

# Elements of Costing

By: Swati Goyal

This reference book can be useful for  
BBA, MBA, B.Com, BMS, M.Com, BCA, MCA  
and many more courses for Various Universities



**NEERAJ**  
**PUBLICATIONS**  
**[www.neerajbooks.com](http://www.neerajbooks.com)**

Published by:



# NEERAJ PUBLICATIONS

*(Publishers of Educational Books)*

Sales Office : 1507, 1st Floor,

Nai Sarak, Delhi-110 006

E-mail: info@neerajbooks.com

Website: www.neerajbooks.com

© **Reserved with the Publishers only.**

Typesetting by: Competent Computers

## Terms & Conditions for Buying E-Book

- The User must Read & Accept the Terms and Conditions (T&C) carefully before clicking on the accept option for Buying the Online Soft Copy of E-books. Under this Particular Facility you may buy only the Online Soft Copy of E-books, no Hard Copy or Printed Copy shall be provided under this facility.
- These E-Books are valid for 365 days online reading only (From the Date of Purchase) and no kind of Downloading, Printing, Copying, etc. are allowed in this facility as these products are just for Online Reading in your Mobile / Tablet / Computers.
- All the online soft copy E-books given in this website shall contain a diffused watermark on nearly every page to protect the material from being pirated / copy / misused, etc.
- This is a Chargeable Facility / Provision to Buy the Online Soft Copy of E-books available online through our Website Which a Subscriber / Buyer may Read Online on his or her Mobile / Tablet / Computer. The E-books content and their answer given in these Soft Copy provides you just the approximate pattern of the actual Answer. However, the actual Content / Study Material / Assignments / Question Papers might somewhat vary in its contents, distribution of marks and their level of difficulty.
- These E-Books are prepared by the author for the help, guidance and reference of the student to get an idea of how he/she can study easily in a short time duration. Content matter & Sample answers given in this E-Book may be Seen as the Guide/Reference Material only. Neither the publisher nor the author or seller will be responsible for any damage or loss due to any mistake, error or discrepancy as we do not claim the Accuracy of these solution / Answers. Any Omission or Error is highly regretted though every care has been taken while preparing these E-Books. Any mistake, error or discrepancy noted may be brought to the publishers notice which shall be taken care of in the next edition. Please consult your Teacher/Tutor or refer to the prescribed & recommended study material of the university / board / institute / Govt. of India Publication or notification if you have any doubts or confusions before you appear in the exam or Prepare your Assignments before submitting to the University/Board/Institute.
- Publisher / Study Badshah / shall remain the custodian of the Contents right / Copy Right of the Content of these reference E-books given / being offered at the website [www.studybadshah.com](http://www.studybadshah.com).
- The User agrees Not to reproduce, duplicate, copy, sell, resell or exploit for any commercial purposes, any portion of these Services / Facilities, use of the Service / Facility, or access to the Service / Facility.
- The Price of these E-books may be Revised / Changed without any Prior Notice.
- The time duration of providing this online reading facility of 365 days may be alter or change by [studybadshah.com](http://studybadshah.com) without any Prior Notice.
- The Right to accept the order or reject the order of any E-books made by any customer is reserved with [www.studybadshah.com](http://www.studybadshah.com) only.
- All material prewritten or custom written is intended for the sole purpose of research and exemplary purposes only. We encourage you to use our material as a research and study aid only. Plagiarism is a crime, and we condone such behaviour. Please use our material responsibly.
- In any Dispute What so ever Maximum Anyone can Claim is the Cost of a particular E-book which he had paid to Study Badshah company / website.
- If In case any Reader/Student has paid for any E-Book and is unable to Access the same at our Website for Online Reading Due to any Technical Error/ Web Admin Issue / Server Blockage at our Website [www.studybadshah.com](http://www.studybadshah.com) then He will be send a New Link for that Particular E-Book to Access the same and if Still the Issue is Not Resolved Because of Technical Error/ Web Admin Issue / Server Blockage at our website then His Amount for that Particular Purchase will be refunded by our website via PayTM.
- All the Terms, Matters & Disputes are Subjected to "Delhi" Jurisdiction Only.

# CONTENTS

<b>S.No.</b>	<b>Page</b>
1. Nature and Scope .....	1
2. Concept of Cost and its Ascertainment .....	10
3. Procurement, Storage and Issue .....	18
4. Inventory Control .....	26
5. Pricing the Issue of Materials .....	36
6. Labour .....	45
7. Classification and Distribution of Overheads .....	61
8. Absorption of Factory Overheads .....	75
9. Treatment of Other Overheads .....	84
10. Unit Costing .....	92
11. Reconciliation of Cost and Financial Accounts .....	101
12. Job and Contract Costing .....	109
13. Process Costing .....	120

# Sample Preview of The Chapter

*Published by:*



**NEERAJ  
PUBLICATIONS**

[www.neerajbooks.com](http://www.neerajbooks.com)

