Unit 1. Basic Concept in Cost
Meaning & Terminology

Cost

‘Cost’ may be defined as

- The amount of expenditure (actual or notional) incurred on or attributable to a given thing; or
- To ascertain the cost of a given thing.

Cost represents the resources that have been or must be sacrificed to attain a particular objective. In other words, cost is the amount of expenditure, actual or notional, incurred on or attributable to a given product or service.
COSTING

Costing may be defined as “The techniques & process of ascertaining costs”.

Costing involves in classification, recording, allocation, appropriation of expenses incurred to facilitate the determination of cost of the product or service.

COST ACCOUNTING

Cost accounting is the process of accounting for cost. It is regarded as a specialized branch of accounting, which involves classification, accumulation, assignment & control of costs.
Meaning & Terminology

Cost Accountancy

- Cost Accountancy is the application of accounting & costing principles, methods & techniques in the ascertainment of costs & the analysis of savings & excess as compared with previous experience or with standards.

Cost Unit

- CIMA defines as “a quantitative unit of product or service in relation to which costs are ascertained”. A ‘cost unit’ is a unit of product or unit of service to which costs are ascertained by means of allocation, apportionment & absorption. It is a unit of quantity of product, service or time or a combination of these in relation to which cost are expressed or ascertained. For Ex. Specific job, contract, unit of product like fabrication job, road construction contract, etc.
Some of the examples of Cost Units

<table>
<thead>
<tr>
<th>Industry/ Product/ Activity</th>
<th>Cost Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brick making</td>
<td>1000 bricks</td>
</tr>
<tr>
<td>Automobile</td>
<td>Automobile unit manufactured</td>
</tr>
<tr>
<td>Cement</td>
<td>Tonne of cement</td>
</tr>
<tr>
<td>Coal</td>
<td>Tonne of coal</td>
</tr>
<tr>
<td>Electricity</td>
<td>Kilowatt-hour (Kwh.)</td>
</tr>
<tr>
<td>Professional service</td>
<td>Chargeable hour</td>
</tr>
<tr>
<td>Education</td>
<td>Enrolled Students</td>
</tr>
</tbody>
</table>
Meaning & Terminology

Cost Object

- Cost object is defined as “any activity for which a separate measurement of costs is desired”

- For example, ascertainment of cost of a particular branded product, particular area of sales.
**COMPARISON**

**Cost Accounting**
- It is an internal reporting system for an organization’s decision making.
- It is concerned with short-term planning & its reporting period is much lesser than Financial Accounting.
- It not only deals with historic data but also futuristic in approach.

**Financial Accounting**
- Related with reporting the results & position of business to persons & authorities other than management like government; creditors, etc.
- The periodicity of reporting in Financial Accounting is much wider.
- The Financial Accounting data is historical in nature.
**Comparison**

**Cost Accounting**
- Cost Accounting system cannot be installed without proper Financial Accounting System.
- It aims at ascertainment of costs & accumulates data for this very purpose.
- It deals partly with facts & figures & partly with estimates.
- Costs are broken into unit basis.

**Financial Accounting**
- Financial Accounting System can be installed without proper Cost Accounting System.
- It emphasizes the measurement of profitability.
- It deals mainly with actual facts & figures.
- The costs are reported in aggregate.
<table>
<thead>
<tr>
<th><strong>Cost Accounting</strong></th>
<th><strong>Financial Accounting</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>It renders information for the guidance of the management for proper planning, operation, control &amp; decision making.</td>
<td>It aims at safeguarding the interests of the business &amp; its properties &amp; others connected with it.</td>
</tr>
<tr>
<td>It uses with both monetary, as well as non-monetary (quantitative) information.</td>
<td>Monetary information is only used in Financial Accounting.</td>
</tr>
<tr>
<td>The items of costs are analyzed, classified in order to ascertain the cost per unit of product or service.</td>
<td>The items of costs are expressed in totals.</td>
</tr>
</tbody>
</table>
OBJECTIVES OF COST ACCOUNTING

- To ascertain the cost per unit of production.
- To help in determining the selling price.
- To help in cost control & cost reduction.
- To ascertain the cost & profitability of each division, unit, activity, center, etc.
- To assist the management in decision making.
- To provide a basis for operating policies.
- To inform about inefficiency & carelessness.
- To inform the real situation of production activity.
- To provide basis for comparative analysis through data collection.
- To facilitate cost estimation.
PRACTICAL DIFFICULTIES IN INSTALLATION

➢ **Lack of Support from Top Management**: The basic objective of Cost Accounting System is to provide necessary information to the internal management for the purpose of problem solving, decision making & control. Without necessary support from top management, the very purpose of Cost System is vitiated.

➢ **Resistance from Existing Accounting Staff**: The existing accounting staff may resist the introduction of Cost Accounting System in the organization due to fear of losing job recognition & importance after the implementation of the system.

➢ **Uneconomical Cost System**: Sometimes the detailed cost system proposed to be installed may cause substantial installation & operating cost.
PRACTICAL DIFFICULTIES IN INSTALLATION

➢ **Lack of Cooperation from other Departments:**- The employees of other departments may not cooperate for installation of Cost Accounting System due to fear of increase in work load, bring-out inefficiency etc.

➢ **Resistance from Operating Level Workers:**- The foreman, supervisors, workers & other operating level staff may resent the introduction of cost system on the ground that it will increase their job responsibilities and paper work & may fear that it may change in wage structure.

➢ **Shortage of Trained Staff:**- The installation & implementation of cost system requires trained, qualified & experienced staff which may be shortage.
LIMITATIONS OF COST ACCOUNTING

a) It is the base for taking best decisions, but it does not give outright solution to the problem.
b) Cost varies with purpose.
c) Cost Accounting is not an exact science, it involves inherent elements of judgment.
d) It lacks a uniform procedure.
e) Existence of numerous methods which may lead to cost differences & it is difficult to ascertain true cost of product or service.
f) Based on some presumed notions.
g) Small & medium concerns may not be in a position to install a costing system.
HAPPY LEARNING

END