CHAPTER 1

Nature and Scope of Cost Accounting

In the modern business world, the nature and functioning of business organisations have become very complicated. They have to serve the needs of variety of parties who are interested in the functioning of the business. These parties constitute the owners, creditors, employees, government agencies, tax authorities, prospective investors, and last but not the least the management of the business. The business has to serve the needs of these different category of people by way of supplying various information from time to time. In order to satisfy the needs of all these group of people a sound organisation of accounting system is very essential. In the ancient days the information required by those who were interested with a business organisation was met by practising a system of accounting known as financial accounting system. Financial accounting is mainly concerned with preparation of two important statements, viz., income statement (or profit & loss account) and positional statement (or Balance Sheet). This information served the needs of all those who are not directly associated with management of business. Thus financial accounting is concerned with external reporting as it provides information to external authorities. But management of every business organisation is interested to know much more than the usual information supplied to outsiders. In order to carry out its functions of planning, decision-making and control, it requires additional cost data. The financial accounting to some extent fails to provide required cost data to management and hence a new system of accounting which could provide internal report to management was conceived of.

NEED FOR COST ACCOUNTING

The need for cost accounting arises owing to the following:

To Overcome the Limitations of Financial Accounting

Financial accounting records in an overall manner the results of the operations of a business, using conventional double entry book-keeping techniques. It suffers from the following limitations:

(i) It provides only past data: Financial accounting provide out of date information to management. But management is interested in current data but not past data as it does not serve any purpose to it. Therefore it has been rightly pointed out that financial accounting provide only a post-mortem analysis of past activities.
(ii) *It reveals only over all result of the business:* Financial accounting does not provide data for each and every product, process, department or operation separately. Instead it provides the financial information in a summary form for the entire organization as a whole.

(iii) *It is static in nature:* Modern business is dynamic but not static. Financial accounting does not incorporate the changes that take place within the business.

(iv) *It fails to take into account the impact of price level change:* In the modern inflationary conditions the price level has significant impact over financial statement. Under financial accounting, assets are shown at the actual or historical cost. Consequently depreciation is also charged on actual or historical cost. This under charging of depreciation will distort the profit figure.

(v) *Possibility of manipulation of financial accounting:* Very often financial accounting is manipulated at the whims and fancies of management so as to project better image in the minds of prospective investors. The chief forms of manipulating the financial accounting assume the form of over or undervaluation of inventory, excessive or inadequate provision for depreciation, creation of secret reserves, etc.

(vi) *It fails to exercise control over resources:* Financial accounting fails to exercise control over materials, labour and other expenses incurred in a business enterprise. As a result, avoidable wastages and losses go unchecked under this system of accounting.

(vii) *It fails to provide adequate data for price fixation:* Financial accounting fail to provide adequate cost data on the basis of which selling price is fixed. In the absence of fixation of prices in advance, it is not possible to supply quotations to the prospective customers. To that extent the income from such sales diminish.

(viii) *It fails to provide adequate data for management in carrying out its functions:* Management of every organization relies heavily on adequate cost data for formulating policies and in decision-making process. But financial accounting fails to provide such useful cost data to management.

(ix) *It does not provide a basis for cost comparison:* Financial accounting does not help in cost comparison over a period of time or between two jobs or two operations. Thus a basis for judging the efficiency of an year with past year or worthfulness of two different jobs or operations cannot be appraised.

(x) *It does not make use of control techniques:* Financial accounting fail to make use of certain important cost control techniques such as budgetary control and standard costing. Thus financial accounting does not facilitate measuring the efficiency of the business with the help of control techniques.

(ix) *It fails to ascertain break-even point:* Financial accounting does not help in ascertaining the break-even point, i.e., the sale or output where the revenue equals the cost. Hence, the point of no-profit-no-loss cannot be made out under financial accounts.

**To Ensure Optimum Utilisation of Resources**

In today's business world, the resources available are very scarce. Hence every business unit must strive hard to obtain maximum output with the available input. In order to ensure the optimum utilization of scarce resources, the value of input is measured against the value of output. This implies matching cost per unit of production against the value of output or
selling price. But financial accounting does not provide the information relating to cost per unit of production. Hence the need for cost accounting was felt necessary.

To Achieve Overall Efficiency of Business

Every businessman will make constant effort to improve his business. In order to formulate suitable policy and sound decision, he has to know answers to certain questions such as (a) What is the maximum profit which a business can make? (b) Is the profit earned by it is more or less compared to the earlier years? (c) Which product line is making more profit? (d) Has too much capital is blocked in raw materials? (e) Whether the cost of production has gone up compared to earlier years? (f) Should the selling price requires revision? Cost accounting serves as an useful tool in the hands of management in this direction. By analysing the cost of production of every unit, it helps management to know the answers to the above questions.

GROWTH AND DEVELOPMENT OF COST ACCOUNTING

The history of cost accounting can be traced back to the fourteenth century. In the course of its evolution it passed through following stages:

1. In the first stage of its development, cost accounting was concerned only with the three prime cost elements, viz., direct material cost, direct labour cost and direct expenses. For recording the transactions relating to materials the important documents used were (a) stores ledger, (b) a material requisition note, and (c) materials received note. To account for labour cost, employee time card and labour cost card were devised by Mr. Metcalfe. Later on a distinction between manufacturing and non-manufacturing cost was made by Mr. Norton. Thus material cost, labour cost and manufacturing cost constituted prime cost.

2. Secondly, around the turn of the nineteenth century, the importance of non-manufacturing cost (overheads) was recognized as one of the distinct element of cost. The method of charging non-manufacturing cost to the production cost was devised under this stage.

3. Thirdly, the techniques of estimation and standards are devised. Instead of using actual cost, standard costs are used and by comparing with the actual cost the differences are noted, analysed and disposed off accordingly. This helps in knowing the efficiency of the business undertaking.

4. Fourthly, cost accounting methods were applied to all types of business undertakings. The costing principles and techniques were also extended to important functions of a business.

5. In modern times the development of electronic data processing has occupied significant stage in the growth of cost accounting system.

Cost Accounting in Indian Context

The application of cost accounting methods in Indian industries was felt from the beginning of the twentieth century. The following factors have accelerated the system of cost accounting in our country:

(a) Increased awareness of cost consciousness by Indian industrialists with a view to ascertain costs more accurately for each product or job.
(b) Growing competition among manufacturers led to fixation of prices at a lower level so as to attract more customers.

(c) Economic policy of government which laid emphasis on planned economy with a view to achieve the targets led to cost reduction programmes by Indian industrialists.

(d) Increased government control over pricing led the Indian manufacturers to give utmost importance to the installation of cost accounting.

(e) The establishment of National Productivity Council in 1958 and the Statutory Recognition of Institute of Cost and Works Accountants of India in 1959 gave further encouragement to install cost accounting system in Indian industries.

**DEFINITION AND SCOPE OF COST ACCOUNTANCY**

The terminology of cost accountancy published by the Institute of Cost and Management Accountants, London defines cost accountancy as “the application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control and the ascertainment of profitability. It includes the presentation of information derived therefrom for the managerial decision-making.”

On analysis of the above definition, the following features of cost accountancy become evident:

(a) “Cost accountancy” is used in the broadest sense when compared to “cost accounting” and “costing”. This is so because cost accountancy is concerned with the formulation of principles, methods and techniques to be applied for ascertaining cost and profit.

(b) Having ascertained ‘cost’ and ‘profit’, cost accountancy is concerned with presentation of information to management. To enable management to carry out its functions, reports must be promptly made available at the right time, to the right person and in a proper form.

