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B.COM HONOURS	SEMESTER 1	CALICUT UNIVERSITY	COURSE CODE: COM1MN104

ESSENTIALS OF COST ACCOUNTING

EXAM REVISION NOTES

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MODULE I

1. INTRODUCTION TO COST ACCOUNTING: NATURE, SCOPE & CORE OBJECTIVES

Introduction to Cost Accounting: Nature, Scope Core Objectives: In modern industrial economics, financial accounting provides a macroscopic, historical view of an enterprise's overall financial performance and solvency.

Core Objectives and Scope of Cost Accounting

- **Ascertainment of Unit Cost:** Determining the true cost per unit of product, job, contract, or service through scientific cost accumulation.
- **Cost Control and Cost Reduction:** Setting standard benchmarks and eliminating operational wastages, idle time, and material scrap.
- **Determination of Selling Price:** Providing accurate total cost data to establish competitive, profit-maximizing price quotations.
- **Managerial Decision Making:** Equipping executive leadership with vital cost information for decisions like Make or Buy, Shut down or Continue, and Product Line Rationalization.

Cost Accounting vs. Financial Accounting vs. Management Accounting: An enterprise maintains distinct accounting subsystems to cater to external compliance authorities and internal decision-makers.

Comprehensive Classification of Costs: In cost accounting, costs are categorized across multiple dimensions depending upon the specific analytical objective of management.

Costs for Managerial Planning Decision Making

- **1. Opportunity Cost:** ; Evaluating whether to invest retained capital in a new plant vs.
- **2. Sunk Cost:** ; Past historical R amp;D costs; must be completely ignored in current pricing and shutdown decisions.
- **3. Marginal Cost:** ; Setting minimum rock-bottom prices for special export orders during recessionary periods.
- **4. Differential / Incremental Cost:** ; Comparing the financial feasibility of expanding plant capacity from 10,000 to 15,000 units.

Methods Techniques of Costing, Cost Centres Cost Units: Because manufacturing processes and service operations differ radically across industrial sectors, cost accounting deploys specialized methods and techniques.

Techniques of Costing

- **Historical Costing:** Recording and ascertaining costs after they have been actualized.
- **Standard Costing:** Establishing scientific predetermined cost benchmarks for materials, labor, and overheads, and analyzing Variances between actual and standard costs.
- **Marginal Costing:** Segregating costs strictly into fixed and variable components, treating fixed costs as period costs charged to contribution margins.
- **Activity-Based Costing (ABC):** , number of purchase orders, number of machine setups) rather than arbitrary volume-based allocation.

Activity-Based Costing (ABC) Framework Cost Hierarchy: 1. , Material Ordering Pool, Machine Setup Pool, Quality Inspection Pool).

- **Stage 1:** , Material Ordering Pool, Machine Setup Pool, Quality Inspection Pool).
- **Stage 2:** , number of purchase orders, setup hours, number of inspections).
- **Unit-Level Activities:** Incurred each time a unit is produced (machine electricity).
- **Batch-Level Activities:** Incurred for each batch processed (setup costs, batch material handling).
- **Product-Sustaining Activities:** Incurred to support specific product lines (product design engineering, patent maintenance).

The Master Cost Sheet Architecture (Statement of Cost): A Cost Sheet is a structured statement designed to accumulate, classify, and compute the various elements of cost incurred during a specific accounting period:

- **CAS-1:** Classification of Cost; Provides broad guidelines for categorizing costs by elements, function, and behavior.
- **CAS-2:** Capacity Determination; Principles for determining Licensed Capacity, Installed Capacity, and Practical Capacity.
- **CAS-3:** Methods of collection, allocation, apportionment, and absorption of factory overheads.
- **CAS-4:** Cost of Production for Captive Consumption; Mandatory standard for assessing excise/GST valuation on goods consumed internally.

Advanced Theoretical Extensions Analytical Problem-Solving: In modern academic curricula and enterprise governance, mastering Essentials of Cost Accounting demands a rigorous integration of foundational theory with multi-stakeholder operational frameworks.

Empirical Comparative Framework: A structured comparative assessment provides valuable clarity regarding organizational practices across varying scales of enterprise operation:

- **Analytical Methodology:** ; Proactive bottleneck prevention and enhanced operational responsiveness.
- **Cross-Functional Alignment:** ; Reduced cycle latency and streamlined organizational communication.
- **Risk amp; Governance Architecture:** ; Comprehensive asset protection and long-term stakeholder trust preservation.
- **Resource Allocation Dynamic:** ; Optimized return on invested capital and enhanced strategic agility.

Contemporary Risk Governance, Statutory Compliance Case Analysis: Modern corporate governance requires that operational decisions withstand scrutiny across legal, financial, and ethical dimensions.

