COST ACCOUNTING

A Comprehensive Guide for B.Com Students

STUDY NOTES & REFERENCE GUIDE

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Unit – 1

1. Ancient Indian Tradition and Business Ethics

Before modern accounting systems existed, ancient civilizations had sophisticated methods for managing resources and calculating costs.

A. Principle of Best Utilization of Resources in Ancient Indian Tradition

In ancient Indian texts, particularly Chanakya's (Kautilya's) Arthashastra, there is a heavy emphasis on the efficient use of resources. The core principle was that the state and businesses must avoid waste to maximize wealth and ensure economic stability.

- **Detailed Explanation:** Resources (land, labor, and capital) were considered sacred and scarce. The focus was on maximizing output with minimal input.
- **Example:** In agriculture or metallurgy during the Mauryan period, records were kept of raw materials issued to artisans, and the final output was weighed and measured against the input to ensure no material was stolen or wasted.

B. Product Costing in Ancient Models

- **Detailed Explanation:** Costing wasn't done using complex software, but it was highly logical. The cost of a product was determined by calculating the raw materials used, the labor time spent, and a fair margin for the artisan's livelihood.
- **Example:** A weaver's product cost would include the exact weight of cotton yarn used plus the days of labor taken to weave the cloth.

C. Relationship Between Business Ethics and Cost Control

- **Detailed Explanation:** Ancient models strictly linked ethics with business. Adulteration (mixing cheap materials to lower costs) was heavily penalized. True cost control meant improving efficiency and skill, not exploiting workers or cheating customers.
- **Example:** Lowering the cost of gold jewelry by secretly mixing it with copper was considered an ethical violation. Cost control had to be achieved through better crafting techniques, not deceit.

2. Fundamentals of Cost Accounting

A. Meaning of Cost Accounting

Cost accounting is a formal system of recording, classifying, analyzing, summarizing, and allocating costs associated with a process, product, or service. It helps management decide how to price products and control expenses.

B. Scope of Cost Accounting

The scope refers to where cost accounting is applied:

1. **Cost Ascertainment:** Finding out the exact cost of a product (e.g., How much does it cost to make one pen?).
2. **Cost Control:** Keeping expenses within a set budget.
3. **Cost Reduction:** Finding permanent ways to lower costs without affecting quality.
4. **Pricing Decisions:** Helping management set selling prices.

C. Advantages of Cost Accounting

- **Identifies unprofitable activities:** Management can see which products are making money and which are losing money.
- **Helps in inventory valuation:** Provides accurate figures for raw materials and finished goods.
- **Guides policy making:** Helps in "make or buy" decisions.
- **Example:** A shoe manufacturer uses cost accounting to realize that producing shoelaces in-house costs ₹5 per pair, but buying them from a supplier costs ₹3. The company can then decide to stop producing shoelaces to save money.

- **Cost Accounting vs. Financial Accounting**
- Students must understand how these two branches of accounting differ

Feature	Financial Accounting	Cost Accounting
Primary Audience	External parties (Investors, Banks, Govt).	Internal management (Managers, Directors).
Main Objective	To show the financial position (Profit/Loss) of the whole business.	To determine and control the cost of specific products or services.
Recording of Data	Records historical data (what has already happened).	Records both historical and estimated/future data (standard costs).
Periodicity	Reports are usually prepared annually.	Reports are prepared continuously (daily, weekly, or monthly) as needed.

B. Cost Records and Auditing Rules

- **Detailed Explanation:** Governments mandate that certain manufacturing, mining, and processing industries must maintain statutory cost records. A "Cost Audit" is an independent verification of these records to ensure the company is calculating costs correctly and following the standards.
- **Example:** A pharmaceutical company must keep strict cost records for the medicines it produces. A Cost Auditor will verify these to ensure the company is not overpricing essential drugs based on inflated cost claims.

Unit – 2

Procurement of Materials

Procurement is the systematic process of sourcing, negotiating, and acquiring the raw materials, tools, or supplies needed for a business to operate. In cost accounting, efficient procurement directly impacts the final cost of production.

