheet) are prepared periodically. Usually on an annual basis.
Control aspect	It provides for a detailed system of controls with the help of certain special techniques like standard costing and budgetary control.	It lays emphasis on the recording on financial transactions and does not attach importance to control aspect.
Historical and pre-determined costs	It is concerned not only with historical costs but also with pre-determined costs. This is because cost accounting does not end with what has happened in the past. It extends to plans and policies to improve performance in the future.	It is concerned almost exclusively with historical records. The historical nature of financial accounting can be easily understood in the context of the purpose for which was designed.
Format of presenting information	Cost accounting has varied forms of presenting cost information which are tailored to meet the needs of management and thus lacks a uniform format.	Financial accounting has a single uniform format of presenting information i.e. Profit and Loss account, Balance Sheet and cashflow statement.
Types of transactions recorded	Cost accounting only records external transactions but also internal or inter-departmental transactions like issue of materials by store-keeper to production department.	Financial accounting records only external transactions like sales, purchases, receipts etc., with outside parties. It does not record internal transactions.
Types of statements prepared	Cost accounting generates special purpose statements and reports like report on loss of materials, idle time report, variance report etc. cost accounting identifies the users, discuses the problems and needs and provides tailored information.	Financial accounting prepares general purpose statements like Profit and Loss account and Balance sheet. That is to say that financial accounting must produce information that is used by many classes of people, none of whom have explicitly defined informational needs.

COST ACCOUNTING

Objectives and Functions of Cost Accounting

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a) **Ascertainment of cost**: This is the primary objective of cost accounting. In other words, the basic objective of cost accounting is to ascertain the cost of products and services. For cost ascertainment different techniques and systems of costing are used in different industries.

b) **Control and reduction of cost**: Cost accounting aims at improving efficiency by controlling and reducing cost. This objective is becoming increasingly important because of growing competition.

c) **Guide to business policy**: Cost accounting aims at serving the needs of management in conducting the business with utmost efficiency. Cost data provide guidelines for various managerial decisions like make or buy, selling below cost, utilization of idle plant capacity, introduction of a new product, etc.

d) **Determination of selling price**: Cost accounting provides cost information on the basis of which selling prices of products or services may be fixed. In periods of depression, cost accounting guides in deciding the extent to which the selling prices may be reduced to meet the situation.

e) **Measuring and improving performance:** Cost accounting measures efficiency by classifying and analyzing cost data and then suggest various steps in improving performance so that profitability is increased.

Advantages of Cost Accounting

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1) Advantages to Management

a) **Reveals profitable and unprofitable activities:** A system of cost accounting reveals profitable and unprofitable activities. On this information, management may take steps to reduce or eliminate wastages and inefficiencies occurring in any form such as idle time, underutilization of plant capacity, spoilage of materials, etc.

b) **Helps in cost control:** Cost accounting helps in controlling costs special techniques like standard costing and budgetary control.

c) **Helps in decision making:** It supplies suitable cost data and other related information for managerial decision-making, such as introduction of a new product line, determining export price of products, make or buy a component, etc.

d) **Guides in fixing selling prices:** Cost is one of the most important factors to be considered while fixing prices. A system of cost accounting guides the management in the fixation of selling prices, particularly during depression period when prices may have to be fixed below cost.

e) **Helps in inventory control:** Perpetual inventory system, which is an integral part of cost accounting. helps in the preparation of interim profit and loss account. Other inventory control techniques like ABC analysis, level setting, etc., are also used in cost accounting.

f) **Aids in formulating policies:** Costing provides such information as enables the management to formulate production and pricing policies and preparing estimates of contracts and tenders.

g) **Helps in cost reduction:** It helps in the introduction of a cost reduction programme and finding out new and improved ways to reduce costs.

h) **Reveals idle capacity:** A concern may not be working to full capacity due to reasons such as shortage of demand, machine breakdown or other bottlenecks in production. A cost accounting system can easily work out the cost of idle capacity so that management may take immediate steps to improve the position.

i) **Checks the accuracy of financial accounts:** Cost accounting provides a reliable check on the accuracy of financial accounts with the help of reconciliation between the two at the end of the accounting period.

j) **Prevents frauds and manipulation:** Cost audit system, which is a part of cost accountancy, helps in preventing manipulation and frauds and thus reliable cost data can be furnished too management.

