

BASIC COST CONCEPTS **(FOR B.COM ONLY)**

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CHAPTER -1
BASIC COST CONCEPTS

Q.NO.1:- Define cost, costing, cost accounting and cost accountancy.**Ans:-**

Cost	It is defined as “ the amount of expenditure incurred on ,or attributable to a given thing.
Costing	It is the technique and processes of ascertaining costs . These techniques consist of principles and rules which govern the procedure of ascertaining cost of products or services.
Cost Accounting:	It may be regarded as a specialised branch of accounting which involves classification, accumulation, assignment and control of costs. The costing terminology of CIMA London defines cost accounting as “ the establishment of budgets, standard costs and actual costs of operations, processes, activities or products and the analysis of variances, profitability or the social use of funds.”
Cost Accountancy	The application of costing and cost accounting principles, methods and techniques to the practice of cost accounting is cost accountancy.

Q.NO.2:- What are the Objects of Cost Accounting?**Ans:-**

- 1. Finding Cost of Production:** To arrive at the cost of production of every unit, job, operations, process, department or service and to develop cost standard.
- 2. Determination of Selling Price :** Cost accounting has vital importance in determining selling price of products as selling price is influenced by cost.
- 3. Finding Inefficiency:** To indicate **management** any inefficiencies and the extent of various forms of **waste**, whether of materials, time, expenses, or in the **use of machinery** or equipment.
- 4. Cost Comparison:** To provide actual figures of cost for comparison with estimates and to serve as a guide for **future estimates or quotations** and to **assist the management** in their **price – fixing** policy.
- 5. Profitability :** To **ascertain profitability** of each of the **products** and advise management as to how these profits can be maximized.
- 6. Incentive Plan:** To guide management in the **formulation** and implementation of incentive bonus plans based on productivity and cost savings.
- 7. Budget Preparation :** To help in the preparation of budgets and implementation of budgetary control.
- 8. Cost Reduction :** To organize Cost reduction program.

Q.NO.3:- State the advantages /Importance/Significance of Cost Accounting.**Ans:-**

- 1. Discloses Profitable and unprofitable activities:-** Cost accounting discloses the profitable and unprofitable activities and on this basis steps can be taken to **eliminate or reduce those activities** from which little or no benefit is obtained.
- 2. Measuring efficiency** It enables a concern to **measure the efficiency** and then to **maintain and improve** it. This is done with the help of valuable data made available for the purpose of comparison.
- 3. Making estimates:-** Cost Accounting provides information upon which estimates and tenders are based. In case of big contracts or jobs, **quotations** cannot be given unless the cost of completing the contracts can be found out.
- 4. Guides in future production Policy:-** It explains the cost incurred and profit made in various lines of business and processes and thereby **provides data** on the basis of which **production** can be **appropriately planned**.
- 5. Helps in increasing profit:-** It helps in increasing profits by disclosing the sources of loss or waste and by suggesting such **controls** so that **wastages, leakages and inefficiencies** of all departments may be detected and prevented.
- 6. Helps in Cost comparison:-** Cost accounting **furnishes reliable data** for comparing costs in different periods, for different volumes of output, in different departments and processes and in different establishments. This helps in maintaining costs at the lowest point consistent with the **most efficient operating conditions**.

Q.NO.4:- Explain various methods of Costing**Ans:-**

- 1. Job Costing :-** This costing method is used in firms which work **on the basis of job work**. There are some manufacturing units which undertake job work and are called as job order units. The main feature of these organizations is that they **produce according to the requirements and specifications of the consumers**. Each job

may be different from the other one. Production is only on specific order and there is no pre demand production. Because of this situation, it is necessary to compute the cost of each job and hence job costing system is used. In this system, each job is treated separately and a job cost sheet is prepared to find out the cost of the job. The job cost sheet helps to compute the cost of the job in a phased manner and finally arrives the total cost of production.