MODULE II

1. ACCOUNTING AND CONTROL OF MATERIAL COST: PROCUREMENT & STORAGE ARCHITECTURE

Accounting and Control of Material Cost: Procurement Storage Architecture: In manufacturing organizations, Material Cost represents the single largest element of total product cost, frequently accounting for 50% to 70% of total manufacturing expenditure.

The Material Procurement Receiving Cycle: To eliminate unauthorized purchasing and fraud, materials follow a disciplined 5-stage documentation pipeline:

- **1. Purchase Requisition:** Initiated by the Storekeeper or Department Head notifying the Purchasing Officer that stock has touched the Re-Order Level.
- 2.
- **3. Purchase Order (PO):** The legal contract sent to the selected vendor specifying item descriptions, quantities, unit prices, delivery schedule, and credit terms.
- **4. Goods Received Note (GRN):** Prepared by the Receiving Section upon physical arrival of goods, verifying quantity against delivery challan.
- **5. Inspection Report amp; Bill Verification:** Quality control tests raw material integrity before sending the approved invoice to the Accounts Department for payment.

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Quantitative Inventory Control Techniques Stock Level Engineering: Inventory Control is the systematic operational technique of maintaining stock levels such that uninterrupted manufacturing is guaranteed while minimizing working capital lock-in and carrying costs.

Economic Order Quantity (EOQ) Mathematical Optimization: The Economic Order Quantity (EOQ) (developed by Ford W. Harris) represents the optimal order size that minimizes total annual inventory costs by balancing two opposing cost forces: Ordering Costs and Carrying Costs.

- A: Annual Consumption Demand in Units.
- O: Cost of placing and receiving one order (Ordering Cost per Order).
- C: Cost of carrying / storing one unit of inventory for one full year (Carrying Cost per unit per annum).

Selective Inventory Control Techniques: ABC, VED, FSN JIT: In large manufacturing plants holding tens of thousands of inventory items, applying equal managerial control across all materials is physically impossible and economically wasteful.

Just-In-Time (JIT) Inventory Kanban Systems

- **Just-In-Time (JIT) Philosophy:** Pioneered by Toyota (Taiichi Ohno), JIT aims for Zero Inventory by synchronizing material arrival at the factory assembly line exactly when needed in production.
- **Kanban Cards:** Visual signaling cards that trigger upstream supplier delivery only when a downstream workstation consumes its immediate buffer, eliminating warehouse storage entirely.

Major Material Issue Pricing Methodologies

- **1. FIFO (First In, First Out):** ; • During Inflation: Low historical costs charged to production (high accounting profits); closing inventory valued at current high market price.
- **2. LIFO (Last In, First Out):** ; • During Inflation: Current high purchase prices matched with revenue (lowers taxable profit); closing inventory reflects outdated low costs.
- **3. Simple Average Method:** ; Ignores the physical quantity of units in each lot; distorts costs if lot sizes vary widely.
- **4. Weighted Average Method:** Issue Price = Total Value of Material in Stock ÷ Total Quantity of Material in Stock.

Specialized Notional Material Issue Pricing Methods

- **1. Base Stock Method:** ; Ensures emergency strategic reserves are never depleted or revalued at inflated prices.
- **2. Standard Price Method:** ; Measures purchasing department efficiency and stabilizes production job costs.
- **3. Inflated Price Method:** ; Automatically recovers normal material loss costs directly from production.
- **4. HIFO (Highest In, First Out):** ; Ultra-conservative costing; charges maximum cost to production during cost-plus contracts.

Periodic vs. Perpetual Inventory Systems: 1. Periodic Inventory System: Physical stocktaking conducted only at the end of the accounting year.

- **2. Perpetual Inventory System:** A continuous recording system comprising Bin Cards and Stores Ledger sheets paired with Continuous Physical Verification.

Accounting Entries for Material Discrepancies Losses

- **1. Material Scrap Realized for Cash:** Cash / Bank / Debtors Account; Factory Overhead Control Account (or Cost of Material Consumed)
- **2. Abnormal Material Wastage / Spoilage:** Costing Profit amp; Loss Account; Stores Ledger Control Account
- **3. Normal Material Shrinkage amp; Evaporation:** Factory Overhead Control Account; Stores Ledger Control Account
- **4. Re-working Cost of Normal Defectives:** Factory Overhead Control Account; Wages / Stores / Direct Expense Control Account

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MODULE III

1. ACCOUNTING AND CONTROL OF LABOUR COST: TIMEKEEPING & TIME BOOKING

Accounting and Control of Labour Cost: Timekeeping Time Booking: In manufacturing economics, Labour Cost represents the human effort expended in converting raw materials into finished goods.