2) Advantages to Workers

Workers are benefited by introduction of incentive plans of wage payment which is an integral part of a cost system. This results not only in higher productivity but also higher earnings for workers.

3) Advantages to Society

An efficient cost system is bound to lower the cost of production. The benefits of cost reduction and cost control accrue to the public at large in the form of lower prices of products and services.

4) Advantages to Government Agencies and Others

A cost system produces ready figures for use by government, wage tribunals, trade unions, etc., for use in problems like price fixing, wage level fixation, settlement of industrial disputes, etc.

Limitations or Objections against Cost Accounting

12M. 1) **The system is more complex:** Cost accounting needs to identify the different types of expenses and allocation of expenses is considered as a complicated system of accounting.

2) **It is expensive:** In installing and maintaining cost accounting system requires more man power and resources, more analysis, allocation and absorption of overheads requires considerable amount of additional work.

3) **Inapplicability of costing method and technique:** Techniques and methods of cost accounting differ from organization. One standard method is not adequate for all the requirements of different organizations. It depends on the nature of business and the type of service or product manufactured by the firm.

4) **Not suitable for small scale units:** one of the limitations faced by the cost accounting in installing it in all types of business is that it is not applicable to small scale units. Through the traditional accounting, small scale units can control the cost efficiency.

5) **Lack of accuracy:** Use of notional cost such as standard cost, estimated cost etc., would not bring out the actual cost of the product. So, the cost accounting lacks accuracy of the result.

6) **Lacks social accounting:** Social accounting is outside the scope of cost accounts. Cost accounting fails to take into account the social obligation of the business.

7) **Need preparation of frequent reconciliation to verify the accuracy:** Results shown by cost accounts differs from those of financial accounts. Preparation of reconciliation statements to verify the accuracy is frequently required. This leads to unnecessary increase in workload.

8) **Duplication of work:** Many industrial units function effectively and control the cost effectively with the financial accounting. Preparing cost accounting is unnecessary for them and it involves duplication of accounting work.

9) **It is unnecessary:** Maintenance of cost records is not necessary. It involves duplication of work. A good number of companies are functioning prosperously without any system of costing.

10) **It is a failure:** The failure of a costing system in some concern is quoted as barrier in introducing costing in other concerns. This is not correct. The reason for failure should be probed.

11) **It is based on estimation and previous data:** Most of the data used by a cost accountant is based on estimation of indirect costs, assumptions and previous data. Not using the actual data and costs is the limitation of the cost accounting.

12) **Use of secondary data:** Cost accounting depends on financial statements for a lot of information. Any errors or short coming in the information will affect the results.

Methods of Costing

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1) **Job order costing:** According to CIMA, UK, this method "applies where work is undertaken to customers' special requirements". Cost unit in job order costing is a job or work order for which cost are separately collected and accumulated. A job, big or small, comprises a specific quantity of a product to be manufactured as per customers specifications.

Examples: Printing press, repair shops, interior decorators, painters, etc.

2) **Contract costing or Terminal costing:** This is a variation of job costing and, principles of job costing apply to this method. The difference between job and contract is that job is small and contract is big. It is well said that 'a contract is a big job and a job is a small contract'. The cost unit here is a 'contract' which is of a long duration and may continue over more than one financial year.

   Examples: Construction of buildings, dams, bridges and roads, ship. building, etc.

3) **Batch costing:** Like contract costing, this is also a variation of job costing. In this method, the cost of a batch or group of identical products is ascertained and therefore each batch of products is a cost unit for which costs are ascertained.

   Examples: Production of readymade garments, toys, shoes, tyres and tubes, component parts, etc.

4) **Process costing:** As distinct from job costing, this method is used in mass production industries manufacturing standardized products in continuous processes of manufacturing. Costs are accumulated for each process or department. Here raw material has to pass through a number of processes in a particular sequence to completion stage. In order to arrive at the unit cost, the total cost of a process is divided by the number of units produced.

   Examples: Textile mills, chemical works, sugar mills, refineries, soap manufacturing, etc.