(c) The information so provided is to serve the purpose of managerial decision-making such as introducing a new line of product, replacement of manual labour by machines, make or buy, decisions, etc.

**SCOPE OF COST ACCOUNTANCY**

The scope of any subject refers to the various areas of study included in that subject. As regards the scope of cost accountancy is concerned, it has vast scope. The following topics fall under the purview of cost accountancy: (1) Costing, (2) Cost Accounting, (3) Cost Control Techniques, (4) Budgeting and (5) Cost Audit.

1. Costing

The terminology of ICMA, London, defines costing as “the technique and process of ascertaining the cost.” According to the revised terminology of ICMA, London, “**Costing is the process of determining the costs of products, services or activities.**”

The above definition is very significant in as much as it carries the main theme of cost accountancy. This definition emphasizes two important aspects, *viz.*
2. Cost Accounting

Kohler in his dictionary for Accountants defines cost accounting as “that branch of accounting dealing with the classification, recording, allocation, summarization and reporting of current and prospective costs.”

Mr. Wheldon defines cost accounting as “the classifying, recording and appropriate allocation of expenditure for the determination of the costs of products or services, the relation of these costs to sales values, and the ascertainment of profitability.”

The above definitions reveal the following aspects of cost accounting:

(a) Cost classification: This refers to grouping of like items of cost into a common group.
(b) Cost recording: This refers to posting of cost transactions into the various ledger maintained under cost accounting system.
(c) Cost allocation: This refers to allotment of costs to various products or department.
(d) Cost determination or cost finding: This refers to the determination of the cost of goods or services by informal procedure, i.e., procedures that do not carry on the regular process of cost accounting on a continuous basis.
(e) Cost reporting: This refers to furnishing of cost data on a regular basis so as to meet the requirements of management.

Differences between Cost Accountancy, Costing and Cost Accounting

<table>
<thead>
<tr>
<th>Points of Differences</th>
<th>Cost Accountancy</th>
<th>Costing</th>
<th>Cost Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Scope</td>
<td>Cost accountancy is broadest in its scope.</td>
<td>It is broader in its scope.</td>
<td>It is narrow in its scope.</td>
</tr>
<tr>
<td>2. Function</td>
<td>It is concerned with formulation of costing principles, methods, techniques to be adopted by a business.</td>
<td>It is concerned with ascertainment of cost.</td>
<td>It is concerned with recording of cost.</td>
</tr>
</tbody>
</table>
3. Cost Control

According to Kohler, cost control represents the employment of management devices in the performance of any necessary operation so that pre-established objectives of quality, quantity and time may be attained at the lowest possible outlay for goods and services. The terminology published by ICMA, London, defines cost control as “The guidance and regulation by executive action of the cost of operating an undertaking.” According to this definition, cost control aims at guiding the actuals towards the lines of target and regulates the actuals if they deviate from the targets. This guidance and regulation is done by the executive who is responsible for causing the deviation. This process will become clear by enumerating the steps involved in any cost control technique.

(a) Fixation of targets in terms of cost and production performance.
(b) Ascertaining the actual cost and production performance.
(c) Comparison of actuals with the targets.
(d) Analysing the variance by causes and the person responsible for it.
(e) Taking remedial steps to set right unfavourable variations.

Cost control is exercised through a variety of techniques such as inventory control, quality control, budgetary control, standard costing, etc. The advantages of cost control are as follows:

(a) It helps in utilizing the resources to the full extent.
(b) It helps in reduction of prices which are benefited by customers.
(c) It helps in competing successfully in the market.
(d) It increases the profit earning capacity of the business.
(e) It increases the goodwill of the business.

4. Budgeting

Mr. Heiser in his book *Budgeting-Principles and Practice*, defines budget as “an overall blue print of a comprehensive plan of operations and actions expressed in financial terms. According to him budgeting process involves the preparation of a budget and its fullest use not only as a devise for planning and co-ordinating but also for control.”

5. Cost Audit

The terminology of ICMA, London, defines cost audit, as “the verification of the correctness of cost accounts and the adherence to the cost accounting plan.”

<table>
<thead>
<tr>
<th>3. Periodicity of functioning</th>
<th>It is a starting point.</th>
<th>It begins where cost accountancy ends.</th>
<th>It begins where costing ends.</th>
</tr>
</thead>
<tbody>
<tr>
<td>4. Persons involved</td>
<td>The persons involved are experts in the field of cost accountancy such as management accountant.</td>
<td>The person involved is cost accountant.</td>
<td>The persons involved are cost clerks.</td>
</tr>
</tbody>
</table>
NATURE AND SCOPE OF COST ACCOUNTING

NATURE OF COST ACCOUNTING

The nature of cost accounting can be brought out under the following headings:

1. **Cost accounting is a branch of knowledge:** Though considered as a branch of financial accounting, cost accounting is one of the important branch of knowledge, *i.e.*, a discipline by itself. It is an organised body of knowledge consisting of its own principles, concepts and conventions. These principles and rules vary from industry to industry.

2. **Cost accounting is a science:** Cost accounting is a science as it is a body of systematic knowledge relating to not only cost accounting but relating to a wide variety of subjects such as law, office practice and procedure, data processing, production and material control, etc. It is necessary for a cost accountant to have intimate knowledge of all these field of study in order to carry on his day-to-day activities. But it is to be admitted that it is not a perfect science as in the case of natural science.

3. **Cost accounting is an art:** Cost accounting is an art in the sense it requires the ability and skill on the part of cost accountant in applying the principles, methods and techniques of cost accountancy to various management problems. These problems include the ascertainment of cost, control of costs, ascertainment of profitability, etc.

4. **Cost accounting is a profession:** In recent years cost accounting has become one of the important professions which has become more challenging. This view is evident from two facts. First, the setting up of various professional bodies such as National Association of Accountants (NAA) in USA. The Institute of Cost and Management Accountants in UK, the Institute of Cost and Works Accountants in India and such other professional bodies both in developed and developing countries have increased the growing awareness of costing profession among the people. Secondly, a large number of students have enrolled in these institutes to obtain costing certificates and memberships for earning their livelihood.

RELATIONSHIP BETWEEN FINANCIAL ACCOUNTING AND COST ACCOUNTING

Cost accounting is very closely-related to financial accounting. Some authorities on the subject consider cost accounting to be the branch of financial accounting. But it may be said that cost accounting is complementary to financial accounting, *i.e.*, a subject which is necessary to make financial accounting whole or complete. Financial accounting and cost accounting are similar in certain respects. But in some other respects they differ from one another. These points of similarities and dissimilarities are enumerated below:

**Points of Similarities**

(a) The fundamental principles of double entry is applicable to both the systems of accounting.

(b) The invoices and vouchers constitute the common basis for recording transactions under both the systems of accounting.
(c) The results of business are revealed by both the systems of accounting.
(d) The causes for losses and wastages of a business are provided by both these systems of accounting.
(e) The determination of future business policy is guided by both these systems of accounting.
(f) A basis for comparison of expenses is being provided by both the accounting systems.
(g) Accuracy of accounts is maintained under both the systems by means of exercising check over errors and commissions which might creep in either of accounting.