2. Batch Costing :- This method of costing is used in those firms where production is made on continuous basis. Each unit coming out is uniform in all respects and production is made prior to the demand, i.e. in anticipation of demand. One batch of production consists of the units produced from the time machinery is set to the time when it will be shut down for maintenance. For example, if production commences on 1st January 2007 and the machine is shut down for maintenance on 1st April 2007, the number of units produced in this period will be the size of one batch. The total cost incurred during this period will be divided by the number of units produced and unit cost will be worked out. Firms producing consumer goods like television, air-conditioners, washing machines etc use batch costing.

3. Process Costing:- Some of the products like sugar, chemicals etc involve **continuous production process** and hence process costing method is used to work out the cost of production. The meaning of continuous process is that the input introduced in the process I travels through continuous process before finished product is produced. The output of process I becomes input of process II and the output of process II becomes input of the process III. If there is no additional process, the output of process III will be the finished product. In process costing, cost per process is worked out and per unit cost is worked out by dividing the total cost by the number of units.

4. Operating Costing:- This type of costing method is used in **service sector** to work out the cost of services offered to the consumers. For example, operating costing method is used in hospitals, power generating units, transportation sector etc. A cost sheet is prepared to compute the total cost and it is divided by cost units for working out the per unit cost.

5. Contract Costing :- This method of costing is used in **construction industry** to work out the cost of contract undertaken. For example, cost of constructing a bridge, commercial complex, residential complex, highways etc is worked out by use of this method of costing. Contract costing is actually similar to job costing, the only difference being that in contract costing, one construction job may take **several months or even years** before they are complete while in job costing, each job may be of a short duration. In contract costing, as each contract may take a long period for completion, the question of computing of profit is to be solved with the help of a well defined and accepted method.

6. Operation costing (Output costing):- This method is adopted when it is desired to ascertain the **cost of carrying out an operation in department**, for example, welding. For large undertakings, it is frequently necessary to ascertain the cost of various operations.

7. Multiple Costing:- It represents the application of **more than one method of costing** in respect of the same product. This is suitable for industries where a number of component parts are separately produced and subsequently assembled into a final product. In such industries each component differs from the others as to price, material used and process of manufacture undergone. So it will necessary to ascertain the cost each component. For this purpose, process costing may be applied. To ascertain the cost of the final product batch costing may be applied. This method is used in factories manufacturing cycles, automobiles, engines, radios, typewriters etc.

Q.NO.5:- Explain different Costing Systems/Techniques.

Ans:-

1. Historical Costing:- In this system, costs are ascertained only **after** they are **incurred** and that is why it is called as historical costing system.. Such type of costing system is extremely useful for conducting post-mortem examination of costs, i.e. **analysis of the costs** incurred in the past. Historical costing system may **not** be **useful** from **cost control** point of view but it certainly indicates a trend in the behavior of costs and is useful for estimation of costs in future.

2. Absorption Costing :- In this type of costing system, costs are **absorbed** in the **product units** irrespective of their nature. In other words, all **fixed** and **variable costs** are absorbed in the products. It is based on the principle that costs should be charged or absorbed to whatever is being costed.

3. Marginal Costing:- In Marginal Costing, only **variable costs** are **charged** to the products and **Fixed costs** are written off to the **Costing Profit and Loss A/c**. The principle followed in this case is that since Fixed costs are largely period costs, they should not enter into the production units. Naturally, the fixed costs will not enter into the inventories and they will be valued at marginal costs only.

4. Uniform Costing :- This is not a distinct method of costing but is the **adoption of identical costing principles** and procedures by **several units** of the same industry or by several undertakings by mutual agreement. Uniform costing facilitates valid comparisons between organizations and helps in eliminating inefficiencies.

5. Standard Costing:- It is a technique whereby actual costs are compared with already set standards. It is thus method of both cost ascertainment and control. This technique may be used along with any technique.

Q.NO.6:- Explain Direct cost and Indirect cost.

Ans:-

Direct Cost

- Those costs which are **directly identifiable** and has **direct relation** with the finished product are called direct cost.
- Change of **output** has **direct impact** on these **costs** and are varied according to variation in the number of units of finished product produced.
- These costs forms part of the **prime cost** of the product.
- E.g. Direct material cost, direct labour cost, direct expenses (Royalty on production) etc.