5) **Operation costing:** This is nothing but a refinement and a more detailed application of process costing. A process may consist of a number of operations and operation costing involves cost ascertainment for each operation instead of a process.

6) **Single, output or unit costing:** This method of cost ascertainment is used when is uniform and consists of a single or two or three varieties of the same product. Where the product is produced in different grades, costs are ascertained grade-vise. As the units of output are identical, the cost per unit is found by dividing the total cost by the number of units produced.

   Examples: Mines, quarries, brick-kilns, steel production, flour mills, etc.

7) **Operating or service costing:** This method should not be confused with operation costing. Operating costing is used in undertakings which provide services instead of manufacturing products.

   Examples: Transport undertakings (road transport, railways, airways, shipping companies), electricity companies, hotels, hospitals, cinema, etc., use this method. The cost units are passenger-kilometer 01 tons - kilometer, kilowatts hour, a room per day in a hotel, a seat per show in cinema, etc. This method is a variation of process costing.

8) **Multiple or composite costing:** It is an application of more than one method of cost ascertainment in respect of the same product. This method is used in industries where a number of components are separately manufactured and then assembled into a final product.

Examples: In a television company, manufacture of different component parts may require different production methods and thus different methods of costing may have to be used. Assembly of these components into final product still requires another method of costing. Other examples of industries which make use of this method are air conditioners, refrigerators, scooters, cars, locomotive works, etc.

Techniques of Costing

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1) **Standard Costing:** In this technique, standard cost is predetermined as a target of performance and actual performance is measured against the standard. The difference between standard and actual costs are analyzed to know the reasons for the difference so that corrective actions may be taken.
2) **Budgetary Control:** A budget is an expression of a firm's plan in financial form and budgetary control is a technique applied to the control of total expenditure on materials, wages and overhead by comparing actual performance with planned performance. Thus, in addition to its use in planning, the budget is also used for control and co-ordination of business operations.
3) **Marginal costing:** This is a technique of profit planning. In this technique, separation of costs into fixed and variable (marginal) is of special interest and importance. This is so because marginal costing regards only variable costs as the cost of the products. Fixed cost is treated as period cost and no attempt is made to allocate or apportion this cost to individual cost centres or cost units. It is transferred to costing profit and loss account of the period. This technique is used to study the effect on profit of changes in volume or type of output.
4) **Total absorption costing:** It is a traditional method of costing whereby total costs (fixed and variable) are charged to products. This is in complete contrast to marginal costing where only variable costs are charged to products. Although until recently this was the only technique employed by cost accountants, it is now-a-days considered to have only a limited application.
5) **Uniform costing:** This is not a separate technique or method of costing like standard costing or process costing. Uniform costing simply denotes a situation in which a number of firms adopt a uniform set of costing principles. It has been defined by CIMA as "the use by several undertakings of the same costing principles and/or practices". This helps to compare the performance of one firm with that of other firms and thus to derive the benefit of anyone's better experience and performance.

Classification of Costs

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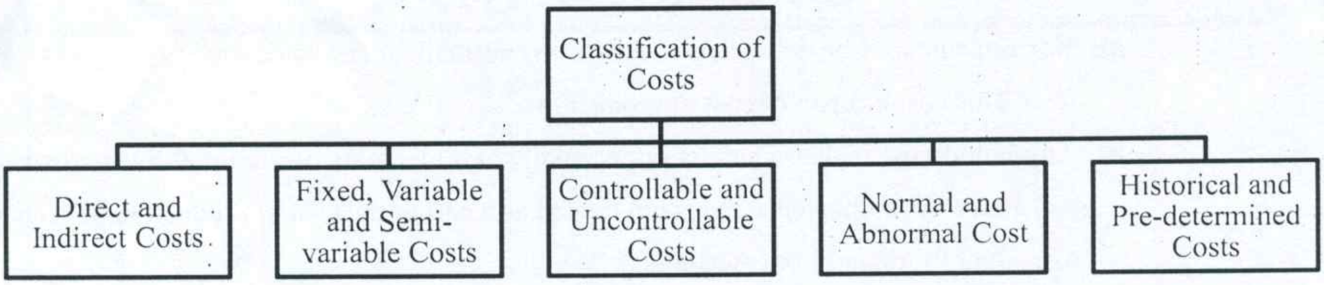
1) **Classification of cost into Direct and Indirect Costs**
   a) **Direct Costs:** These are those which are incurred for and conveniently identified with particular cost unit, process or department.