- **Purchase Requisition:** The process begins when a department (like production or stores) raises a formal request for materials.
- **Supplier Selection:** The purchasing department invites tenders or quotations from approved vendors to compare prices, quality, and delivery terms.
- **Purchase Order (PO):** A legally binding document is issued to the selected supplier detailing the quantity, price, and terms of the purchase.
- **Receipt and Inspection:** Upon delivery, a Goods Received Note (GRN) is prepared. Materials are inspected for quality and quantity to ensure they match the PO.
- **Invoice Approval:** The supplier's invoice is matched against the PO and GRN before payment is released.

2. Inventory Management and Control

This involves maintaining the optimal level of inventory to ensure that production is never halted due to a shortage of materials, while simultaneously avoiding overstocking, which ties up working capital.

- **Cost Minimization:** Balancing ordering costs (freight, paperwork) and carrying costs (storage, insurance, obsolescence).
- **Key Techniques:**
    - **Economic Order Quantity (EOQ):** Calculating the ideal order size that minimizes total inventory costs.
    - **Stock Levels:** Setting Maximum, Minimum, Re-order, and Danger levels for each material to trigger timely purchases.
    - **ABC Analysis:** Categorizing inventory into A (high value, low quantity), B (moderate value and quantity), and C (low value, high quantity) to prioritize control efforts.

3. Inventory Accounting Cost Price Methods

When materials are issued from the store to the production floor, they must be priced. Since materials are purchased at different times and different prices, specific accounting methods are used to determine the cost of materials issued and the value of the closing stock.

First-In, First-Out (FIFO)

- **Concept:** Assumes that the oldest materials received are the first ones to be issued to production.
- **Impact:** The materials issued are charged at older prices, while the closing stock is valued at the latest, current market prices.
- **Best For:** Perishable goods or environments where stock physically deteriorates.

Last-In, First-Out (LIFO)

- **Concept:** Assumes that the most recently received materials are the first ones issued to production.
- **Impact:** Matches current revenues with current material costs. However, closing inventory is valued at older, often outdated prices.
- **Best For:** Periods of inflation, as it reports lower profits and defers income tax.

Highest-In, First-Out (HIFO)

- **Concept:** Assumes that the materials with the highest purchase cost are issued first, regardless of when they were purchased.
- **Impact:** Production costs are kept at their maximum, which conservatively lowers reported profit and minimizes the value of closing stock.
- **Best For:** Highly volatile markets or cost-plus contract pricing.

Average Cost Method

- **Simple Average:** Takes the average of all the different purchase prices available in stock, ignoring the quantities bought at each price. (e.g., Prices of $10, $12, and $14 average out to $12).
- **Weighted Average:** Total cost of all materials in stock is divided by the total quantity in stock. This creates a smoothed-out issue price that updates every time a new batch is purchased.

Inflated Price Method

- **Concept:** Used when there is a normal, unavoidable loss of material during storage (e.g., evaporation of chemicals, shrinkage).
- **Application:** The total purchase cost is divided by the actual surviving quantity rather than the original purchased quantity. This artificially inflates the per-unit issue price so that the cost of the lost material is automatically absorbed by the production process.

4. Physical Verification

Physical verification is the process of physically counting, measuring, or weighing the actual inventory on hand and comparing it with the stock ledger (book records).

- **Periodic Inventory:** Counting all stock at the end of an accounting period (e.g., annually).
- **Perpetual Inventory:** A system of continuous checking where different sections of the store are checked daily or weekly throughout the year.
- **Purpose:** To detect discrepancies, identify theft, spot accounting errors, and ensure financial statements are accurate.

5. Slow and Non-Moving Stock

Identifying and managing inventory that is not being utilized efficiently.

- **Slow-Moving Stock:** Materials that have a very low turnover rate and are rarely issued to production.
- **Non-Moving Stock (Dead Stock):** Items that have not been issued at all over a long period. They may be obsolete.
- **Treatment:** These tie up valuable capital and storage space. Management must decide whether to sell them at a discount, scrap them, or find alternative uses to recover funds.