Indirect Cost

- Those costs which **cannot** be directly **identifiable** and allocable in relation to a particular product are called indirect costs or in other words these are called Overhead.
- Overheads** may be in factory, administration, selling department or Distribution department.
- E.g. Electricity of office, Telephone bill, Salary of office staff.

Q.NO.7:- Explain Responsibility Centre, cost centre, investment centre and profit centre .

Ans:-

Responsibility centre:

It is an **activity centre** of a business organization entrusted with a **special task**. It is a unit of function of a business organization headed by an executive responsible for its performance. Responsibilities centre are of three types.

(i) Cost Centre / Cost Object

- It can be defined as, 'a **production or service**, function, **activity** or item of **equipment** whose **costs** may be attributed to cost units. In simple words, a cost center is nothing but a location, person or item of equipment for which cost may be ascertained and used for the purpose of cost control.
- A cost center is the smallest organizational **sub unit** for which separate cost allocation is attempted'.
- Personal Cost Centre:** A personal cost centre consists of a person or a group of persons.
- An impersonal cost centre:** is one which consists of a department, plant, or item of equipment.

(ii) Profit Centre :

- Profit Center is defined as, 'a **segment** of the business entity by which both **revenues** are received and **expenses** are incurred or **controlled**'.
- Such revenues and expenditure are being used to **evaluate segmental performance** as well as managerial performance.

(iii) Investment Centre

- Those centre which are **responsible** for earning adequate **return** on investment.

Q.NO.8:- Explain Cost object and Cost Unit.

Ans:

Cost Unit:

- Cost unit is a **unit** of production, service or time or combination of these, in **relation to which costs** may be **ascertained** or expressed. It should be one with which expenditure can be most readily associated.
- Cost unit is a form of measurement of volume of production or service.
- Cost unit **differ** from **business to business**. They are usually units of physical measurement e.g. **number, weight, area, volume, time**.

Cost Object:

- Cost object is anything for which a **separate measurement of cost** is **desired**.
- Cost object is defined as any unit of cost accounting selected with view to accumulating all cost under that unit.
- Cost object may be a product, a service, a project, a customer, a brand, an activity or a program.

Q.NO.9. List the method of costing and cost units applicable for the following industries.

Ans:-

Industry	Method of costing	Cost unit
Interior decoration	Job	Per job

Advertising	Job	Per job
Toy making	Batch/unit	Per batch
Pharmaceuticals	Batch/unit	Per unit/box
Ship Building	contract	Per ship
Bridge construction	Contract	Per contract
Cement-	Unit	Per tonne/per bag
Coal	Single/unit	Per tone
Brick works	Single/unit	Per 1000 bricks
Steel	process	Per tonne
Oil Refining	Process	Per tonne
Soap	Process	Per unit
Sugar company having own sugarcane field	Process	Per quintal/per tone
Hospital/Nursing home	Operating	Per patient day or room day
Road Transport	Operating	Per tone-km /passenger km
Radio	Multiple	Per unit/per batch
Bicycles	Multiple	Per unit/per batch
Furniture	Multiple	Per unit

Q.NO.10:- Explain different types of costs**Ans:-****(I) Classification according to elements:-****(a) Material Cost:-**

- It is the cost of material of any nature used for the purpose of production of a product of a service.
- It includes cost of procurement, freight inwards, taxes and duties, insurance, etc, directly attributable to the acquisition.
- Trade discounts rebates, duty drawbacks, refunds on account of CENVAT, GST are deducted.

(b) Labour Cost:-

- Means the payment made to the employees, permanent or temporary for their services.
- Includes salaries and wages paid to employees.
- Salaries and wages include all fringe benefits like PF contribution, Gratuity, ESI, Overtime, Incentive, Bonus, Ex-Gratia, leave encashment, wages for holidays and idle time. Etc.

(c) Expenses:-

- Expenses are other than material cost and labour cost, which are involved in an activity.
- Expenditure on account of utilities, payment for bought out services, job processing charges etc. can be termed as expenses.