   Examples: Cost of raw materials used and wages of machine operators



b) **Indirect Costs:** These are general costs and are incurred for the benefit of number of cost units, process or departments. These costs cannot be conveniently identified with a particular cost unit or cost centre.

Examples: Depreciation of machinery, insurance, lighting, power, rent, managerial salaries, materials used in repairs etc.

2) **Classification of Cost into Fixed, Variable and Semi-variable Costs**

a) **Fixed Cost or Period Cost:** Fixed costs are those costs which remain fixed irrespective of change in volume of output. As production increases cost per unit of fixed cost decreases and as production decreases cost per unit of fixed cost increases.

Examples: Rent, managerial salaries, building insurance etc.

b) **Variable Cost or Product Cost:** Variable Costs are those costs which vary in direct proportion to the volume of output. As production increases total cost increases and as production decreases total cost also decreases. But cost per unit remains same.

Examples: Cost of raw materials, labor etc.

c) **Semi-variable Costs:** These costs are partly fixed and partly variable.

Examples: Telephone bill – it includes partly fixed charge up to certain level and then varies according to the calls.

3) **Classification of Cost into Controllable and Uncontrollable Costs**

a) **Controllable costs:** These are the costs which may be directly regulated at a given level of management authority. Variable costs are generally controllable by department heads.

Examples: Cost of raw material may be controlled by purchasing in larger quantities.

b) **Non-controllable costs:** These are those costs which cannot be influenced by the action of a specified member of an enterprise.

Examples: it is very difficult to control costs like factory rent, managerial salaries, etc.

4) **Classification of Cost into Normal and Abnormal Costs**

a) **Normal cost** may be defined as cost which is normally incurred on expected lines at a given level This cost is a pan of cost of production.

b) **Abnormal cost** is that which is not normally at a given level of output. Such cost is over and above the normal cost and is not treated as a part of the cost of production. It is charged to costing Profit and Loss Account.

5) **Classification of Cost into Historical and Pre-determined Costs**

a) **Historical costs** are thus nothing but actual costs. These costs are not available until after the completion of the manufacturing operations.

b) **Pre-determined costs:** These are future costs which are ascertained in advance of production on the basis of a specification of all the factors affecting cost. These costs are extensively used for the purpose of planning and control.

Classification of Costs for Decision-making

a) **Sunk Costs:** A sunk cost is a cost that has already been incurred and that cannot be changed by any decision made now or in the future. Such costs are not relevant for decision-making about the future.

b) **Differential (or Incremental) Costs:** This cost may be regarded as the difference in total cost resulting from a contemplated change. In other words, differential cost is the increase or decrease in total cost that results from an alternative course of action. It is ascertained by subtracting the cost of one alternative from the cost of another alternatives. The alternative choice may arise because of change in method of production, ill sales volume, change in product mix, make or buy decisions, take or refuse decision, etc.

c) **Marginal Cost:** Marginal cost is the additional cost of producing one additional unit. Marginal cost is the same thing as variable cost. Marginal costing (or variable costing) is a technique of charging only variable costs to products.

d) **Imputed Costs (Implicit cost):** These are hypothetical costs which are specially computed outside the accounting system for the purpose of decision-making. Interest on capital invested is a common type of imputed cost. As interest on capital is usually not included in cost, it is considered necessary to take it into account when deciding about the alternative capital investment projects.

For example, project A requires a capital investment of 50,000 and project B 40, 000. Both the projects are expected to yield 10,000 as additional profit. Obviously, these two projects are not equally profitable since project B requires less investment and thus, it should be preferred.

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e) **Opportunity Cost:** An opportunity cost may be defined as the potential benefit that is lost or sacrificed when the selection of one course of action makes it necessary to give up competing course of action.