### Points of Dissimilarities

<table>
<thead>
<tr>
<th>Points of Differences</th>
<th>Financial Accounting</th>
<th>Cost Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Purpose</td>
<td>The purpose of financial accounting is external reporting mainly to owners, creditors, tax authorities, government, and prospective investors.</td>
<td>The purpose of cost accounting is internal reporting, i.e., to the management of every business.</td>
</tr>
<tr>
<td>2. Obligation to maintain accounts</td>
<td>This is to be maintained compulsorily by higher forms of business organizations. The preparation of accounts must be in accordance with the statutory provisions.</td>
<td>Cost accounting are maintained voluntarily. In some cases government has directed some companies to maintain cost accounts to improve efficiency.</td>
</tr>
</tbody>
</table>
| 3. Recording           | (a) Financial accounting records transactions in a subjective manner, i.e., according to the nature of expenditure.  
                          | (b) In financial accounting expenses are recorded in totals.  
                          | (c) Financial accounting records all transactions which takes place in the business.  
                          | (d) Financial accounting records only historical costs. | (a) Cost accounting records transactions in an objective manner, i.e., according to purpose for which costs are incurred.  
                          | (b) In cost accounting costs are expressed by proper analysis and classification in order to find out cost per unit.  
                          | (c) Cost accounting records only those costs which affect production and sales.  
                          | (d) Cost accounting records both historical and estimated costs. |
| 4. Analysis of profit  | Financial accounting discloses profit for the entire business as a whole.               | Cost accounting shows the profitability or otherwise of each product, process or operation so as to reveal the areas of profitability. |
| 5. Control             | (a) It does not make use of any control techniques.                                    | (a) It makes use of some important control techniques such as Marginal Costing, Budgetary Control, Standard Costing, etc., in order to control cost. |
Differences Between Cost and Management Accounting

The American Accounting Association 1958, committee on management accounting defines management accounting as “the application of appropriate techniques and concepts in processing the historical and projected economic data of an entity to assist management in establishing a plan for reasonable economic objectives and in the making of rational decisions with a view towards achieving these objectives.” It includes the methods and concepts necessary for effective planning for choosing among alternative business actions, and for control through the evaluation and interpretation of performance. Its study involves consideration of ways in which accounting information may be accumulated, synthesised, analysed and presented in relation to specific problems, decisions and day-to-day tasks of business management.

The terminology published by ICMA, London, defines management accounting as “the application of professional knowledge and skill in the preparation and presentation of accounting information in such a way as to assist management in the formulation of policies and in the planning and control of the operation of the undertaking.”

If we examine the above two definitions of management accounting, it appears that both the systems of accounting serve the same purpose. However, they differ from one another in respect of the following:

<table>
<thead>
<tr>
<th>Points of Differences</th>
<th>Cost Accounting</th>
<th>Management Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Growth of Accounting</td>
<td>The history of cost accounting dates back to fourteenth century.</td>
<td>This system of accounting evolved in the middle of 20th century. Hence it is of recent origin when is compared to cost accounting.</td>
</tr>
<tr>
<td></td>
<td>The main objects of cost accounting is to ascertain and control cost.</td>
<td>The main objective of management accounting is to provide useful information to management for decision-making.</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>2. Object</td>
<td>It is based on both present and future transactions for cost ascertainment.</td>
<td>It is concerned purely with the transactions relating to future.</td>
</tr>
<tr>
<td>3. Basis of recording</td>
<td>Cost accounting has narrow scope as it covers matters relating to ascertainment and control of cost.</td>
<td>It has a wide scope in as much as it covers the areas of financial accounting, cost accounting, taxation, etc.</td>
</tr>
<tr>
<td>4. Scope</td>
<td>Cost accounting serves the needs of both internal management and external parties.</td>
<td>Management accounting serves the needs of only internal management.</td>
</tr>
<tr>
<td>5. Utility</td>
<td>It deals only with monetary transactions. <em>i.e.</em>, it covers only quantitative aspect.</td>
<td>It deals with both monetary and non-monetary transaction, <em>i.e.</em>, both quantitative and qualitative aspects.</td>
</tr>
<tr>
<td>6. Types of transactions dealt with</td>
<td>Cost accounting follows a definite principle for ascertaining cost and a format for recording.</td>
<td>It does not follow a definite principle and format. Instead, the data to be presented depends upon the need of the management.</td>
</tr>
<tr>
<td>7. Observation of principles and format</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**RELATIONSHIP BETWEEN COST, ESTIMATE AND PRICE**

The terms ‘estimates’, ‘costs’ and ‘prices’ are closely related to each other in costing. An estimate is a forecast of the probable cost of a product, job, or process for a future date. Estimation is purely based on past experience. Cost accounting provide reliable data on the basis of which future cost is estimated. However, an estimate is only an opinion because there is every chance of committing mistake while estimating. Estimation is also based on the future conditions and much depends on guesswork. But such guesswork must be as far as possible closer to the facts.

Cost represents actual total cost incurred in manufacturing a product or in completing a job. The total cost of manufacturing a product broadly consists of material, labour and other expenses. The true cost is ascertained either at the various stages of completing the production or at the end of completion of the job. The current cost serves as the basis for future estimates. Thus cost is considered as a fact as it represents the actual or true cost of manufacturing a product or completing the job.

Price in costing refers to selling price of product. Selling price is arrived at after adding a certain margin of profit to the actual cost. Of course, certain other factors also determine the price fixation policy such as demand for the product, tastes and preferences of customers, price of competitive products, future trends of prices and so on. So price fixing is regarded as a matter of policy. Hence it has been popularly said that an “estimate is an opinion, cost is a fact and price is a policy.”
PURPOSES OR OBJECTS OF COST ACCOUNTS

Costing serves number of purposes among which the following are considered to be most important:

1. **Ascertainment of cost:** This was considered to be the primary objective of cost accounting in the initial stages of its development. However, in modern times this has assumed the secondary objective of cost accounting. Cost ascertainment involves the collection and classification of expenses at the first instance. Those items of expenses which are capable of charging directly to the products manufactured are allocated. Then the other expenses which are not capable of direct allocation are apportioned on some suitable basis. Thus the cost of production of goods manufactured is ascertained. In this process, cost accounting involves maintenance of different books to record various elements of cost. Cost of production is ascertained by using any of the costing technique such as historical costing, marginal costing, etc.

2. **Cost control:** At one time cost control was considered as secondary objective of cost accounts. But in modern times it constitutes the primary purpose because of its utmost importance in all business undertakings. Cost control is exercised at different stages in a factory, viz., acquisition of materials, recruiting and deployment of labour force, during the production process and so on. As such we have material cost control, labour cost control, production control, quality control and so on. However, control over cost is exercised through the techniques of budgetary control and standard costing. The control techniques enable the management in knowing the operating efficiency of a business.

3. **Determination of selling price:** Every business organisation aims at maximising profit. Total cost of production constitutes the basis on which selling price is fixed by adding a margin of profit. Cost accounting furnishes both the total cost of production as well as cost incurred at each and every stage of production. No doubt other factors are taken into consideration before fixing price such as market conditions, the area of distribution, volume of sales, etc. But cost plays the dominating role in price fixation.

4. **Frequent preparation of accounts and other reports:** The management of every business constantly rely upon the reports on cost data in order to know the level of efficiency relating to purchase, production, sales and operating results. Financial accounting provides information only at the end of the year because closing stock value is available only at the end of the year. But cost accounts provide the value of closing stock at frequent intervals by adopting a “continuous stock verification” system. Using the value of closing stock it is possible to prepare final accounts and know the operating results of the business.