6. Treatment of Losses

In any manufacturing process, some material will inevitably be lost or damaged. Cost accounting strictly categorizes these losses to determine how they impact profitability.

Scrap

- **Concept:** Incidental residue or by-products from the manufacturing process (e.g., metal shavings, sawdust, fabric offcuts).

- **Treatment:** Scrap usually has a small realizable (sale) value. The income generated from selling scrap is generally deducted from the cost of materials or credited to factory overheads to reduce overall production costs.

Spoilage

- **Concept:** Goods that are damaged beyond repair during the production process. They do not meet quality standards and cannot be fixed economically.
- **Treatment:** Depending on the nature of the spoilage, it is classified as either normal or abnormal (see Wastage rules below).

Defectives

- **Concept:** Products that fail to meet quality standards but can be repaired or reworked by applying additional labor or materials.
- **Treatment:** The extra cost incurred to rectify defective units (rework cost) is usually charged to factory overheads if it is a normal occurrence, or to a specific job if the defect was unique to that order.

Normal vs. Abnormal Wastage

Wastage refers to material lost in the process (like evaporation, dust, or shrinkage) that has zero recovery value.

- **Normal Wastage:**
  - **Concept:** An expected, unavoidable loss inherent to the manufacturing process.
  - **Accounting Treatment:** The cost of normal wastage is absorbed by the "good" units produced. The total cost is spread over fewer completed units, increasing the per-unit cost.
- **Abnormal Wastage:**
  - **Concept:** An unexpected loss arising from inefficiency, machine breakdown, substandard materials, or negligence.
  - **Accounting Treatment:** It is not fair to charge customers for internal inefficiencies. Therefore, the cost of abnormal wastage is completely separated from production costs and transferred directly to the **Costing Profit and Loss Account** as a loss for the period.

Unit – 3

1. Accounting and Control of Labour Cost

Labor is a primary element of cost in manufacturing and services. Controlling it ensures that the business remains profitable and competitive.

- **Accounting:** This involves recording the total cost of labor, allocating it to specific jobs, processes, or departments, and differentiating between direct labor (traceable to a product) and indirect labor (factory overheads).
- **Control:** This is a coordinated effort across multiple departments to optimize labor productivity and minimize wasted time and costs.
    - Personnel Department: Hiring the right people at the right wage rates.
    - Engineering Department: Setting standard times for jobs and designing efficient workflows.
    - Time-keeping & Payroll: Accurately recording attendance and calculating wages.
    - Cost Accounting: Analyzing labor cost variances (actual vs. budgeted) and identifying areas of inefficiency.

2. Time Keeping

Time keeping is the fundamental process of recording the exact time workers arrive at and depart from the factory.

- **Purpose:** It serves as the legal basis for attendance, is essential for calculating the total hours worked for payroll, helps maintain workplace discipline, and helps meet statutory requirements.

- **Methods:**
    - Manual: Muster rolls or attendance registers maintained by a supervisor.
    - Mechanical: Time-recording clocks where workers punch in their timecards.
    - Electronic: Biometric systems (fingerprint or face recognition) and RFID swipe cards, which integrate directly with payroll software.

3. Time Booking

While time keeping records how long a worker was in the factory, time booking records exactly **what** the worker was doing during those hours.

- **Purpose:** Essential for cost accounting. It allows the business to allocate labor costs directly to the specific jobs, batches, or processes the worker was assigned to. It also highlights the difference between time attended and time worked (which reveals idle time).
- **Documents Used:**
    - Daily/Weekly Time Sheets: The worker logs their hours against specific job numbers.
    - Job Cards: A card that follows a specific job, where each worker records the time they spent working on it.

4. Payroll

Payroll is the administrative and accounting process of calculating and distributing employee compensation.

- **Calculation:** Total Wages = Regular Pay + Overtime + Allowances + Bonuses.
- **Deductions:** The payroll department must legally deduct taxes, provident fund (PF) contributions, Employee State Insurance (ESI), and any advance recoveries.
- **Output:** The process generates the Payroll Register (a master summary of all employee wages) and individual Payslips given to the employees.

5. Overtime

Overtime refers to the time a worker spends working beyond their normal, stipulated working hours.

- **Overtime Premium:** By law, overtime is usually paid at a premium rate (e.g., double the normal hourly wage).
- **Accounting Treatment:**

- If overtime is done at the specific request of a customer to rush an order, the extra cost is charged directly to that customer's job.
- If overtime is required due to general factory pressure or seasonal demand, the premium is treated as a general factory overhead.
- If overtime is forced due to abnormal reasons (like a machine breakdown delaying work), the premium is charged as a loss to the Costing Profit & Loss Account.

6. Idle Time

Idle time represents the time for which workers are paid, but no actual production takes place.

- **Normal Idle Time:** Unavoidable lost time inherent in the workday, such as walking from the gate to the machine, machine setup times, and mandatory tea/lunch breaks.
  - Treatment: The cost of this time is absorbed by inflating the hourly labor rate charged to "good" production units.
- **Abnormal Idle Time:** Avoidable lost time caused by inefficiencies, such as power failures, raw material shortages, machine breakdowns, or strikes.
  - Treatment: Since it is abnormal, it should not inflate product costs. It is transferred directly to the Costing Profit & Loss Account as a dead loss.

7. Labour Turnover

Labour turnover is the rate at which employees leave the organization and require replacement. High turnover is costly.

- **Causes:**
  - Personal: Marriage, relocation, finding a better job.
  - Unavoidable: Retirement, prolonged illness, death.
  - Avoidable: Low wages, toxic work environment, poor management, lack of safety.
- **Associated Costs:**
  - Preventive Costs: Money spent to keep workers happy (medical benefits, welfare programs, good canteens) to stop them from leaving.

- Replacement Costs: Money wasted when workers leave (recruitment advertising, interviewing, training new hires, and the initial low productivity and high scrap rates of new workers).

8. Fringe Benefits

These are supplementary compensations provided to employees in addition to their basic wages.

- **Examples:** Paid holidays, subsidized canteens, medical insurance, housing allowances, and employer contributions to retirement funds.
- **Treatment:** Fringe benefits are generally treated as part of the overall labor cost and apportioned as factory overheads, as they are a necessary cost of maintaining the workforce.

9. Employee Cost Reporting

This involves compiling data on labor costs and presenting it to management to facilitate decision-making and cost control.

- **Common Reports:**
  - Idle Time Reports: Highlighting areas where time is being wasted.
  - Overtime Reports: To monitor if supervisors are overusing expensive overtime.
  - Labour Turnover Reports: To flag retention issues in specific departments.
  - Efficiency Reports: Comparing actual time taken by workers against the standard allowed time.

10. Methods of Wage Payments and Incentive Schemes

To motivate workers to produce more in less time, various payment plans are utilized.

- **Time Rate System:** Workers are paid strictly based on time spent (e.g., $15/hour), regardless of how much they produce.
- **Piece Rate System:** Workers are paid strictly based on units produced (e.g., $2 per unit), regardless of how long it takes.
- **Incentive Schemes (Premium Bonus Plans):** These combine guaranteed time wages with bonuses for efficiency.

- **Halsey Premium Plan:** A standard time is set for a job. The worker is paid their normal hourly rate for the time they actually take. If they finish early (Time Saved), they get a bonus. The bonus is usually 50% of the wages of the time saved.
  - Bonus Formula: 50% × Time Saved × Hourly Rate.
- **Rowan Premium Plan:** Similar to Halsey, it guarantees a time wage. However, the bonus is calculated as a proportion of the time taken, based on the ratio of time saved to the standard time. It protects the employer from paying excessive bonuses if standard times are set incorrectly.
  - Bonus Formula: (Time Saved / Standard Time) × Time Taken × Hourly Rate.
- **Taylor's Differential Piece Rate System:** Introduced by F.W. Taylor (Scientific Management). This system does not guarantee a daily wage. Instead, it sets a strict standard output. It uses two piece-rates:
  - Low Rate: If a worker produces below standard, they get a lower piece rate (punishing inefficiency).
  - High Rate: If a worker produces at or above standard, they get a significantly higher piece rate (rewarding high efficiency).