# ELEMENTS OF COSTING

## BASIC CONCEPTS

1

## Nature and Scope

### INTRODUCTION

Cost Accounting is recent development in field of accounting. It is basically concerned with classifying, recording, and appropriate allocation of expenditure to determine cost of products or services. It is application of accounting principles and costing methods for ascertainment of cost, so that it can be compared with previous experiences and standards. It is the mechanism by means of which cost of products or services are ascertained and controlled. It lays down all accounting procedures related to recording of all income and expenditure and preparation of periodical statements and reports with object of minimizing the cost. It also enables controlling of cost and helps management to take decisions related to cost. The basic aim is to control the cost and reduce it to minimum possible level. In this chapter, we shall discuss cost accounting, its need, its objectives, its advantages and also the installation of costing system in an organization.

### CHAPTER AT A GLANCE

#### NEED FOR COSTING

Every activity involved in production of goods or providing services involves some expenditure. This expenditure may be direct or indirect; the major purpose of such activity in business organization is to generate

profit. Therefore, in order to achieve the goal of earning profit a firm should clearly identify the basic elements of a transaction which are Cost, Profit and Price.

For example, a mobile company launches a new mobile phone with excellent features to capture market. It has to incur Rs. 2000 for material, Rs. 3000 for labour, Rs. 2500 for other expenses on every set produced by it and supplied in market. The company has fixed the selling price of the mobile phone at Rs.10,000 per piece. Thus the cost of the phone is Rs. 7500 (2000 + 3000 + 2500), its selling price is Rs. 10,000; and clearly the profit per piece is Rs. 2500 (10,000 – 7500). The management requires all such information for purposes of planning, cost control and decision-making. Financial accounting fails to fulfil this need of management which leads to development of new system of accounting cost information of each product, job department, process, etc. is available. All these deficiencies of financial accounting gave birth to “Cost Accounting”.

#### LIMITATIONS OF FINANCIAL ACCOUNTING

- (i) It is limited to provide with the information regarding income, expenses, assets and liabilities. It does not provide any constructive knowledge about for each department, process, and unit of organization.

## 2/NEERAJ : ELEMENTS OF COSTING

- (ii) It does not classify expenses as direct, indirect, fixed and variable. It also not shows controllable and uncontrollable items separately.
- (iii) It does not provide analysis of process and also not differentiate between various types of losses.
- (iv) It does not fix standards or norms against which different cost items can be compared.
- (v) It does not provide management information regarding the prices of products manufacture or services provided due to which management faces difficulties in fixing selling price of the product.
- (vi) It contains actual information at the end of specified period so it is not possible for management to have the cost data at frequent intervals.
- (vii) It does not provide the reasons for losses or profit because the information is not provided product-wise.

## COSTING AND ECONOMY

Costing is also a necessity for modern economy. The features which establish necessity of costing can be summarized as follows:

- (i) **Global Competition:** There is high degree of competition in global market, to counter this competition, producers need to have strict control over cost and must follow sound pricing policies.
- (ii) **Limited Resources:** There is limited availability of resources. Therefore economic utilization of resources should be done in order to reduce wastages and losses.
- (iii) **Complex Management:** The management of organizations, specially of industries is really tedious as it requires action at every stage of operation and also demands regular monitoring.
- (iv) **Fast Decisions:** Quick decision-making is required on basis of information available.
- (v) **Social Responsibilities:** Every business organization has a responsibility towards society in terms of proper quality, reasonable prices, proper supply etc.

- (vi) **Optimum Profit:** Every organization is set to earn profit, this can be achieved by efficient performance in activities like financial, production, marketing etc.

Looking at the above points, it can be concluded that costing is a unifying force behind business success. It performs all the functions which are required for a firm to enhance the revenue generation. Its main features like resource management, removal of wastage, pricing, management of processes, decision-making, fulfilling social responsibility etc. contributes to making large profits.

## DEFINITION OF COSTING AND COST ACCOUNTING

Costing is a technique and process of determining cost. It lays down rules and principles which are applied for ascertaining the cost of products manufactured and services provided.

The term “Cost Accounting” refers to the process of accounting for costs. In this process firstly, the income and expenditure are recorded, and at last the periodical statements and reports are prepared to ascertain and control cost.

Generally, the word “Costing” and “Cost Accounting” differs but in actual practice these terms are used interchangeably.

“Costing” is the classifying, recording, and appropriate allocation of expenditure to determine cost of products or services; and for presentation suitably of arranged data for purpose of control and guidance of management. The Institute of Cost and Management Accounts (ICMA) of UK made distinction between cost accounting and cost accountancy. It defined latter as “*The application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control.*”

The word cost accountancy is replaced by cost accounting these days. According to ICMA, “*Cost Accounting is that part of management accounting which establishes budgets and standard cost and actual cost of operations, processes, departments or products and the analysis of variances, profitability or social use of funds.*” Thus it can be said that:

- (i) Cost accounting is process for accounting for costs.
- (ii) It lays down accounting procedures to record all income and expenditures related to product manufacture.
- (iii) It provides all the statistical data for making future estimates.
- (iv) It is a mechanism to ascertain cost.
- (v) It involves functions of analysis, recording, comparison, reporting, and establishment of budgeting of standards.