5. **To provide a basis for operating policy:** Cost data to a great extent helps in formulating the policies of a business and in decision-making. As every alternative decisions involve investment of capital outlay, costs play an important role in decision making. Therefore availability of cost data is a must for all levels of management. Some of the decisions which are based on cost are (a) make or buy decision, (b) manufacturing by mechanisation or automation, (c) whether to close or continue operation in spite of losses.
FUNCTIONS OF COST ACCOUNTANT

The functions of cost accountant may be enumerated under the following:

**Traditional Functions**

The traditional functions comprise of the routine functions of cost accountant. Such functions are as follows:

(a) To establish various cost centres in the organisation.
(b) To ascertain the cost of every product, job or process both in terms of total and per unit of product.
(c) To design suitable system for defining responsibilities and controlling cost.
(d) To provide necessary data to enable management in fixing the price.
(e) To prepare reports on wastages of material, loss of labour time, idle capacity of machines so as to improve profitability of business.
(f) To implement cost control techniques such as budgetary control and standard costing.
(g) To prepare cost schedules to assist management in making decisions and in formulating policies.
(h) To design suitable forms for organising an effective system of reporting which ensures provision of adequate cost data to all levels of management.
(i) To assist management in the valuation of closing stock of raw materials and work-in-progress so that too much of capital is not locked up in unnecessary inventories.
(j) To prepare periodical cost statements and profit and loss account.

**Modern Functions**

In recent times the functions of a cost accountant are not only confined to ascertain and control cost but extend far beyond these functions. This is on account of the additional responsibilities arising from the various branches of accounting, works organisation, office management and administration, methods of statistical analysis, system analysis O and M studies, modern principles of management, use of computers, etc. These modern functions are as follows:

(i) Supervising the functions of mechanised accounting.
(ii) Organisation of internal audit in the field of accounting.
(iii) To work in close co-ordination with various departmental managers so as to implement cost reduction programmes and methods of improvement.
(iv) To undertake cost audit programmes as per the directives issued by the government and the provision of the Indian Companies Act of 1956.

As regards the role of cost accountant in an industry, it has been beautifully summarised by Mr. Wilmot in his article on “the cost accountant’s place in management”. According to him, the role of cost accountant, is “that of a historian, news agent, and prophet”. As historian he must be meticulously accurate, i.e., while supplying cost information to management he has to furnish in greater detail with carefulness and exactness. As news agent, he must be up-do-date, selective and provide full cost information to the needy person. As a prophet he must combine knowledge and experience with foresight and courage.
At the outset it is to be understood that a common cost accounting system cannot be installed for all types of business undertakings. The cost accounting system depends upon the nature of business and the product manufactured. Before a suitable system of cost accounting is installed it is necessary to undertake a preliminary investigation so as to know the feasibility of installing cost accounting system to such business. While introducing a system of cost accounts it should be borne in mind that cost accounting system must suit the business. There should not be any attempt to make the business suit the system. One more consideration that is of practical importance is that the benefits derived from cost accounting system must be more than the investment made on it. This means the system must be simple and it must lead to savings through the control of materials, labour and overheads when compared to expenses incurred in maintaining it. For the successful functioning of the costing system, the following conditions are essential:

(a) There must be an efficient system of material control.
(b) A sound and well-designed method of wage payment must be set up.
(c) The existence of sound basis for collection of all indirect expenses and a basis for its apportionment to various production departments.
(d) The integration of cost and financial accounts to facilitate reconciliation of profit as shown by these two system of accounting.
(e) The use of printed forms so as to facilitate quick compilation of cost reports.
(f) The duties and responsibilities of cost accountant must be made clear.

Factors to be Considered before Installing a Cost Accounting System

The following factors are to be considered before installing a cost accounting system:

1. **History of business unit:** The history of a business unit implies the duration of its existence, position in the industry, the rate of growth, policy and philosophy of management and the like. The history of business unit serves as the basis for designing the cost accounting in respect of necessity, simplicity, and investment involved in installing cost accounting.

2. **Nature of the industry:** The nature of business such as manufacturing, mining, trading, etc., determines the costing techniques to be applied. Similarly, the type of product manufactured also determine the method of costing that is to be employed. In other words, there is no all purpose technique and method of costing that can be applied universally.

3. **Product range:** The range of products manufactured and sold also determine the method of costing to be selected. Accordingly range of products must be analysed in terms of size, models, fashions, area of market, competitors and whether the products are made to customers specification or for stocking and selling.

4. **Technical considerations:** Technical considerations that influence the installation of cost accounting are as follows:
   (a) Size and layout of the factory
   (b) The existence of production and service departments
   (c) Flow of production
(d) Capacity of machines and degree of mechanisation
(e) Existence of laboratories
(f) Internal transport and material handling equipments
(g) Production control techniques
(h) Inspection and testing of materials and finished goods.

5. **Organisational factors:** The problem of installing cost accounting is somewhat difficult in case of an existing business when compared to new business. However, the existing set up of the organisation should be least disturbed should the need arise. In order to fix up responsibility to the executives it may be necessary to group the departments. The organisational factors to be considered are: (a) size and the type of organisation such as line, line and staff, functional and committee organisation, (b) the levels of management, viz., top level, middle level and bottom level management, (c) extent of delegation and responsibility, (d) extent of centralization and decentralization, (e) extent of of departmentation, (f) availability of modern office equipments, and (g) number of managerial and supervisory staff.

6. **Selling and distribution method:** The chief factors to be considered with regard to distribution process are the warehousing facilities, external transport, market research and other promotional measures, terms of sale and procurement of orders from customers.

7. **Accounting aspects:** The factors to be considered in respect of accounting are: (a) number of financial records, (b) existing forms, (c) registers used, and (d) number of copies required.

8. **Area of control to be exercised:** The areas where cost control is to be exercised is to be identified so that each manager may take action relevant to his activities. If material control occupies significant area of control, it must be given topmost priority for exercising control over materials.

9. **Reporting:** The cost accounting system to be installed must ensure frequency and promptitude in reporting cost data to all levels of management. It must also to be pointed out that duplication of reporting is to be avoided. Further, only those information which are relevant for the management in a particular context alone should be reported.

10. **Uniformity:** The practice of adopting uniform costing facilitates inter-firm comparison among various firms belonging to the same industry. Further it also has the benefit of adopting common costing practice if a holding company has number of subsidiaries.

11. **Use of electronic data processing:** In modern days, it has become a common practice to use electronic data processing equipments and computers. In this situation, it is essential to ensure that the equipment meets the needs of the system but not the other way round.

12. **Practical consideration:** The cost accounting system to be installed must be flexible in operation and must be capable of adaptation to changing conditions. The system must be periodically scrutinised so as to make necessary changes owing to development in business.
The steps involved in the installation of a cost accounting system are as follows:

1. **Determination of objectives:** The costing system will be simple if the objective is only to determine cost. It will have to be elaborate if the objective is to have information which will help the management in exercising control and taking decisions.

2. **Studying the existing organisations and routine practice:** The various matters to be considered in this regard are the nature of the business, the various operations carried on, extent of responsibility and authority attached to the various functionaries, the lay-out of the factory with particular reference to the manufacturing department, the methods of dealing with wastage of materials, the system of time recording and the methods of computing and paying wages, the system of issuing orders for production to the factory and the method of treating fixed, semi-variable and variable overheads.

3. **Deciding the structure of cost accounts:** This refers to deciding the system of costing based on a thorough study of the manufacturing process and their ancillary services. The structure of cost accounting should follow the natural production line. The sequence can be simple, analytical or synthetic. The designing of the system should be such that there is gradual build up of the cost at each significant stage of production as the product proceeds to completion.

4. **Determining the cost rates:** This entails a thorough study of factory conditions, classification of cost into direct and indirect, grouping of indirect costs into production, selling, administration etc., treatment of wastes of all kinds, methods of pricing issues, methods of recovering overheads and calculation of overheads rates. A complete cost accounting code should be drawn up so that expenditure may be quickly classified in the office as to both source and cause.