Unit – 4

1. Classification of Overhead Expenses

Overheads are indirect costs—comprising indirect materials, indirect labor, and indirect expenses—that cannot be directly traced to a specific unit of production. They are classified to help managers control costs effectively.

- **By Function:**
  - **Factory/Manufacturing Overheads:** All indirect costs incurred inside the factory (e.g., factory rent, machinery depreciation, supervisor salaries, factory power).
  - **Office & Administration Overheads:** Costs related to management and general administration (e.g., office stationery, manager salaries, legal fees, audit fees).

- **Selling & Distribution Overheads:** Costs incurred to create demand and deliver products to customers (e.g., advertising, sales commissions, delivery van maintenance, showroom expenses).

- **By Behavior (Variability):**
  - **Fixed Overheads:** Costs that remain constant in total, regardless of production volume (e.g., building rent, insurance).
  - **Variable Overheads:** Costs that change in direct proportion to the volume of output (e.g., indirect materials, packing supplies).
  - **Semi-Variable Overheads:** Costs containing both fixed and variable elements (e.g., electricity bills with a fixed meter charge plus a usage charge).

2. Allocation and Absorption of Overhead Expenses

Because overheads cannot be traced directly to a single product, they must be systematically assigned to products through a multi-step process.

- **Allocation:** This is the process of charging the entire amount of an overhead item directly to a specific department or cost center. This happens when the expense is exclusively identifiable with that department (e.g., depreciation of a machine used solely in the cutting department).
- **Apportionment:** When an overhead cost is common to multiple departments, it must be distributed among them using a fair and logical basis (e.g., sharing total factory rent among departments based on the square footage each occupies).
- **Absorption (Recovery):** This is the final step where the accumulated overheads of a production department are charged to the actual jobs, products, or units passing through it. This is done using an **Overhead Absorption Rate (OAR)**, calculated using bases like direct labor hours, machine hours, or a percentage of direct wages.

3. Under and Over Absorption

Because Overhead Absorption Rates (OAR) are calculated at the beginning of the year based on estimates (budgeted overheads and budgeted hours), a discrepancy usually arises by the end of the year when compared to actuals.

- **Under-Absorption:** Occurs when the Actual Overheads incurred are greater than the Overheads Absorbed into production. This means the products were under-costed, which inflates reported profits artificially.

- **Over-Absorption:** Occurs when the Overheads Absorbed into production are greater than the Actual Overheads incurred. This means products were over-costed.
- **Accounting Treatment:** Small discrepancies are typically written off directly to the Costing Profit & Loss Account. Large discrepancies caused by estimating errors or major disruptions may require recalculating product costs using a "supplementary rate."

4. Capacity Level of Cost

Overhead rates are highly sensitive to the assumed production capacity. If you spread fixed overheads over a small number of expected units, the cost per unit skyrockets. Different levels of capacity include:

- **Theoretical (Maximum) Capacity:** Assumes 100% efficiency with no breakdowns, holidays, or delays. It is practically impossible to achieve.
- **Practical Capacity:** Theoretical capacity minus unavoidable normal losses of time (e.g., Sundays, routine maintenance, setup time).
- **Normal Capacity:** The average expected utilization of the plant over a long period (e.g., 3-5 years) that smooths out seasonal and cyclical fluctuations. This is the most common capacity used for determining overhead absorption rates.
- **Actual Capacity:** The physical volume of production actually achieved in a specific given period.

5. Treatment of Certain Items in Costing

Cost accounting differs from financial accounting. Not all financial expenses belong in a product's cost.