(II) Classification according to nature :

(a) **Direct costs** are the costs which are identifiable with the product unit or cost center.

(b) **Indirect costs** are not identifiable with the product unit or cost center and hence they are to be allocated, apportioned and then absorb in the production units.

(III) Classification according to behaviour

(a) **Fixed Costs** :- Out of the total costs, some costs remain fixed irrespective of changes in the production volume. These costs are called as fixed costs. The feature of these costs is that the total costs remain same while per unit fixed cost is always variable.

Fixed Costs are further divided into Committed Fixed costs and Discretionary fixed cost:

- Committed Fixed Costs** are incurred to maintain certain facilities and cannot be quickly eliminated. The management has little or no discretion in this cost e.g. rent, insurance etc.
- Discretionary Fixed Costs:-** These are not related to the operations and can be controlled by the management. These costs result from special policy decisions, new researches etc. and can be eliminated or reduced to a desirable level at the discretion of the management.

(b) **Variable Costs** :- These costs are variable in nature, i.e. they change according to the volume of production. Their variability is in the same proportion to the production. Variable cost per unit remain same but in totality they vary according to the quantity of production.

(c) **Semi-variable Costs** :- Certain costs are partly fixed and partly variable. These costs are neither totally fixed nor totally variable. Maintenance costs, supervisory costs etc are examples of semi-variable costs. These costs

are also called as 'stepped costs'.

(IV) Classification according to functions :

Production Costs:- All costs incurred for production of goods are known as production costs.

Administrative Costs:- Costs incurred for administration are known as administrative costs. Examples of these costs are office salaries, printing and stationery, office telephone, office rent, office insurance etc.

Selling and Distribution Costs :- All costs incurred for procuring an order are called as selling costs while all costs incurred for execution of order are distribution costs. Market research expenses, advertising, sales staff salary, sales promotion expenses are some of the examples of selling costs. Transportation expenses incurred on sales, warehouse rent etc are examples of distribution costs.

Research Costs :- Cost of development of new product and manufacturing process, improvement of existing products, process and equipment, finding new uses for known products, solving technical problems arising in manufacture and application of products, etc.

Development costs:- The cost of the process which begins with the implementation of the decision to produce a new or improved product or to employ a new or improved method and ends with commencement of the production of that product or by that method.

Pre-Production Costs:- The part of development cost incurred in making a trial production run prior to formal production.

Conversion cost:- The total of Direct wages, direct expenses and production overhead , cost of converting raw-material into finished goods.

Special note on distribution costs

Primary packing cost is included in **Production cost** and **secondary packing** cost is **distribution cost**.

(V) Classification according to association with product

(a) Product cost: Product costs are those which are traceable to the product and included in inventory values. In a manufacturing concern it comprises the cost of direct materials, direct labour and manufacturing overheads. Product cost is a full factory cost. Product costs are used for valuing inventories which are shown in the balance sheet as asset till they are sold. The product cost of goods sold is transferred to the cost of goods sold account.

(b) Period Cost:- Period costs are incurred on the basis of time such as rent , salaries etc include many selling and administrative costs essential to keep the business running. Though they are necessary to generate revenue, they are not associated with production, therefore , they cannot be assigned to a product. They are charges to the period in which they are incurred and are treated as expenses.

(VI) Classification according to time :

(a) Historical Costs :- These are the costs which are incurred in the past, i.e. in the past year, past month or even in the last week or yesterday. The historical costs are ascertained after the period is over. In other words it becomes a post-mortem analysis of what has happened in the past. Though historical costs have limited importance, still they can be effectively used for predicting the future costs.

(b) Predetermined Cost:- These costs relating to the product are computed in advance of production, on the basis of a specification of all the factors affecting cost and cost data. Pre determined costs may be either standard or estimated.

- i. **Standard Cost** is a predetermined calculation of how much cost should be under specific working conditions. It is based on technical studies regarding material, labor and expenses. The main purpose of standard cost is to have some kind of benchmark for comparing the actual performance with the standards.
- ii. **Estimated costs** are predetermined costs based on past performance and adjusted to the anticipated changes. It can be used in any business situation or decision making which does not require accurate cost.