5. **Introducing the system:** No costing system can be expected to function effectively unless cooperation of all the officials could be obtained. Before the system is put into effect, the implications of the system should be explained to all indicating to them the benefits that will accrue to each and to the business as a whole. However, instead of introducing the complete system, it should be introduced only by stages and the existing routines and practices should be utilised unless, there are good grounds to supersede them.

6. **Organising the cost office:** It is always better that the cost office is situated adjacent to the factory so that delay in routing out documents or in clearing up discrepancies and doubts is avoided. The costing staff must be allowed to perform their duties properly. The size of staff would depend on the volume of work involved. The duties of cost office fall into the following spheres.
   
   (a) **Stores accounts.** Posting of materials, receipts and stores issues in stores ledgers, preparing material abstracts.

   (b) **Labour accounting.** Evaluation of time sheets, jobs cards etc., preparing labour abstracts. In some cases preparation of actual pay rolls.

   (c) **Cost accounts.** Posting of all cost accounts, whether job or process or service accounts.
(d) **Cost control.** Posting cost control accounts from data supplied from sections (a) and (b) above. Preparation of special statistical and other information for management for carrying out special investigation and preparation of periodical trading statements.

7. **Relationship of cost office to other department:** The cost department should function independently. The cost accountant being made directly responsible to the General Manager or Managing Director. The costing system should be designed to serve management at all levels. The cost accountant, therefore, should design his whole system of records and reports; with this end in view. He must know and understand the problems faced in the process of production and try to translate them into financial implications so that correct decisions may be taken.

**Practical Difficulties in Installing Cost Accounting**

In addition to the above problems, a cost accountant will encounter the following practical difficulties at the time of installation of cost accounting system:

1. **Lack of support from management:** Wherever costing system is installed, it is essential to seek the support of various departmental managers. Very often the managers show hostile attitude towards the costing system. They feel that this system will interfere in their routine work and probably as a means of checking their efficiency. Under such circumstances it is better to convince them about the utility of costing system for the business as a whole.

2. **Resistance by existing accounting staff:** Very often the existing accounting staff resist the installation of the cost accounting system on two grounds. Firstly, they feel that the new system of accounting might lead to excess work. Secondly, they are afraid of their job security. But this difficulty may be overcome by encouraging them about the usefulness of cost accounting as a supplement to financial accounts and the generation of more employment opportunities from the installation of cost accounting system.

3. **Non-cooperation from middle and bottom level management:** At times the middle and bottom level managers such as foremen, supervisors and inspectors also fail to extend their wholehearted cooperation fearing additional work which may be entrusted to them. This problem may be overcome by suggesting them about the simplicity of the system and the existence of a separate cost accounting department to look after costing matters. However, they may be required to provide necessary reports concerning their area of activity so as to enable functioning of cost accounting department efficiently.

4. **Lack of trained staff:** This was no doubt a problem in olden days. Today this problem is overcome, thanks to the establishment of The Institute of Cost and Works Accountant of India in our country which offers professional course in costing and also offers training facilities through various companies to the candidates undergoing the course. In spite of this facility, it is somewhat difficult to get the competent and experienced staff at the time of installation. This problem can be overcome by paying attractive salaries to the cost accountants.

5. **Heavy expenses in installing and maintaining the system:** The setting up of a separate costing department with staff often poses a problem. In addition to installation, the operating expenses in the form of printing and stationery, heating and lighting, depreciation and insurance, rent and rates are to be incurred. However,
as was mentioned earlier, the system of cost accounting must be a useful investment, *i.e.*, benefits derived from it must be more than the investment made on it. If this is not possible, for the time being the system must be discarded.

**REQUISITES OR ESSENTIALS OF COST ACCOUNTING SYSTEM**

The following are the essentials of an ideal cost accounting system:

1. **Accuracy**: The system of cost accounting must provide for accuracy in terms of both cost ascertainment and presentation. Otherwise it will prove to be misleading.

2. **Simplicity**: Cost accounting system involves detailed analysis of cost. To avoid complications in the procedure of cost ascertainment an elaborate system of costing should be avoided and every care must be taken to keep it as simple as possible.

3. **Elasticity**: The costs accounting system should be capable of adapting itself to the changing situations of business. It must be capable of expansion or contraction depending upon the needs of the business.

4. **Economy**: The cost of operating costing system must be less. It must result in increased benefit when compared to the expenditure incurred in installing it.

5. **Comparability**: The records to be maintained must facilitate comparison over a period of time. The past records must serve as a basis to guide the future.

6. **Promptness**: An ideal costing system is one which provides cost data in an analytical form to the management. So all the departments of a factory must analyse and record the relevant items of cost promptly in order to furnish cost information on a regular basis to various levels of management. This helps in checking up the progress of the business on a regular basis.

7. **Periodical preparation of accounts**: With a view to facilitate the comparison of results frequently, it is desirable to prepare accounts periodically. Constant comparison of actual result with standard result enables to spot out areas of inefficiency. This can be set right by taking remedial measures.

8. **Reconciliation with financial accounts**: The system of cost accounts must be capable of reconciling with financial accounts so as to check accuracy of both the system of accounts.

9. **Uniformity**: The various forms and documents used under costing system must be uniform in size and quality of paper. Printed forms must be used to avoid delay in the preparation of reports. This also reduces the burden of clerical staff. Forms of different colours can be used to distinguish different documents.

10. **Equity**: The basis of apportioning indirect expenses to products, departments or jobs must be fair and equitable.

**ORGANISATION OF COST ACCOUNTING DEPARTMENT**

The organisation of cost accounting department depends upon the size of the concern. Whatever may be the structure of cost accounting department in a factory, it is established to serve the
following purposes: (i) To compile cost data in order to meet the statutory requirement wherever applicable, (ii) To provide necessary cost data to management to carry out its functions efficiently, and (iii) To ensure efficiency and economy in the functioning of cost accounting department. To achieve the above purposes cost accounting department usually performs the following functions:

1. Designing and installation of appropriate method of costing.
2. Accumulation of cost data by process, department and product.
3. Analysis of such cost by elements of cost.
4. Estimation of cost of production.
5. Reporting of cost information to all levels of management.
6. Advising management in relation to investment based on cost information.

In a small and medium-sized concern, the cost accounting department may be set up as a section of financial accounting system. The cost accountant who is incharge of cost accounting department may be authorised to report to the chief accountant. In large-sized concern, a separate cost accounting department is established under the supervision of a full-fledged cost accountant. The cost accounting department is equipped with sufficient staff each to look after different facets of cost accounting function. While important functions such as budgeting, cost analysis, etc., are performed by cost accountant, cost recording, cost reporting and such other functions are performed by cost clerks.

The cost accounting department may be organised either on the principle of centralisation or decentralisation. Under centralised system, the functions of cost accounting departments relating to all firms belonging to same industry is performed at a common central place. The extent of centralisation of cost accounting department depends upon the following factors:

(a) The philosophy of management regarding divisional responsibility.
(b) The ready availability of cost data from each firm.
(c) Size of the firm.
(d) The area of operations of every firm.
(e) The economy involved in centralisation process.

**Advantages of Centralised Cost Accounting Department**

1. It facilitates full utilisation of services of costing staff.
2. It permits mechanisation of accounting which is not possible under decentralisation system.
3. It reduces paper work and economise stationery costs.
4. It facilitates prompt reporting.

Under decentralisation system a separate cost accounting department is set up for each and every firm under the supervision of a competent cost accountant. This system has certain advantages.