- **Interest on Capital:** Highly debated. Traditionally, it is considered a financial matter (a distribution of profit or cost of financing) and is **excluded** from cost accounts. However, it may be included for internal decision-making when comparing the profitability of projects requiring vastly different capital investments.
- **Packaging Expenses:**
    - Primary Packaging: Essential for the product's existence or basic handling (e.g., a tube for toothpaste, a bottle for liquid medicine). Treated as a **Direct Material Cost**.
    - Secondary/Transit Packaging: Used solely for safe transportation or marketing appeal (e.g., large corrugated shipping boxes, decorative gift wrappers). Treated as **Selling & Distribution Overhead**.

- **Bad Debts:** Generally viewed as an abnormal financial loss and **excluded** from cost accounts. However, if selling on credit is standard industry practice, a normal level of expected bad debts might be treated as a Selling Overhead.
- **Research and Development (R&D) Expenses:**
    - Basic or pure research (not related to a specific product) is usually treated as a general administration overhead or written off to the Costing P&L.
    - Applied research or development costs tied to a specific, successful new product are often capitalized and amortized (spread out) over the useful life of that product.

6. Calculation of Unit Costing and Preparation of Cost Sheet

Unit costing is used by industries producing identical, homogeneous goods continuously (e.g., cement, bricks, sugar). The objective is to find the cost per unit by dividing the total cost by the number of units produced. This is documented in a **Cost Sheet**.

- **The Structure of a Cost Sheet:**
    1. **Prime Cost:** Direct Material Consumed + Direct Labor + Direct Expenses.
    2. **Factory Cost (Works Cost):** Prime Cost + Factory Overheads (+ Opening WIP - Closing WIP).
    3. **Cost of Production:** Factory Cost + Office & Administration Overheads.
    4. **Cost of Goods Sold (COGS):** Cost of Production + Opening Stock of Finished Goods - Closing Stock of Finished Goods.
    5. **Cost of Sales (Total Cost):** COGS + Selling & Distribution Overheads.
    6. **Profit or Loss:** Sales Revenue - Cost of Sales.

7. Job Costing

Unlike unit costing (where mass quantities of identical items are produced), Job Costing is used when production is non-continuous and every order is custom-made to the customer's specific requirements.

- **Concept:** Each specific job or order is treated as a distinct "cost unit."
- **Execution:** A separate "Job Cost Card" or job account is opened for every order. All direct materials, direct labor, and a specific share of overheads are charged individually to that card.

- **Suitability:** Ideal for printing presses, custom furniture manufacturers, shipbuilders, automobile repair shops, and interior decorators.

Unit – 5

1. Contract Costing

Contract costing is a specialized variation of job costing applied to large, long-term projects that take substantial time to complete and frequently span across multiple accounting periods.

- **Application:** Primarily used in construction and engineering industries for projects like building dams, bridges, highways, or large residential complexes.
- **Site-Based Execution:** Unlike factory-based job costing, the work is executed at the customer's site (the contract site).
- **Contract Account:** A separate ledger account is opened for each distinct contract to track its specific profitability.
- **Direct Cost Heavy:** Most expenses (materials delivered to the site, labor hired specifically for the site, special machinery) are direct costs and are debited straight to the specific Contract Account. Overheads play a relatively minor role compared to standard manufacturing.
- **Work in Progress (WIP):** Because contracts span years, at the end of an accounting year, the unfinished work is valued in two parts:
    - **Work Certified:** The portion of work completed and officially approved by an independent architect or surveyor.
    - **Work Uncertified:** Work completed by the contractor but not yet inspected or approved by the architect.

2. Sub Contract Costing

In large contracts, the main contractor may not have the expertise or resources to handle every single aspect of the project.

- **Concept:** The main contractor outsources or delegates a specialized, specific portion of the work to a third party, known as the sub-contractor.
- **Examples:** A general builder outsourcing the electrical wiring, plumbing, or elevator installation to specialized firms.
- **Accounting Treatment:** The relationship is strictly between the main contractor and the sub-contractor. Any payments made to the sub-contractor are treated as a direct expense and debited directly to the main Contract Account.

3. Process Costing (Excluding Process Losses)

Process costing is utilized when a product undergoes a continuous, sequential series of operations before emerging as a finished good.