For example, a company has deposited 1 lakh in bank at 10% p. a. interest. Now, it is considering a proposal to invest this amount in debentures where the yield is 12% p. a. If the company decides to invest in debentures, it will have to forego bank interest of Rs. 10,000 which is Opportunity cost.

f) **Replacement Cost:** Replacement Cost is the cost at which there could be purchased an asset identical to that which is being replaced. In Simple words, replacement cost is the current market cost of replacing an asset. When the management considers the replacement of an asset, it has to keep in mind its replacement cost and not the cost at which it was purchased earlier.

For example, a machinery purchased in 1995 at 10,000 is discarded in 2003 and a new machinery of the same type is purchased for 15,000. So, the replacement cost of the machinery is 15,000.

g) **Out-of-pocket Cost (Explicit Cost):** There are certain costs which require cash payment to be made (such a wages, rent) whereas many costs do not require cash outlay (such as depreciation). Out-of-pocket costs, also known as explicit costs, are those costs that involve cash outlays or require the utilization of current resources.

h) **Future Cost:** No decision can change what has already happened. The past is history and decisions made now can affect only what will happen in the future. Thus, the only relevant costs for decision-making are predetermined or future costs. But it is the historical costs which generally provide a basis for computing future costs. However, changing relationships in the future are also given due consideration while estimating future costs.

i) **Conversion Cost:** It is the total cost of converting a raw material into finished product. This term is used to denote the sum of direct labor and factory overhead costs in the production of a product. In other words, conversion cost is the factory cost minus direct material cost. Appropriate use of this cost can be made in certain managerial decisions.

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Elements of Cost

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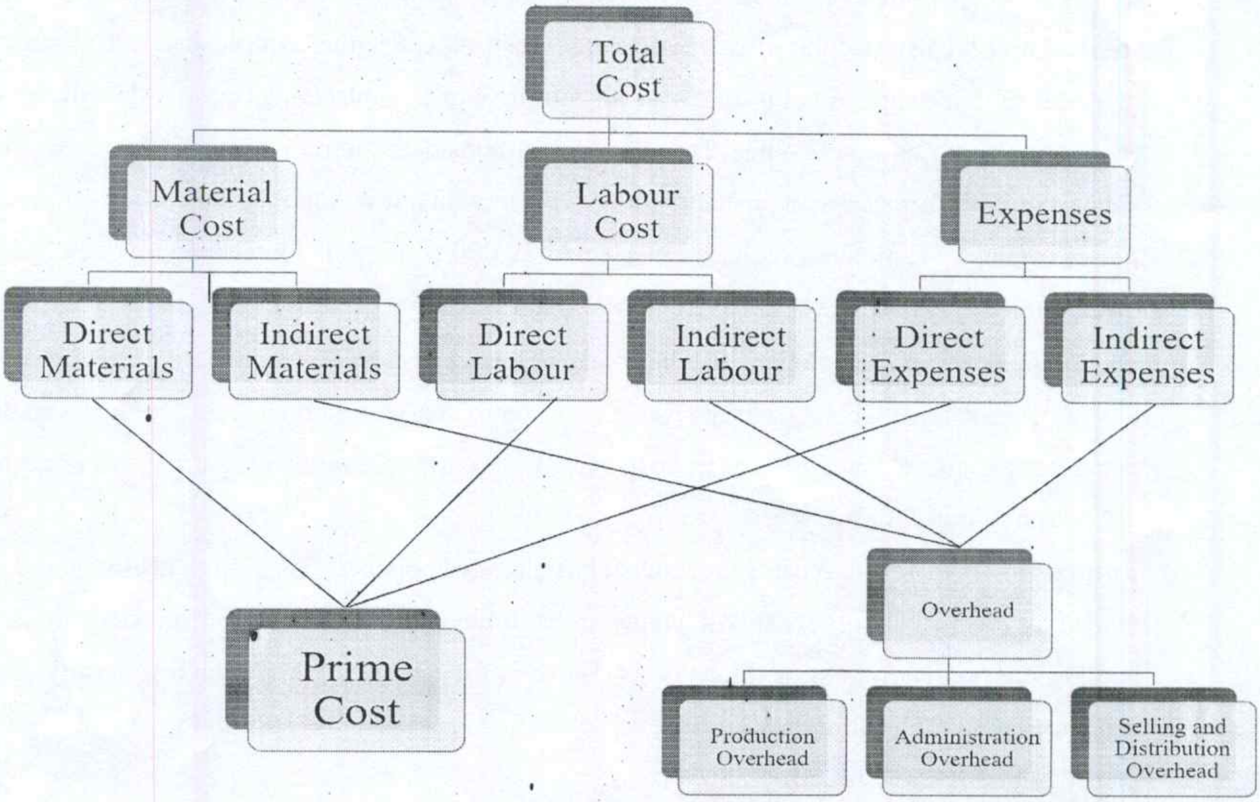
1) **Materials:** Materials may be direct or indirect