(a) It tends to increase the initiative of the cost accountants of every firm as the responsibility to control lies in their hands.
(b) It eliminates duplication of recording and reporting.
(c) It increases the speed of functioning of cost accounting department.
Relationship of Cost Department to Other Departments

1. Cost accounting department and production department: It can well be said that production department and cost department are interwoven together as the former cannot function efficiently without the existence of the latter. The production process is concerned with the utilisation of materials, money and human resources. The cost department helps in estimating the material cost, labour cost and other expenses for manufacturing a product. It also helps in controlling these costs so as to minimise the cost of production. In fact, the main objective of cost accounting system is to reduce the cost of production of goods or services manufactured and rendered by business units.

The other areas where cost accounting department is helpful in manufacturing process are:

(a) Engineering department which is concerned with designing a product,
(b) Research and development department which is concerned with development of a new product,
(c) Production planning and control department which ensures completion of production within the time schedule, and
(d) Quality control section, which ensures quality of products. All these departments heavily rely on cost accounting department because costs to be incurred in these departments have a direct impact over the functioning of these departments.

2. Cost accounting department and personnel department: The personnel department which is concerned with proper recruitment, selection, training, time-keeping, fixation of wage rate and preparation of payroll, will work with close coordination of cost department. Each and every function performed by personnel department is again influenced by additional cost to be incurred on such function as for example promotion of employees leads to incurrence of additional wages.

3. Cost accounting department and finance department: The finance department is concerned with receiving and disbursement of cash. The allocation of investments on fixed and working capital entirely depends upon the cost reports submitted to it by the cost department. Judicious utilisation of available capital is possible only when priority is given for more important areas of investment. This is facilitated by furnishing prompt report by cost department.

4. Cost accounting department and purchase department: In majority of firms purchase of raw materials at right quantity, of right quality, from right supplier, at a right time not only ensures ready supply but also at a reasonably low price. Any purchase of substandard quality of materials will lead to dissatisfaction among customers and consequently it leads to loss of orders. Further, purchase of materials at high rate will increase the cost of production tremendously. Delay in getting supplies of materials lead to delay in executing customers orders. In these respects cost accounting department can assist purchase department to ensure efficient purchasing. Cost department also helps in reducing (a) waste of materials, (b) the risk from theft, and (c) excessive investment in inventories.

5. Cost accounting department and marketing department: Marketing department relies on cost information in order to (a) Estimate future product cost for fixing the selling price, (b) In knowing the expenses incurred in marketing the products so that if the amount exceeds the target, control measures can be taken to reduce such
expenses, (c) To consider alternative selling methods and promotional measures, and (d) To make further investment in warehousing and distribution process. Cost department provides all such information as is required by the marketing department for its efficient functioning.

6. **Cost accounting department and financial accounting department**: The existence of cost accounting department makes the financial accounting department a complete organisation by furnishing additional cost data to the chief accountant. Cost department enables financial accounts department in carrying out the latter’s function furnishing necessary data in respect of the following:

   (a) Supply of material cost, labour cost and expenses to facilitate preparation of manufacturing account.

   (b) Provision of the value of closing stock frequently to facilitate the preparation of interim final accounts.

   (c) Assist financial accounting department in matters relating to taxation, insurance and in solving legal matters.

   (d) Enables financial accounting department to settle the bills by duly approving them.

   (e) Helps financial accounting department in budgeting.

### ADVANTAGES OF COST ACCOUNTING

A good costing system serves the needs of a large sections of people. The advantages of cost accounting are discussed below:

**Advantages of Cost Accounting to Management**

1. **Fixation of responsibility**: Whenever a cost centre is established, it implies establishing a kind of relationship between superior and subordinates. Thus, responsibilities are fixed on every individual who is concerned with incurrence of cost.

2. **Measures economic performance**: By applying cost control techniques such as budgetary control and standard costing it helps in knowing the performance of business.

3. **Fixation of price**: By providing cost data it helps management to fix the selling price in advance. Hence, quotations can be supplied to prospective customers to secure orders.

4. **Aids in decision-making**: It helps management in making suitable decisions such as make or buy, replace manual labour by machines, shut down or continue operations based on cost reports.

5. **Helps in the preparation of interim final accounts**: By the process of continuous stock taking it enables to know the value of closing stock of materials at any time. This facilitates preparation of final accounts wherever desired.

6. **Helps in minimising wastages and losses**: Cost accounting system enables to locate the losses relating to materials, idle time and under utilisation of plant and machinery.
7. **Facilitates comparison:** It facilitates cost comparison in respect of jobs, process, departments and also between two periods. This reveals the efficiency or otherwise of each job, process or department.

8. **Assists in increasing profitability:** Costing reports provide information about profitable or unprofitable areas of operation. The management can discontinue that product line or that department which are responsible for incurring losses and only profitable line of activities alone are retained.

9. **Reconciliation with financial accounts:** A well maintained cost accounting system facilitates reconciliation with financial accounts to check the arithmetical accuracy of both the systems.

10. **It guides future production policy:** Cost data help management in determining future production policy. Any expansion or contraction of production for the future is based on past cost data.

**Advantages to Employees**

1. Cost accounting system enables employees to earn better wages through overtime wages and incentive systems of wage payment.

2. By providing better facilities it ensures job security to employees.

3. Employees benefit by merit rating techniques which is conducted by scientific process.

**Advantages to Creditors**

1. It increases the confidence of creditors in the capital employed in the business.

2. The frequent preparation of reports and statements help in knowing solvency position of the business.

**Advantages to Government**

1. It helps government in formulating policies regarding export, import, taxation, price control measures, wage fixation, etc.

2. It helps in assessing excise duty, sales tax and income tax of the business.

3. Costing information helps in preparing national plans.

**Advantages to Society**

1. Cost reduction and cost control programmes go to minimise cost of production of goods and services. A portion of the reduced cost of production is shared by customers by paying less price for goods and services.

2. It offers employment opportunities in the cost accounting department in the capacity of cost accountants and cost clerks.

**LIMITATIONS OF COST ACCOUNTING**

1. **It is expensive:** The system of cost accounting involves additional expenditure to be incurred in installing and maintaining it. However, before installing it, care must be taken to ensure that the benefits derived is more than the investment made on this system of accounting.
2. **The system is more complex:** As the cost accounting system involve number of steps in ascertaining cost such as collection and classification of expenses, allocation and apportionment of expenses, it is considered to be complicated system of accounts. Moreover the system makes use of several documents and forms in preparing the reports. This will tend to delay in the preparation of accounts.

3. **Inapplicability of same costing method and technique:** All business enterprises cannot make use of a single method and technique of costing. It all depends upon the nature of business and type of product manufactured by it. If a wrong technique and method is used, it misleads the results of business.

4. **Not suitable for small-scale units:** A cost accounting system is applicable only to a large-sized business but not to small-sized one. Hence, there is limitation to its application to all types of business.

5. **Lack of accuracy:** The accuracy of cost accounts get distorted owing to the use of notional cost such as standard cost, estimated cost, etc.

6. **It lacks social accounting:** Cost accounting fails to take into account the social obligation of the business. In other words, social accounting is outside the purview of cost accounts.

---

**CRITICISMS OR OBJECTIONS LEVELLED AGAINST COST ACCOUNTS**

Despite several benefits offered by cost accounts, critics have levelled the following criticisms against it:

1. **Cost accounting is merely a system of estimates and probabilities:** Though the main purpose of cost accounting is to ascertain the cost of production with a reasonable degree of accuracy, yet absolute accuracy is not possible owing to the two reasons. *(a)* Indirect expenditures are absorbed on the basis of predetermined rates instead of actual rates, and *(b)* The material cost and labour cost is inflated so as to cover the normal loss and wastage of materials and normal idle time of workers.