- **Application:** Ideal for mass-production industries manufacturing identical units, such as textiles, oil refineries, sugar mills, and chemical plants.
- **Sequential Costing:** The production is divided into distinct stages or "processes." A separate account is maintained for each.
- **Transfer of Costs:** The output of Process A becomes the raw material input for Process B. Consequently, the total cost incurred in Process A is transferred to the debit side of Process B's account.
- **Unit Cost Calculation:** At each stage, the cost per unit is calculated by dividing the total cost of that specific process by the total number of good units produced in it.
- **Scope Note:** Based on this specific syllabus requirement, complex calculations regarding normal wastage, abnormal losses, or abnormal gains during transit between these continuous stages are excluded.

4. Joint and By-products

In many process industries, the processing of a single raw material simultaneously yields multiple different products. Differentiating them is key for cost allocation.

- **Joint Products:** * These are two or more products produced simultaneously from the same raw material, which hold relatively equal economic importance and high sales value.
    - **Example:** Refining crude oil yields petrol, diesel, and aviation fuel as joint products.
    - **Costing Challenge:** The combined costs incurred up to the "split-off point" (where the products become separately identifiable) must be logically apportioned among the joint products using methods like physical volume or relative sales value.
- **By-products:** * These are secondary products that emerge incidentally during the manufacturing of the main product. They have a relatively minor economic value compared to the main product.
    - **Example:** Molasses generated during the production of crystal sugar, or sawdust in a timber mill.
    - **Treatment:** The minor revenue generated from selling by-products is usually deducted from the main process's cost of production.

5. Activity - Workshops (Business Tools)

Moving beyond theoretical frameworks, hands-on workshops are essential to bridge the gap between academic cost accounting and real-world corporate execution.

- **ERP Systems (Tally & SAP):** Training students on these platforms demonstrates how modern businesses automate the recording of overheads, assign costs to specific cost centers, and instantly generate comprehensive cost sheets or payroll reports.
- **Advanced Spreadsheet Modeling:** Alongside dedicated software, teaching students how to build dynamic cost models, automate variance analysis, and design interactive dashboards using advanced Excel functions provides them with highly versatile analytical skills that are universally valued in financial and administrative roles.
- **Objective:** This practical exposure transitions students from simply calculating costs on paper to actively managing and interpreting financial data using the exact technological tools they will encounter in the workforce.

Unit – 6

1. Operating Cost Accounting (Service Costing)

Operating Costing, also known as Service Costing, is a method of cost accounting used by organizations that provide services rather than manufacture tangible goods. The goal is to determine the cost of providing a specific unit of service.

- **Key Feature:** Because services are intangible, defining a "cost unit" is more complex than in manufacturing. Cost units are often **composite** (a combination of two variables), such as "passenger-kilometer" or "room-day."

A. Transportation Costing

Used by transport undertakings like bus companies, railways, airlines, and logistics/trucking firms to calculate the cost of carrying passengers or goods.

- **Cost Unit:** * *Passenger Transport:* Passenger-kilometer (cost of carrying one passenger for one kilometer).
    - *Goods Transport:* Tonne-kilometer (cost of carrying one tonne of goods for one kilometer).
- **Cost Classification:** Expenses are strictly grouped into three categories to build an operating cost sheet:
    1. **Standing Charges (Fixed Costs):** Costs incurred regardless of whether the vehicle moves. Examples: Road tax, vehicle insurance, garage rent, depreciation (if based on time), manager's salary.
    2. **Running Charges (Variable Costs):** Costs directly proportional to the distance traveled. Examples: Fuel (petrol/diesel), oil, depreciation (if based on mileage).
    3. **Maintenance Charges (Semi-Variable Costs):** Costs related to keeping the vehicle in working order. Examples: Repairs, tire replacements, spare parts, mechanic's wages.

B. Hotel Service Costing

Used by the hospitality industry (hotels, motels, resorts) to determine the cost of providing lodging and related amenities, which helps in fixing room tariffs.