**OBJECTIVES OF COST ACCOUNTING**

The main objectives of cost accounting are:

- (i) The foremost objective of cost accounting is to ascertain the cost of production and services rendered.
- (ii) To determine the selling price of product.
- (iii) To classify different cost elements.
- (iv) To identify causes of wastage and application of remedies to remove them.
- (v) Reduce and control cost through comparisons and analysis.
- (vi) To help management in formulating policies and taking decisions.
- (vii) It leads to judgement of efficiency of organization as a whole as well as department-wise.
- (viii) It produces statements at such intervals as management requires. It is essential for management to review production, sale, profit etc.

At last it can be concluded that costing is an essential branch of accounting.

**DIFFERENCE BETWEEN COST ACCOUNTING AND FINANCIAL ACCOUNTING**

The differences can be summarized as follows:

S.No.	Cost Accounting	Financial Accounting
1.	Its main purpose is to control cost.	Its main purpose is to reflect financial position of firm.

S.No.	Cost Accounting	Financial Accounting
2.	There is no format to make these accounts as it is made for internal management.	There is a fixed format of making financial accounts which is followed throughout the world.
3.	It is not mandatory for every firm to have these accounts.	It is mandatory for every firm to have these accounts.
4.	It records both monetary and non-monetary transactions.	It records only monetary transactions.
5.	It presents cost information at frequent intervals.	It presents financial information once or twice a year.
6.	Cost Accounts do not require auditing.	Financial Accounts require auditing.
7.	In this, profit is reflected segment-wise.	In this, total profit of firm is reflected.
8.	It provides the information required by management.	It provides the information required by share holders, creditors, employees.
9.	It classifies expenses into material, labour and direct, indirect.	Transactions related to receipts and payments are classified into debit and related entries.
10.	In this, expenses are shown in accounts like cost sheet, contract account.	In this, transactions are shown into forms of accounts which are balance sheet and P&L account.
11.	It maximizes efficiency of operations.	It generally computes the major trends which have already taken place in

4/NEERAJ : ELEMENTS OF COSTING

S.No.	Cost Accounting	Financial Accounting
12.	It doesn't form basis for determination of tax.	previous accounting period. It forms basis for determination of tax.
13.	Stock is valued by LIFO or FIFO methods.	Stock is either valued at historical cost or market price whichever is lower.

**ADVANTAGES OF COST ACCOUNTING**

After understanding meaning, objectives, differences between cost accounting and financial accounting now let us list the advantages of cost accounting, which are as follows:

- (i) It helps in output planning and also provides information regarding production, cost, material, labour etc.
- (ii) It increases overall productivity of business by eliminating all unproductive activities, losses, wastages etc.
- (iii) Compilation of reliable cost data.
- (iv) Preparation of budgets and estimating profits.
- (v) It sets standards and norms which helps in measuring performance of organization.
- (vi) Determination of selling price of product manufactured.
- (vii) Estimations of income and expenditure in advance.
- (viii) It also controls inventory.
- (ix) It provides profit and lays down its causes.
- (x) It identifies cost of working below installed capacity.
- (xi) It helps management to take decisions like:
  - Level of output.
  - Buying decision.
  - Replacement of machinery.
  - To shut down or continue during depression period.
    - Acceptance of order.
    - Introduction of new products.
    - Replacement of labour with machinery.

Due to the above listed advantages costing is now also used by institutions like Banks, Schools, Hospitals, and Local Authorities etc.

Proper costing enables consumers to get products at fair price, employees to get bonus, investors and bankers to evaluate profitability.

**INSTALLATION OF COSTING SYSTEM**

Costing principles and procedures have to be applied in each organization according to its own characteristics and environment. A properly made costing system can help organization to achieve success. Therefore in order to introduce costing system it is advisable to conduct investigations in respect of:

- (a) Product
- (b) Organization
- (c) Manufacturing process
- (d) Selling and distribution methods.

It should be ensured that:

- (a) Organization is distributed to minimum.
- (b) Gradually the system is implemented.
- (c) Process of costing should be compact and meaningful.
- (d) Procedure should be economical and simple to operate.
- (e) It should be able to generate reports required by management at frequent intervals.

Before installation **costing objectives** and possible practical **difficulties** in process of introduction of system should be properly assessed.

**Possible Difficulties**

The possible difficulties generally faced in introduction of costing system are:

- (i) The system indulges heavy cost.
- (ii) Unavailability of efficient and trained staff.
- (iii) Resistance from staff due to increase in workload.
- (iv) Top management may not agree for introduction of the system.

**Factors to be Considered**

The following factors must be considered before installation of costing system: