COST CONTROL ACCOUNTS

Meaning:

In many firms here is a separate Costing Department which maintains an independent set of books as compared to that maintained by Finance or Accounting Department. This is very often referred to an interlocking system.

An interlocking system is a method of recording accounting transactions in two sets of ledgers - a financial ledger and a cost accounting ledger. The financial accounts ledger will contain all of the transactions of the business whereas the cost accounting ledger will only contain those accounts and transactions relating to costs.

In the Costing Books, only nominal accounts, eg. Income and expenses, losses and gains etc., and, to some extent, real accounts are recorded. Costing Department is concerned with income and expenditure relating to business carried on. Here transactions are entered into on the basis of double entry book keeping principle - every debit must have a corresponding credit. It is generally the responsibility of the Cost Accountant to record the costing transactions.

Special Advantages of maintaining Cost Ledger:

1] With the growth of any business, it is impossible to keep track of all transactions. Cost control accounts will summarize masses of detailed information contained in subsidiary records. The control accounts are therefore, invaluable to management in policy formulation.

2] It facilitates prompt preparation of costing profit and loss account and helps management to know results of operations of the firm.

3] A system of internal check exists through the use of various control accounts. This helps in detecting errors and thus maintaining accuracy.

4] Due to maintenance of cost accounts separately, it is possible to maintain confidentiality of cost data.

5] Accounting information can be made more relevant to users. The most common use of this facility is in the valuation of stock. For management purposes, LIFO is often considered to be the most useful method, but since it is not allowed for financial accounting, an integrated system is unlikely to use this method. Thus, in an interlocking system LIFO may be used in the cost accounting ledger and one of the most permissible methods may be used in the financial accounting ledger.

However, the disadvantages of the interlocking system are that effectively many transactions are posted twice, once in each set of ledgers. This is time consuming and costly. Also, the profit shown by the cost accounting ledger differs from that shown by the financial accounting ledger and, therefore a reconciliation is required.
**Ledgers to be maintained:**

The following important ledgers are usually maintained in the Costing Department:

1] Cost Ledger: This is the principal ledger and records nominal accounts and to some extent real accounts. This is also called Nominal Ledger.

2] Stores Ledger: Stores Accounts for various types of stores are maintained.

3] Work-in-progress Ledger: Records are being made of each type of job undertaken, cost incurred and production during the period.

4] Finished Goods Ledger: It contains separate accounts for each type of job/work completed.

Since stores, work-in-progress and finished goods may be of various types, and separate accounts are to be maintained for each type of them, it is necessary to have a control account in each of these three ledgers.

**PRINCIPAL ACCOUNTS:**

The accounts which are generally in use when a separate Cost Ledger is maintained are:

1] **Cost Ledger Control Account:**

This account is also known as Financial Ledger Control Account, Nominal Ledger Control Account or General Ledger Adjustment Account. The purpose of this account is to double entry. All items of expenditure must be credited to this account. Sales are debited to this account and net profit/loss is transferred to this account. In short, transactions which appear in the financial accounts must be entered into this account. That is why, transfer entries, such as issue of materials from stores to production and transfer of materials from one production shop to another, which have no financial implications, will not appear in the Cost Ledger Control Account. The balance of this account will represent the net total of all the balances of the impersonal accounts.

2] **Stores Ledger Control Account:**

The account is debited for purchase of materials and credited for issue of materials. The balance of this account indicates the total balance of all the individual stores accounts. Abnormal losses or gains on stores are transferred to Costing Profit and Loss Account. Entries are recorded on the basis of Goods Receipt Notes and Stores Requisition Notes.

3] **Work-in Progress Control Account:**

This account is debited with the cost of production-direct materials, direct labour, direct expenses and production overheads recovered. And credited with the value of finished goods, completed and transferred. The balance of this account will show total balances of jobs/works which are in progress as per various individual job accounts.
4] Finished Goods Control Account:

Debited to this account is the value of goods transferred from work in progress account and administration costs recovered where such costs are not directly charged to Costing Profit and Loss Account. When goods are sold, this account is credited with the cost of goods sold and cost of Sales Account is debited. The balance of this account will represent the value of goods lying at hand.

5] Wages Control Account:

To this account, total wages paid are debited. Direct wages are then transferred to Work-in-Progress Account and indirect wages to Production overheads, Administration overheads, or Selling and Distribution overheads account, as the case may be. Wages paid for abnormal idle time is transferred to Costing Profit and Loss Account being abnormal loss. Alternatively, if an abnormal loss account is opened, such transfer to Profit and Loss Account is made through Abnormal Loss Account.

6] Production/Works Manufacturing Overheads Account:

Production indirect costs, such as indirect material, labour and expenses, are debited to this account. This account is credited with the amount of overheads recovered. The difference between overheads incurred and recovered is transferred to Overheads Adjustment Account.

7] Administration Overheads Account:

Debited with administration overheads incurred and credited with overheads recovered from finished goods. Like Production Overheads Account, difference of this account, if any, is transferred to Overheads Adjustment Account.

8] Selling and Distribution Overheads Account:

Debited with overheads incurred and credited with overheads recovered from goods sold. Difference, if any, is transferred to Overheads Adjustment account.

9] Overheads Adjustment Account:

If the amount incurred as overheads exceeds that recovered, there is under recovery and vice versa. For under-recovery, Overheads Adjustment Account is to be debited and respective overheads account credited. For Over-recovery, the entry will be reverse. The net balance of the Adjustment Account is to be transferred to Costing Profit and Loss Account. Sometimes, Overheads Adjustment Account is dispensed with and under/over absorbed overheads are directly transferred to Costing Profit and Loss Account from the respective overheads.

Another treatment of over/under-absorbed overheads is to carry forward these under/over-absorbed amounts to the next financial year by means of respective overheads suspense accounts. If this method is followed, the costing profit will not agree with financial profit.
10] **Cost of Sales Account:**

This account is debited with the cost of finished goods transferred from Finished Goods Account for sale as well as with the amount of selling and distribution overheads recovered. The balance of this account is ultimately transferred to Sales Account or Costing Profit and Loss Account, if sales account is dispensed with.

11] **Costing Profit and Loss Account:**

The net profit or loss on this account is transferred to Cost Ledger Control Account.

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