- **Cost Unit:** "Room-day" or "Guest-day" (cost of maintaining one room for one day).

- **Cost Centers:** Large hotels divide costs among various departments, such as Accommodation (Rooms), Restaurant, Laundry, and Spa.
- **Cost Classification:**
    - **Fixed Costs:** Building depreciation, property taxes, salaries of permanent administrative and reception staff.
    - **Variable Costs:** Electricity consumed per occupied room, complimentary toiletries, laundry for bed linens, housekeeping supplies.
- **Occupancy Rate:** This is a critical metric. Hotels rarely operate at 100% capacity year-round. Costs must be spread over the *expected occupancy rate* (e.g., 70% of total rooms) to ensure the room tariff covers total costs even during off-peak seasons.

2. Integral and Non-Integral Cost Accounting

These are the two fundamental systems used by companies to maintain their accounting records.

Non-Integral Cost Accounting (Interlocking System)

- **Concept:** The company maintains **two separate sets of books**: one for Financial Accounting (focusing on overall profit/loss for external stakeholders) and one for Cost Accounting (focusing on product/job costs for internal management).
- **Features:** * Cost books only record transactions related to manufacturing and operations (materials, labor, overheads).
    - They ignore purely financial items like dividends, taxes, or interest on loans.
    - Because they are separate, they use "Control Accounts" (like the General Ledger Adjustment Account) to complete the double-entry bookkeeping cycle within the cost ledger.
- **Drawback:** Inevitably leads to two different profit figures at the end of the year, necessitating a complex reconciliation process.

Integral Cost Accounting (Integrated System)

- **Concept:** A **single, combined accounting system** that records both financial and cost transactions in one set of books.
- **Features:**
    - Eliminates the duplication of effort of maintaining two separate ledgers.

- Provides management with complete information (both financial and operational) from a single source.
- **No Reconciliation Needed:** Because there is only one set of books, there is only one profit figure.
- Relies heavily on computerized ERP systems (like SAP or Tally) due to the large volume of data coded for both financial categories and cost centers.

3. Reconciliation of Cost Accounting Records with Financial Accounts

When a company uses the **Non-Integral system**, the profit shown by the Cost Accounts will almost always differ from the profit shown by the Financial Accounts. Reconciliation is the process of identifying and explaining these differences to verify the accuracy of both sets of books.

- **Reasons for Disagreement:**
  1. **Purely Financial Charges (Not in Cost Accounts):** Income tax, dividends paid, interest on bank loans, penalties, and losses on the sale of fixed assets. These reduce financial profit but do not affect cost profit.
  2. **Purely Financial Incomes (Not in Cost Accounts):** Interest received on investments, rent received from subletting, dividends received. These increase financial profit but are ignored in cost accounts.
  3. **Purely Costing Items (Not in Financial Accounts):** Notional (imaginary) costs, such as rent for a self-owned factory building or interest on self-owned capital. These reduce cost profit but are not actual cash outflows in financial accounts.
  4. **Different Valuation of Inventory:** Financial accounts usually value closing stock at "Cost or Market Price, whichever is lower" (conservatism). Cost accounts value it strictly at the Cost of Production.
  5. **Over/Under Absorption of Overheads:** Cost accounts charge overheads based on *predetermined estimates* (rates). Financial accounts record the *actual* cash spent. This difference directly impacts the profit margins in each ledger.
- **The Process:** A "Memorandum of Reconciliation" statement is prepared. You typically start with the "Profit as per Cost Accounts" and add or deduct the differing items to systematically arrive at the "Profit as per Financial Accounts" (similar to a bank reconciliation statement).

COST ACCOUNTING

A Comprehensive Guide for B.Com Students

This essential text provides B.Com students with a clear and concise liat path to mastering Cost Accounting principles. From foundational cost concepts to advanced methodologies, every chapter is designed for academic clarity and practical understanding. Packed with solved examples, comprehensive diagrams, and review questions, it is your definitive guide to academic success and professional preparation.

STUDY NOTES & REFERENCE GUIDE