   a) **Direct Materials:** Direct Material cost is that which can be conveniently identified with and allocated cost units. Direct material generally become a part of finished goods.

   Example: Clay in bricks, leather in shoes, steel in machine, cotton in cloth etc.

   b) **Indirect Materials:** These are those materials which cannot be conveniently identified with individual cost units. These are of minor importance.

   Example: Lubricating oil, sand paper, nuts and bolts, coal, small tools, office stationery etc.



Elements of Cost

2) **Labour:** It means cost of remuneration of the employee.
   a) **Direct Labour:** It consists of wages paid to workers who are directly engaged in the activity of converting raw materials into finished goods. These wages can be conveniently identified with a particular product, job or process.
   Example: Machine operator wages
   b) **Indirect Labour:** It is of general character and cannot be conveniently identified with a particular cost unit.
   Example: salary of supervisor, inspector, cleaner, clerk, peon, watch men etc.
3) **Expenses:** All the other costs other than material and labour.
   a) **Direct Expenses:** Direct Expenses are those expenses which can be identified with and allocated to the cost centres or units.
   Example: Cost of patent rights, experimental costs, royalty paid in mining etc.
   b) **Indirect Expenses:** All indirect cost other than indirect material and indirect labour costs are termed as indirect expenses.

Example: Rent and rates, depreciation, lighting and power, advertising, insurance, repairs etc.

Prime cost: The aggregate of direct materials, direct labour and direct expenses are termed as Prime Cost.

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Thus, **Prime Cost = Direct Materials + Direct Labour + Direct Expenses**

Overhead: This is the aggregate of indirect materials, indirect labour and indirect expenses. Overhead is also known as On cost.

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Thus, **Overhead = Indirect Materials + Indirect Labour + Indirect Expenses**

Overheads are divided as follows

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1) **Production overhead:** Also known as factory overhead, works overhead or manufacturing overhead, these are those overheads which are concerned with the production function. It includes indirect materials, indirect wages and indirect expenses in producing goods or services.
   a) **Indirect Material** — Examples: Coal, oil, grease, etc., stationery in factory officer cotton waste, brush, sweeping broom etc.
   b) **Indirect Labour** — Examples: Works managers salary, salary of factory, office staff, salary of inspector and supervisor, wages of factory sweeper, wages of factory watchmen.
   c) **Indirect Expenses** - Examples: Factory rent, depreciation of plant, repair and maintenance of plant, insurance of factory building, factory lighting and power, internal transport expenses.
2) **Office and administration overhead:** This is the indirect expenditure incurred in general administrative function, i.e., in formulating policies, planning and controlling the functions, directing and motivating the personnel of an organization in the attainment of its objectives. These overheads are of general character and have no direct connection with production or sales activities. This category of overhead is also classified into indirect material, indirect labour and indirect expenses.
   a) **Indirect Material** - Examples: Stationery used in general administrative office, postage, sweeping broom and brush, etc.
   b) **Indirect Labour** - Examples: Salary of office staff, salary of managing director, remuneration of directors of the company.
   c) **Indirect Expenses** - Examples: Rent of office building, legal expenses, office lighting and power, telephone expenses, depreciation of office furniture and equipment, office air-conditioning, sundry office expenses.
3) **Selling and distribution overhead:** Selling overhead is the cost of promoting sales and retaining customers. It is defined as "the cost of seeking to create and stimulate demand and of securing

orders". Distribution cost includes all expenditure incurred from the time the product is completed until it reaches its destination. Selling and distribution overheads are also grouped into indirect material, indirect labour and indirect expenses.