2. **Cost accounting is unnecessary in such business enterprises which make large profit:** It is argued that industries which earn large amount of profit need not have a system of cost accounting. This statement is absolutely wrong. Earning of more profit by industry does not necessarily mean that its cost of production is lowest and there is no scope for further reduction in the cost. Profit represents the difference between the selling price and the cost of a product. Profit earned by a business may be high because of increased price prevailing in the market. Two or more than two products manufactured by business may earn profit for one line of product and loss by other. The profit earned by one product may outweigh the loss suffered by other product thus resulting in overall profit. So it is wrong to judge the efficiency of the business on the basis of overall profitability of the business. If necessary steps are taken to reduce or eliminate losses suffered by a second line product, the industry would earn more amount of profit. It is in this context that a system of costing is felt.

3. **It is unnecessary:** This criticism is levelled owing to lack of understanding of the objectives and advantages of costing. In the present-day competitive world, every manufacturer must know the cost of production for each article so that he can fix
serving price on a reliable and reasonable basis. Further he can also compare his selling price thus fixed with the price prevailing in the market. Cost ascertainment involves application of certain principles and techniques. Having ascertained the cost, control techniques are used to keep the costs under check and thereby increase the profit. Thus it can be said that cost accounting is necessary in most of the concerns.

4. **It is expensive:** This criticism is true as long as the benefits derived from this system is not commensurate with the investment made on it. But by carefully designing the system so as to suit the business, the criticism can be nullified.

5. **Competition governs price and hence there is no need for costing system:** Some critics contend that in these days of competition prices are determined by the forces of demand and supply as against fixation of selling price by adding a desired margin of profit on the cost price. This argument is incorrect. Even in this situation cost accounts disclose the margin of profit that is earned by comparing the market price and cost of production. It impresses upon management the need to reduce cost by increasing the volume of production or by elimination of losses and wastages if any. If the cost price tend to be higher than the market price, it is desirable to abandon such product line and pay attention to profitable line of products.

6. **There is no need for costing where production efficiency is high:** The statement is misleading as without a yardstick to measure the efficiency it is not possible to appraise the efficiency of a business. Cost accounting system offers number of techniques such as standard costing, budgetary control, inter-firm comparison and so on. The cost of production can also be compared between two periods of time to know whether business is currently running efficiently when compared to previous year. In case of inefficient operation remedial measures can be taken to improve the business.

7. **Other objections:** Some other objections that are raised against the installation of cost accounting system are as follows:

   (a) **It is a mere matter of forms and rulings:** Often it is argued that the cost accounting system degenerates into a matter of mere forms and rulings. This is not the defect of cost accounting system but the way in which the system is maintained. No doubt different forms are necessary under costing system but they must be simplified and altered to meet the changing condition.

   (b) **Failure in many cases:** The system of cost accounting is often condemned as defective in as much as it has failed to produce the desired result. The defect does not lie in the costing system but for some other reasons such as indifferent attitude of the management, lack of adequate facilities, non-cooperations or opposition from employees. These defects can be overcome by reversing the above trend.

   (c) **For want of necessity:** It is contended by some that costing is of recent origin and that its application was not felt in the past. Though it was not used earlier, still many industries prospered. So it is felt by some critics that the installation of costing involves unnecessary expenditure. However, it is to be remembered that todays business functions in a competitive conditions and every manufacturer must know the actual cost of production in order to reduce the selling price. Many industrial failures in the past may be attributed to the lack of knowledge on the part of management relating to the actual cost of production thereby selling product below cost.
I. A. Indicate whether the following statements are True or False

1. Cost accounting is not needed for a non-profit organisation such as a club.  
   \[ T/F \]

2. If management is not interested in costing information, there should be no costing department.  
   \[ T/F \]

3. The cost accounting system is designed in such a way the flow of costs parallel the physical movement of products.  
   \[ T/F \]

4. Effective control of cost can be secured only if the responsibility for cost incurrence is clearly defined.  
   \[ T/F \]

5. Installation of a suitable system of cost accounting is restricted to manufacturing concerns only.  
   \[ T/F \]

6. Cost Audit is a part of cost accounting.  
   \[ T/F \]

7. Both financial accounting and cost accounting are written up with the same basic documents.  
   \[ T/F \]

8. Since pricing is a matter of management policy cost information is useless for price fixation.  
   \[ T/F \]

9. A concern that has been quite prosperous needs no costing system.  
   \[ T/F \]

10. Cost accounting is a branch of financial accounting.  
    \[ Answers: True–2, 3, 4, 6, 7  
    False–1, 5, 8, 9, 10 \]

B. Choose the correct answer from the following:

1. Which one of the following is most important tool in cost planning
   \( (a) \) cost unit  \( (b) \) direct cost  
   \( (c) \) cost statement  \( (d) \) budgeting

2. Cost accounting concepts include all the following except:
   \( (a) \) planning  \( (b) \) profit sharing  
   \( (c) \) controlling  \( (d) \) product costing

3. The principal factor to be considered in designing a cost system include:
   \( (a) \) company organisation structure  \( (b) \) nature of business  
   \( (c) \) manufacturing process  \( (d) \) all of the above

4. The chief objective of cost accounting is to
   \( (a) \) earn more profit  \( (b) \) increase production  
   \( (c) \) provide information for management for planning and control  
   \( (d) \) fix the prices

5. Cost accounting is
   \( (a) \) nothing more than a detailed analysis of expenditure  
   \( (b) \) an instrument of management control  
   \( (c) \) useful only in such organisation as have profit as the aim  
   \( (d) \) not needed if prices are beyond the control of the firm

6. The need for cost accounting arises as it helps in
   \( (a) \) ascertaining and control of cost  \( (b) \) increasing the sales  
   \( (c) \) increasing the production  \( (d) \) solving labour problem
7. The primary objective of cost accounting in modern time is
   (a) cost ascertainment  \hspace{2cm} (b) cost control
   (c) ascertainment of profit \hspace{2cm} (d) preparation of reports
8. The purpose of financial accounting is to provide information for
   (a) fixing prices \hspace{2cm} (b) recording expenses
   (c) locating factors leading to wastage and losses \hspace{2cm} (d) assessing the profitability and financial position of the firm
9. Which one of the following is not a factor to be considered in designing a cost system
   (a) price factor \hspace{2cm} (b) organisational factor
   (c) economy factor \hspace{2cm} (d) reporting factor
10. Cost accounting differs from financial accounting in respect of
    (a) recording cost \hspace{2cm} (b) ascertaining cost
    (c) control of cost \hspace{2cm} (d) reporting of cost

\textbf{C. Match the following:}

\begin{tabular}{ll}
\textit{List A} & \textit{List B} \\
1. Financial accounting provides & (a) management needs \\
2. One of the objections against costing & (b) ascertainment of profit of business \\
3. Cost accounting was evolved & (c) is expensive \\
4. Financial accounting is concerned with & (d) find the actual cost of product \\
5. Cost accounting is concerned with & (e) factual financial information \\
\end{tabular}

\textit{Answers:} 1. (a), 2. (b), 3. (d), 4. (c), 5. (b), 6. (a), 7. (b), 8. (d), 9. (a), 10. (c)