(VII) Classification of Costs for Management decision making :

One of the important function of cost accounting is to present information to the Management for the purpose of decision making. For decision making certain types of costs are relevant.

(a) Relevant Cost :- The relevant cost is a cost which is **relevant** in various **decisions** of management. Decision making involves consideration of several alternative courses of action. In this process, whatever costs are relevant are to be taken into consideration. In other words, **costs** which are going to be **affected** **matter** the most and these costs are called as relevant costs. Relevant cost is a future cost which is different for different alternatives. It can also be defined as any cost which is affected by the decision on hand. Thus in decision making relevant costs play a vital role.

(b) Marginal Cost :- Marginal cost is the **change** in the **aggregate costs** due to **change** in the volume of **output** by one unit. For example, suppose a manufacturing company produces 10,000 units and the aggregate costs are Rs. 25,000, if 10,001 units are produced the aggregate costs may be Rs. 25,020 which means that the marginal cost is Rs. 20. Marginal cost is also termed as variable cost and hence per unit marginal cost is always same, i.e. per unit marginal cost is always fixed but in totality they vary .

(c) Differential Costs (Incremental Costs) :- ***

Differential costs are also known as **incremental cost**. This cost is the difference in total cost that will arise from the **selection** of one **alternative** to the other. In other words, it is an added cost of a change in the level of activity. This type of analysis is useful for taking various decisions like

- **change** in the **level** of activity,
- **adding** or **dropping** a **product**,
- **change** in **product mix**, **make** or **buy** decisions,
- **accepting** an export offer and so on.

The differential cost between any two levels of production is the difference between the marginal costs at these two levels and the increase or decrease in fixed costs, if any.

Differential costs are **useful** in **planning** and **decision making** and helps to choose the best alternative. It helps management to know the additional profit that would be earned if idle capacity is used or when additional investments are made.

(d) Opportunity Costs :- ***

It is the value of **benefit sacrificed** in favor of an alternative course of action. It is the maximum amount that could be obtained at any given point of time if a resource was sold or put to the most valuable alternative use that would be practicable.

Opportunity cost of goods or services is measured in terms of revenue which could have been earned by employing that goods or services in some other alternative uses.

Example:- Capital is invested in plant and machinery . It cannot be now invested in shares or debentures. The loss of interest and dividend that would be earned is the opportunity cost for plant.

Opportunity cost are not recorded in the books but it is important in decision making and comparing alternatives.

(e) Replacement Cost:- This is the cost at which existing items of material or fixed assets can be replaced. Thus this, is the cost of replacing existing assets at present or at a future date.

(f) Imputed Costs (Notional costs):- Some costs are **not incurred** and are useful while taking decision pertaining to a particular situation. These costs are known as **imputed or notional costs** and they do not enter into accounting system. E.g. **Owners salary**, Rent of own building engaged in business.

(g) Controllable Costs and Uncontrollable cost (*):-**

- i. **Controllable costs:-** These are the costs which can be influenced and controlled by managerial action.
- ii. **Non-controllable cost:-** These are costs that **cannot** be influenced and controlled by a **specific member** of the organization.

Controllability of costs is subject to the following factors

- a) **Time:-** Certain costs are controllable in long run and not in the short run.
- b) **Location:-** Certain costs are not influenced and decided at a particular location/cost centre. For example, if rent agreement of all factory premises are executed centrally at the Head office , factory managers cannot control the incurrence the rent cost.
- c) **Product:-** Certain costs are controllable by reference to one product or market segment and not by reference to the other. For example, some products require more advertising and sales promotion efforts than other products.

(h) Shutdown Cost :- These costs are the costs which are incurred if the operations are shut down and they will disappear if the operations are continued. Examples of these costs are costs of sheltering the plant and machinery and construction of sheds for storing exposed property. Computation of shutdown costs is extremely important for taking a decision of continuing or shutting down operations.

(i) Capacity Cost :- These costs are normally fixed costs. The cost incurred by a company for providing production, administration and selling and distribution capabilities in order to perform various functions. Capacity costs include the costs of plant, machinery and building for production, warehouses and vehicles for distribution and key personnel for administration. These costs are in the nature of long-term costs and are incurred as a result of planning decisions.

(j) Sunk costs:- A Sunk Cost is one that has already been incurred and cannot be avoided by decisions taken in the future. As it refers to past costs, it is unavoidable cost. It can be defined as "an expenditure for equipment or productive resources which has no economic relevance to the present decision making process". This cost is not useful for decision making as all past costs are irrelevant.

(k) Urgent Costs :- These costs are those which must be incurred in order to continue operations of the firm. For example, cost of material and labor must be incurred if production is to take place.

(l) Joint Costs:- The processing of a single raw material results in two or more different products simultaneously. The joint products are not identifiable as different types of product until a certain stage of production known as the split off point is reached. Joint costs are cost incurred upto the point of separation. One product may be of major importance and others of minor importance which are called by -products.

(m) Common Costs:- Common Costs are those costs which are incurred for more than one product, job, territory or any other specific costing object. They are not easily related with individual products and hence are generally apportioned.

(n) Out of Pocket costs:- These are costs which entail current or near future outlays of cash for the decision at hand. Such costs are relevant for decision making, as these will occur in near future. Out of pocket costs can be avoidable if the particular proposal under consideration is not accepted.

(o) Avoidable and Unavoidable cost:-

- i. **Avoidable costs** are those cost which under given conditions of performance efficiency should not have been incurred. Cost variances which are controllable may be termed as Avoidable costs.
- ii. **Unavoidable costs** are inescapable costs which are essentially to be incurred, within the limits provided for it. It is the cost that must be incurred under a program of business restriction. It is fixed in nature.

(p) Engineering Cost:

These are cost that result specifically from a clear cause and effect relationship between inputs and outputs. The relationship is usually personally observable. Examples of input are direct material cost, direct labour cost. Examples of output are cars, computers etc.

Q.NO.11:- How are costs classified on the basis of Normality?

Ans:-

Normal Cost:-

- a) Costs which can be reasonably expected to be incurred under normal routing and regular operating conditions. Are called Normal cost
- b) Cost that is normally incurred at a given level of input in the conditions in which that level of output is achieved.

Abnormal cost:-

- a) Cost over and above normal cost, which is not incurred under normal operating conditions e.g. fines and penalties, abnormal wastage.

Q.NO.12:- Distinguish between Explicit and Implicit costs

Ans:-

Particulars	Explicit cost	Implicit cost
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Meaning	Costs which involve some cash payment or outflow of resources.	Cost which do not involve any cash payment at all.
Also known as	Out of pocket cost	Economic cost/notional cost/Imputed cost
Example	Salary, wages, advertising	Interest on own capital, rent of own building.
Measurement	These are actually incurred and hence can be easily measured.	They are not actually incurred .They cannot be easily measurable.
Recording	Recorded in books	Not recorded in books.

Q.NO.13:- Distinguish between Cost reduction and Cost Control**Ans:-**

Particulars	Cost Reduction	Cost Control
Permanence	Permanent , real and genuine saving in cost	Temporary control in nature
Product quality	Product's quality is maintained	Maintenance of quality is not guaranteed.
Nature of costs	Emphasis here is partly on present costs and largely on future costs.	Emphasis on present and past behaviour of costs.
Nature of standards	Continuous process of critical examination , includes analysis and challenge of standards.	Control is achieved through compliance with standards . Standards itself is not examined.
Tools and techniques	Value engineering , work study , market research, job evaluation and merit rating , standardization and simplification, quality control ,Bench marking, Business process re-engineering etc. are examples of tools	Budgetary control , standard cost .

Q.NO.14:- Distinguish between Financial Accounting and Cost Accounting**Ans:-**

Points	Financial Accounting	Cost Accounting
Object	Financial Accounting aims at finding out results of accounting year in the form of Profit and Loss Account and Balance Sheet .	Cost Accounting aims at computing cost of production/ service in a scientific manner and then cost control and cost reduction .
Reporting	Financial Accounting is more attached with external reporting the results and position of business to persons and authorities other than management like government , creditors , investors , owners etc.	Cost Accounting is an internal reporting system for an organization's own management for decision making
Nature	Financial Accounting data is historical in nature	Cost Accounting not only deals with historical data but is also futuristic in approach.
Transaction	In financial accounting, only those transactions are recorded which can be expressed in monetary terms .	In Cost accounting uses both monetary as well as quantitative information.

Q.NO.15:- what are the advantages/necessity of having a proper costing system in an organization?**Ans:-****Necessity /Advantages of having a proper costing system in an organisation**

- A proper cost accounting system assists management in the **planning and control** of the business operations as well as in analyzing product profitability.
- Generating information for **decision making**,
- Supplying information to the management for **internal control**,
- Detailed analysis of costs** like fixed costs, variable costs, controllable costs, labor costs, material costs, overheads etc.
- However it is necessary that the cost accounting system is properly installed in an organization. Costing system installed in an organization should be simple to understand, easy to operate, highly reliable and

suitable to the organization.

Q.NO.16:- Explain the factors that should be taken into consideration while designing a costing system in an organization.

Ans:-

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. In such situation, the cost accounting system should be capable of supplying such information.

2. Manufacturing Process :- Process of manufacturer changes from industry to industry. In **some industries**, there 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, labor 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. Management Control Needs:- The designing of a cost accounting system in a business organization is guided by the management control requirements. The costing system should **supply data** to persons at **different levels** in the **organization** to take suitable action in their respective areas.

5. Raw Materials :- The designing of a cost accounting system in a business is also guided by the raw materials required for the production. The **nature** of **raw materials** and the degree of waste therein **influence** the **designing** of **costing system**. There are some materials which have a high degree of spoilage. The costing system should be such that identification of spoilage, keeping records of materials, pricing of the issues etc are taken into consideration.

6. Organization Structure :- The structure of the organization also plays a vital role in designing a costing system. The system should **correspond** to the **hierarchy** of the organization.

7. External Factors :- External factors are also important in designing of a costing system. For example, Cost Accounting Record Rules have been mandatory for certain types of industries. For the sake of compliance of the same, costing system should be designed.

Q.NO.17:- State the practical Difficulties in Installation of Costing system.

Ans:-

1. Lack of support:- Top Management of an organization may not give necessary support and recognition to the costing system installed in an organization. Due to lack of support, this system may not give desired results.

2. Resistance from Staff:- There may be resistance from existing accounting staff due to **fear of losing job** recognition and importance after the implementation of the system.

3. Lack of co-operation:- Employees of other departments may not co-operate for installation of costing system due to **fear of increase** in **workload** or revealing of inefficiency.

4. Lack of professional qualification:- Shortage of qualified and efficient staff may be another difficulty in installing and operating a costing system.

5. High cost of installation:- Sometimes firms resist a costing system due to the heavy cost of installation and operating of the same. The **cost** may be **more** than the **benefits** of the same.

Q.NO.18:- List the essential features of good cost accounting system.

Ans:-

1. Simple and easy to operate:- The system should be **tailor -made**, **practical**, **simple** and capable of meeting the requirements of a business.

2. Accuracy of data:- The data to be used by the cost accounting system should be accurate . Otherwise it may distort the output of the system.

3. Relevancy of data:- The system should handle and report relevant **data** for **use** of **managers** for **decision** making.

4. Management's role:- The top management should have **faith** in the **costing system** and should also provide a helping hand for its development and success.

5. Cost effective:- The cost of installing and operating the system should justify the results. The **benefits** from the system should **exceed** the **amount spent** on it.

6. Smooth implementation:- The system should be effectively implemented.

Q.NO.19:- Define Management Accounting. Explain its features.

Ans:-**Meaning:**

Management Accounting is an accounting system which will help the Management to improve its efficiency. The main thrust of Management Accounting is towards determining policy and formulating plans to achieve desired objectives of management. It helps the Management in planning, controlling and analyzing the performance of the organization in order to follow the path of continuous improvement. Management Accounting utilizes the principle and practices of financial accounting and cost accounting in addition to other modern management techniques for effective operation of a company. In fact there is an overlapping in various areas of cost accounting and management accounting.

Features

- i. The Management Accounting data are derived from both, the financial accounting and cost accounting.
- ii. The main thrust in management accounting is towards determining policy and formulating plans to achieve desired objectives of management.
- iii. Management Accounting makes corporate planning and strategy effective and meaningful.
- iv. It is concerned with short and long range planning and uses highly sophisticated techniques like sensitivity analysis, probability techniques, decision tree, ratio analysis etc for planning, control and evaluation.
- v. It is futuristic in approach and predictive in nature.
- vi. Management Accounting system cannot be installed without proper cost accounting system.
- vii. Management Accounting systems generate various reports which are extremely useful from the Management point of view.

Q.NO.20:- Explain importance of Management Accounting**Ans:-**

1.Measurement: For measurement of full costs, the management accounting system focuses on the measurement of full costs. Full costs are the total costs required for producing goods or offering services. These costs are divided into A] Direct costs and B] Indirect costs. Direct costs are identifiable or traceable to the products or services offered while indirect costs are not traceable to the products or services. Full cost accounting measures not only the total costs [direct plus indirect costs] required for producing products or services but also the full costs required to run other activity like conducting a research project or running a welfare scheme and so on. Thus full cost accounting is not restricted to solely to measure the cost of manufacturing.

2.Control: An important aspect of the management accounting information is to provide information, which can be used for 'Control'. The management accounting system is structured in such a manner that information is generated for each 'Responsibility Center'. A responsibility center is an organization unit headed by a manager who is responsible for its operations and performance. Management accounting helps to prepare budget for each responsibility center and also facilitates comparison between the budgeted and actual results. A report is prepared for each responsibility center, which shows the budgeted and actual performance and also the difference between the two. This enables the performance analysis of each responsibility center so that proper corrective action can be taken in this respect.

3.Decision Making: Management accounting generates useful information for decision making. Management has to take several decisions in the course of business. Some of the major decisions are, Make or Buy, Accepting or rejecting of an Export Order, Working of second shift, Fixation of selling price, Capital expenditure decisions, Increasing production capacity, Optimizing of Product Mix and so on. For all these decisions, providing of information is necessary and the management accounting generates this information, which enables the management to take such decisions.

4.Supply Chain Analysis: Companies can also implement strategy, cut costs and create value by enhancing their supply chain. The term 'Supply Chain' describes the flow of goods, services and information from the initial sources of materials and services to the delivery of products to customers regardless of whether those activities occur in the same organization or in other organization. Customers expect improved performance from companies through the supply chain. They expect that the companies should perform all these activities in an efficient manner so as to reduce costs and also maintain quality of the products and the products be available easily for them. This is no doubt a daunting task and the management accounting plays a vital role in ensuring value for money for the customers. Tools like standard costing and target costing can be used effectively for cost control and cost reduction and thus ensure reasonable prices for customers. A system of budgets and budgetary control will ensure continuous planning and monitoring various functions and thus provide for introspection. Continuous improvement in these activities will help in creating value for customers.

5.Performance Measurement: Management accounting helps immensely for the measurement of performance of

the organization. The main aspect of performance measurement is **comparison between the targets and actual**. There are several tools and techniques like budgets and **budgetary control**, **standard costing** and **marginal costing**, which are used in measuring the actual performance against the target performance. This will facilitate introspection and corrective action can be taken for further improving the performance.

Q.NO.21: Write short note on Direct Expenses.

Ans:-

Meaning

These are expenses **other than material** and **labour** which can be **allocated directly** to jobs, processes, cost centres or cost units. Direct expenses are “cost other than material and wages which are incurred for a specific product or saleable services”.

Nature

- i. These are **other than material** and **labour** cost
- ii. These are **included in prime costs**.

Example

- **Hire** charges of **special machinery**
- **Royalty** on production
- **Sub –contracting** charges
- Cost of **special moulds**, designs