2M All examples
a) **Indirect Material** - Examples: Packing material, stationery used in sates office, cost of samples, price list, catalogues, oil, grease, etc., for delivery vans, etc.

b) **Indirect Labour** – Examples: Salary of sales manager, salary of sales office staff, salary of warehouse staff, salary of drivers of delivery vans etc.

c) **Indirect Expenses** – Examples: Advertising, travelling expenses, showroom expenses, carriage outwards, rent of warehouse staff, bad debts, insurance of goods in transit etc.

Cost Centre

A cost centre is defined by CIMA of UK as **"a location, person, or item of equipment (or group of for which costs may be ascertained and used for the purpose of control".**

Thus, a cost centre refers to a section of the business to which costs can be charged. It may be a location (a department, a sales area), an item of equipment (a machine, a delivery van), a person (a salesman, a machine operator) or a group of these (two automatic machines operated by one workman). The main purpose of ascertaining the cost of a cost centre is control of cost.

Cost centres are primarily of two types:

Personal cost centre - which consists of a person or a group of persons,

Impersonal cost centre - which consists of a location or an item of equipment or group of these.

From functional point of view, cost centres may be of following two types:

Production cost centre - This is that cost centre where actual production work takes place. Examples are melting shop, machine department, welding department, finishing shop, etc.

Service cost centre - This is that cost centre which are ancillary to and render services to production cost centres. Examples of service cost centres are power house, tool-room, stores department, repair shop, canteen, etc. Costs incurred in service cost centres are of indirect type.

Cost Unit

2M A cost unit is defined by CIMA as a **"unit of product, service or time in relation to which cost may be ascertained or expressed".**

Cost units are the 'things', that the business is set up to provide of which cost is ascertained.

For example, in a sugar mill, the cost per tonne of sugar may be ascertained, in a textile mill the cost per metre of cloth may be ascertained.

Cost Object

Cost object may be defined as **"anything for which a separate measurement of cost may be desired"**

Examples of cost objects given below:

Cost Object	Examples
Product	Car, shaving razor, TV
Service	Telephone hotline, taxi service, electricity
Process	Melting process in a steel mill, weaving process in a textile mill
Activity	Developing a website on the Internet, Purchasing raw material
Department	Purchasing department, Personnel department, Production department

Cost Control

Cost control is an essential component of any system of cost accounting. It is exercised through comparing actual costs with pre-determined standard costs so that the difference between the two can be measured and then analyzed according to reasons for taking corrective action.

2M CIMA, London has defined cost control as, **"the regulation by executive action of the cost of operating an undertaking particularly where action is guided by cost accounting".**

Steps in Cost Control:

- **Establishing norms:** The first step in cost control is to set norms or standards which may serve as yardsticks for measuring performance. These standards or norms are set on the basis of past performance adjusted for changes in future and on the basis of studies conducted.
- **Comparison with actual:** The actual costs incurred are compared with established standard costs to know the level of achievement. The variations are analyzed so as to arrive at the causes which are controllable and uncontrollable.
- **Corrective action:** Remedial or corrective measures are taken to avoid the recurrence of variations is future and for revision of standards, wherever necessary.

Cost Reduction

2M Cost reduction is defined by CIMA London as **"the achievement of real and permanent reduction in the unit cost of goods manufactured or services rendered without impairing their suitability for use intended".**

Cost reduction is much wider in scope and consists of effecting savings in cost by continuous research for improvement in products, methods, procedures and organizational practices.

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COST ACCOUNTING

Assignment 1

Section A

1) Define the following terms -
    a) Costing
    b) Cost Accounting
    c) Cost Accountancy
    d) Cost Reduction
    e) Cost Control
2) What is Cost Unit?
3) Give the meaning of Prime cost and Overhead?
4) State the examples of Selling and Distribution Overheads.
5) State any two objectives of Cost accounting.
6) What is Opportunity Cost?
7) What is Conversion cost?

Section B

1) Differentiate between Financial Accounting and Cost Accounting.
2) Enumerate the different types of overheads.
3) Explain the methods of Costing.
4) Brief in detail the techniques of costing.

Section C

1) Enumerate the advantages and disadvantages of Cost accounting.
2) Briefly explain the classification of costs.
3) Give a detailed note on Elements of Cost.