\textbf{SECTION–A}

\textbf{Simple questions}

1. Define Cost Accounting. \hspace{5cm} \textit{(Bangalore University, B.Com., April 2000)}
2. Distinguish between costing and cost accounting. \hspace{5cm} \textit{(Bangalore University, M.Com., 1998)}
3. Mention any two uses of cost accounting system to management. \hspace{5cm} \textit{(Bangalore University, B.Com., November 1999)}
4. Mention two limitations of costing. \hspace{5cm} \textit{(Bangalore University, B.Com., November 1997)}
5. Distinguish between cost, estimate and price. \hspace{5cm} \textit{(Sri Krishnadevaraya University, B.Com., March 1997)}
6. State any four items which are not included in cost accounts. \hspace{5cm} \textit{(Bangalore University, B.Com., April 1995)}
7. Mention steps that you should take to instal cost accounting. \hspace{5cm} \textit{(Bharathidasan University, B.Com., November 1995)}
8. Mention two objects of cost accounting. \hspace{5cm} \textit{(M.G. University, B.Com., April 1994)}
9. What are the limitations of financial accounting? \hspace{5cm} \textit{(Osmania University, B.Com., October 1996)}

\textbf{SECTION–B}

\textbf{Short answer questions}

1. “Cost accounting is becoming more and more relevant in the emerging economic scenario in India.” Comment. \hspace{5cm} \textit{(C.S. Intermediate, June 2000)}
2. “Cost accounting system that simply records for the purpose of fixing sale price has accomplished only a small part of its mission.” Explain.  
   (C.S. Intermediate, June 1999)
3. “Selling price is always based on total cost.” Comment.  
   (C.S. Intermediate, June 1999)
4. “Cost accounts are key to economy in manufacture and one indispensable to the intelligent and economical management of a factory.” Discuss.  
   (C.S. Intermediate, June 1998)
5. State the steps involved in the installation of a costing system in a large manufacturing company.  
   (C.S. Intermediate, June 1997) (S.V. University, B. Com., Sept. 94)
6. Cost accounting is a system of foresight and not a postmortem examination, it turns losses into profits, speeds up activities and eliminates wastes. Comment.  
   (C.S. Inter, December 1997)
7. State two differences between financial accounts and cost accounts.  
   (Bharathidasan University, B.Com., April 1998)
8. What are the main characteristics of an ideal cost accounting system?  
   (M.G. University, B.Com., September 1994)
9. What is costing? What are its objectives?  
   (Calcutta University, B.Com., October 1994)
10. Describe the pre-requisites for the installation of cost accounting system.  
    (Karnataka University, M.Com., April 1997)
11. Write a note on cost control.  
    (Mangalore University, B.Com., April 1997)
12. What is cost accounting? What are its objectives? In what respects does cost accounting differ from financial accounting?  
    (Mangalore University, B.Com., October 1996)
13. Distinguish between cost, estimation and cost ascertainment.  
    (University of Kerala, B.Com., April 1996)
    (Bangalore University, B.Com., November 1992)

**SECTION–C**

**Long answer questions**

   (University of Mysore, B.Com., April 1998)
   (University of Mysore, B.Com., April 2000)
3. “A Good system of costing must place the same emphasis on cost control as on cost ascertainment.” Comment on this statement.  
   (University of Mysore, B.Com., October 1999)
4. “Cost accounting is better understood as a cost control and cost reduction exercise and not a mere cost ascertainment process.” Discuss.  
   (University of Mysore, B.Com., April 1997)
5. “Cost accounting is a system of foresight like pre-natal care, but financial accounting is just a post-mortem examination.” Critically examine this statement.  
   (University of Mysore, B.Com., October 1996)
6. What are the limitations of financial accounting? How do you overcome them in cost accounting?  
   (University of Mysore, B.Com., November 1995)
   (University of Mysore, B.Com., November 1998)
8. State the advantages of costing. How it aids the management and what objections are raised against cost accounts?  
   (University of Mysore, B.Com., November 1991)
9. Define costing. Discuss briefly the objectives and advantages of costing.  
   (S.V. University, B.Com., April 1998)
    (Madurai Kamaraj University, B.Com., April 1998)
11. Define costing. Critically evaluate the arguments for the installation of costing system in an industry.  
   (Mangalore University, B.Com., April 1998)
12. What are the objectives of cost accounting? What are its advantages and limitations?  
   (Nagarjuna University, B.Com., March 1998)
13. Cost accounting has become an essential tool of management. Mention the steps to be taken while installing cost accounting system in a manufacturing concern.  
   (Sri Krishnadevaraya University, M.Com., April 1998)
14. What are the objectives of cost accounting and what is the relation with Management accounting department?  
   (S.V. University, B.Com., September 1995)
15. “Cost accounting has become an essential tool of modern management.” Comment.  
   (Mangalore University, B.Com., April 1994)
16. Explain briefly the objects, advantages and limitations of costing.  
   (Sri Krishnadevaraya University, B.Com., April 1994)
17. Define cost accounting. How does a good system of cost accounting serve the management?  
   (Bharathidasan University, B.Com., April 1994)
18. Discuss the limitations of financial accounting and explain the importance of cost accounting.  
   (M.G. University, B.Com., April 1996)
19. “An efficient system of costing is essential factor for industrial control under modern conditions of business and as such may be regarded as an important part in the efforts of any management to secure business stability.” – Elaborate.  
   (Mangalore University, B.Com., September 1997)
   (Madurai Kamaraj University, B.Com., April 1997)
21. What do you mean by installation of costing system? Explain the practical difficulties involved in installing such a system in a manufacturing concern.  
   (Osmania University, B.Com., October 1996)
22. Explain the advantages of cost accounting. What are the differences between cost accounting and Financial accounting?  
   (Sri Krishnadevaraya University, B.Com., October 1996)
23. “A good costing system is an invaluable aid to management.” Discuss.  
   (Osmania University, B.Com., March 1996)
24. How cost accounting is superior over financial accounting? Explain the technique of costing and their application and suitability.  
   (Karnataka University, M.Com., May 1996)
25. What is cost accounting? What are its objectives? Discuss.  
   (Mangalore University, B.Com., October 1995)
26. “Cost accounting has become an essential tool of management.” Comment and state the steps to be taken while installing a costing system in a manufacturing concern.  
   (Bangalore University, M.Com., May 1995)
27. Explain the advantages of cost accounting.  
   (University of Kerala, M.Com., May 1995)
28. Explain the significance of cost accounting in a manufacturing company.  
   (Sri Krishnadevaraya University, M.Com., April 1995)
29. Enumerate the main objectives of introduction of a cost accounting system in a manufacturing organisation.  
   (C.A. PE-II November 2002)
30. Distinguish between costing and cost accounting.  
   (C.S. June 2004)
31. Explain the advantages and limitations of cost accounting system for a modern manufacturing organisation.  
   (Osmania University, M.Com., (Final) June 2003)
32. State the objectives of cost accounting and list out the characteristics of an ideal costing system.  
   (Osmania University, M.Com., (Final) June 2002)
33. Enumerate the matters which you will investigate and the problems which you expect to face before installing a costing system in a manufacturing company.  
   (Osmania University, M.Com., April 2000)
34. Explain the need for the development of cost accounting and state its objectives.  
   (Osmania University, B.Com., March 2004)
35. Explain the significance of cost accounting.  
   (Osmania University, B.Com., October 2003)
36. Explain the differences between cost accounting and financial accounting.  
   (Osmania University, B.Com., March 2003)
37. Define costing and explain the advantages and limitations of costing.  
   (Kakatiya University, B.Com., July 2003)
38. (a) State any five differences between financial accounting and cost accounting.  
    (Sri Sathya Sai University, B.Com., (Hons) March 2005)
   (b) Explain any five essential features of an ideal cost accounting system.  
    (Sri Sathya Sai University, B.Com., (Hons) March 2005)
39. “Cost accounting is considered to be an invaluable aid to management.” Bring out the advantages of cost accounting to management of an organisation.  
   (Sri Sathya Sai University, B.Com., (Hons) March 2001)