COST ACCOUNTING

MODULE – 1

Conceptual framework of Cost Accounting: Basic Concepts of Cost Accounting, Objectives, Importance and Advantages of Cost Accounting, Cost Centre, Cost Unit, Elements of Cost, Classification and Analysis of Costs, Relevant and Irrelevant Costs, Differential Costs, Sunk Cost, Opportunity Cost. Unit & Output Costing - Preparation of Cost Sheet and Tender/Quotations.

Basic Concepts of Cost Accounting

Definition: Cost accounting is a branch of accounting that **records, analyzes, and controls costs** to help businesses **reduce expenses and improve profitability**.

Key Elements of Cost Accounting:

Element	**Description**	**Example**
Cost	The amount spent on resources to produce goods/services.	**$50,000 spent on raw materials.**
Cost Center	A department or unit where costs are incurred.	**Production department in a factory.**
Cost Object	Any product, service, or process that costs are assigned to.	**Manufacturing a smartphone.**
Direct Cost	Costs that can be directly traced to a product/service.	**Raw materials, labor.**
Indirect Cost	Costs that cannot be traced directly to a specific product.	**Rent, utilities, salaries of managers.**

2. Objectives of Cost Accounting

- **Determine the Cost of Production** – Helps set the right price for products.
- **Control Costs** – Identifies areas to reduce waste and inefficiency.
- **Aid in Decision-Making** – Helps management decide pricing, budgeting, and investment strategies.
- **Profitability Analysis** – Determines which products or services are more profitable.
- **Budgeting & Forecasting** – Assists in planning future expenses.
- **Inventory Valuation** – Helps in determining the value of raw materials and finished goods.

Importance of Cost Accounting

- **Helps in Cost Reduction** – Identifies areas where costs can be minimized.
- **Improves Efficiency** – Tracks production processes for better resource utilization.
- **Enhances Profitability** – Ensures that products are priced appropriately.
- **Aids in Decision-Making** – Provides data-driven insights for financial planning.
- **Assists in Financial Reporting** – Helps in preparing accurate financial statements.

Advantages of Cost Accounting

Advantage	Explanation	Example
Cost Control	Helps track and manage costs to avoid overspending.	**A company reduces energy consumption to save costs.**
Profit Maximization	Identifies the most profitable products/services.	**McDonald's analyzes which menu items bring the highest profit.**
Better Decision-Making	Provides accurate data for financial planning.	**A company decides whether to manufacture or outsource production.**
Budget Preparation	Helps businesses create budgets for future expenses.	**A factory estimates material costs for the next year.**
Inventory Management	Tracks raw material and finished goods costs.	**Amazon optimizes its warehouse stock using cost data.**
Prevents Fraud	Identifies discrepancies in financial records.	**Internal audits detect unnecessary spending.**

Cost Centre

Definition: A **Cost Centre** is a **department, location, or function** within an organization where costs are incurred but not directly linked to revenue generation.

Types of Cost Centres:

Type	**Description**	**Example**
Production Cost Centre	Involved in manufacturing.	**Assembly line in an automobile factory.**
Service Cost Centre	Supports production but doesn’t produce goods.	**Maintenance or IT department.**
Personal Cost Centre	Associated with employees or workforce.	**HR department.**
Impersonal Cost Centre	Associated with equipment or locations.	**Machinery unit in a factory.**

Cost Unit

Definition: A **Cost Unit** is the **unit of measurement** of cost for a product or service. It helps in determining the **cost per unit**.

Examples of Cost Units:

Industry	Cost Unit Example
Automobile	Cost per **car/bike**
Textile	Cost per **meter of fabric**
Hospital	Cost per **patient/day**
Transport	Cost per **kilometer traveled**

Elements of Cost

Cost is divided into three main elements:

Element	Description	Example
Material Cost	Cost of raw materials used in production.	**Steel used in car manufacturing.**
Labour Cost	Wages paid to workers involved in production.	**Factory workers' salaries.**
Overhead Cost	Indirect costs like rent, electricity, etc.	**Factory rent, utilities, and administration.**

Classification & Analysis of Costs

Costs can be classified based on **behavior, traceability, function, and time**.

Basis of Classification	Types of Costs	Example
By Behavior	Fixed, Variable, Semi-variable	Rent (Fixed), Raw material (Variable)
By Traceability	Direct, Indirect	Paint for a car (Direct), Factory rent (Indirect)

Basis of Classification	Types of Costs	Example
By Function	Production, Administration, Selling & Distribution	Sales commission (Selling cost)
By Time	Historical, Future, Standard	Last year's costs (Historical), Budgeted costs (Future)

Relevant & Irrelevant Costs: Costs are categorized based on their impact on **decision-making**.

Cost Type	Description	Example
Relevant Cost	A cost that affects future business decisions.	Additional material cost for a special order.
Irrelevant Cost	A cost that does not change a business decision.	Past R&D expenses on a discontinued product.

Differential Cost: The difference in **total cost between two alternatives**.

Option	Total Cost
In-House Production	$50,000
Outsourcing	$40,000
Differential Cost	**$10,000 Savings**

Sunk Cost: Past expenses that **cannot be recovered** and should **not affect future decisions**.

Opportunity Cost: The **benefit lost** when choosing one alternative over another.

Option	Benefit
Start a Business	Potential profit
Keep Money in Bank	Earn 5% interest ($2,500 per year)
Opportunity Cost	$2,500

Introduction to Unit & Output Costing

Definition: Unit & Output Costing is a costing method used to **ascertain the cost per unit of a product**. It is mainly used in **industries where production is continuous**, such as **cement, textiles, steel, and automobiles**.

Applicability:

- Used in **manufacturing industries** where identical units are produced.
- Helps in **pricing decisions** and cost control.

Preparation of a Cost Sheet

Definition: A **Cost Sheet** is a detailed statement that shows the **total cost and per-unit cost** of production. It helps in tracking **materials, labor, and overhead expenses**.

Format of Cost Sheet

M/s Company Name

Cost Sheet as on date------

Particulars	**Amount ($)**
Prime Cost	
Direct Material	XX
Direct Labour	XX
Direct Expenses	XX
Prime Cost (A)	XX
Factory Cost	
Prime Cost (A)	XX
Add: Factory Overheads	XX
Factory Cost (B)	XX
Cost of Production	
Factory Cost (B)	XX
Add: Administrative Overheads	XX

Particulars	Amount ($)
Total Cost of Production (C)	XX
Cost of Sales	
Cost of Production (C)	XX
Add: Selling & Distribution Overheads	XX
Total Cost (D)	XX
Add: Profit	XX
Selling Price	XX

Tender and Quotations

Definition: A **tender or quotation** is an **estimate of cost and price** provided by a business to a customer before accepting an order.

Purpose of Tenders & Quotations:

- Helps in **bidding for projects** in competitive industries.
- Ensures **profitability** by including all costs + desired profit.
- Used in **government and private contracts** (e.g., construction, manufacturing).

Formula for Quotation Price:

$$\text{Quotation Price} = \text{Total Cost} + \text{Profit Margin}$$