Timekeeping vs. Time Booking Architecture: Accurate labor accounting requires two distinct but complementary time-recording functions:

- **1. Core Objective:** ; To record the exact time spent by a worker on specific production jobs, operations, or idle machine waiting.
- **2. Primary Purpose:** ; Ascertainment of direct labor cost for individual jobs, measuring worker efficiency, and allocating overheads.
- **3. Key Mechanisms:** ; Daily Time Sheets, Weekly Time Sheets, Job Cards (Job Tickets), Route Cards, Piece Work Cards.
- **4. Department Responsible:** ; Shop-Floor Supervisors and Production Planning Department inside the factory.

Practical Methods of Time Booking (Shop Floor Recording)

- **1. Daily Time Sheet:** ; Used in small workshops where workers switch between multiple quick jobs daily.
- **2. Weekly Time Sheet:** ; Used in building contracting, maintenance crews, and repair yards.
- **3. Job Card / Ticket:** ; Directly accumulates direct labor hours to calculate total direct labor cost of the job.
- **4. Idle Time Card:** ; Segregates normal and abnormal idle labor hours for cost analysis and supervisory control.

Time-Rate Systems vs. Piece-Rate Systems: 1. Time-Rate System: Wages = Hours Worked × Guaranteed Hourly Wage Rate.

- **Advantages:** Guaranteed steady income; high craftsmanship quality; zero equipment rushing.
- **Disadvantages:** Lacks incentive for high performers; requires strict supervision; ignores worker efficiency.
- **Best Suited For:** Precision toolmaking, artistic craftsmanship, testing/inspection jobs.
- **Advantages:** Direct incentive for speed; rewards efficiency; simplifies direct labor cost allocation.
- **Disadvantages:** Workers compromise product quality for speed; high machine wear and tear; zero guaranteed minimum wage.

Premium Bonus Incentive Schemes: Halsey Rowan Plans: To overcome the disadvantages of both pure time rates and pure piece rates, industrial economists formulated Premium Bonus Plans, where workers receive guaranteed time wages plus a financial bonus proportional to the Time Saved (S - T).

Alternative Individual Group Incentive Schemes

- **1. Emerson's Efficiency Plan:** ; Encourages slow and steady workers to cross standard thresholds without intimidation.
- **2. Bedeaux Point Premium System:** Standard time divided into standard minutes called "Bedeaux points" (B's).
- **3. Scanlon Plan (Group Incentive):** A collective bonus based on the ratio of total labor costs to total sales value of production (SVOP).
- **4. Priestman Plan (Group Output):** A standard output is fixed for the factory as a whole.

Overtime Premium: Statutory Mandates Accounting Treatment: Under Section 59 of the Factories Act, 1948, any worker working more than 9 hours in a day or 48 hours in a week must be paid overtime wages at twice the normal wage rate (Normal Wage + Overtime Premium).

- **1. At Customer's Specific Urgent Request:** Charged directly to the specific customer job as a Direct Expense.
- **3. Due to Departmental Bottleneck or Inefficiency:** Charged to the specific departmental overhead causing the delay.
- **4. Due to Abnormal Delays (Fire, Strike, Flood):** Charged directly to the Costing Profit amp; Loss Account.

Labour Turnover Learning Curve Theory: Labour Turnover (LTO) is the rate at which workers leave an organization and are replaced by new recruits. Excessive labor turnover destabilizes production schedules, escalates recruitment/training costs, and impairs factory productivity.

Wright's Learning Curve Theory (Experience Curve): P. Wright in aircraft manufacturing, Learning Curve Theory asserts that as the cumulative volume of units produced doubles, the cumulative average direct labor hours required per unit decreases at a constant percentage rate (typically an 80% Learning Curve).

- **Managerial Costing Implication:** Direct labor cost per unit is highest for initial prototype batches and declines systematically as workers master repetitive tasks, enabling aggressive forward pricing and accurate budget forecasting.

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MODULE IV

1. OVERHEADS: CONCEPTUAL FOUNDATION, CLASSIFICATION & CODIFICATION

Overheads: Conceptual Foundation, Classification Codification: In cost accounting terminology, Overheads represent the aggregate of all indirect expenditures incurred in running an enterprise.

Codification Collection of Overheads: To accumulate thousands of overhead transactions without confusion, cost accounting assigns pre-structured numerical or alphanumeric Cost Account Codes (Standing Order Numbers for factory overheads; Cost Account Numbers for administration/selling expenses) linked directly to source documents such as Material Requisition Slips, Invoices, Wage Summaries, and Journal Vouchers.

Departmentalization, Allocation Primary Distribution of Overheads: , Boiler House, Tool Room, Canteen, Stores).

The Three Stages of Overhead Accounting: Synthesis

- **Stage 1: Overhead Allocation:** ; Whole Expense rarr; Single Department.
- **Stage 2: Overhead Apportionment:** ; Common Expense rarr; Multiple Departments.
- **Stage 3: Overhead Absorption:** ; Department Overheads rarr; Product Cost Units.

Secondary Distribution Methodologies

- **1. Direct Re-Apportionment:** ; When inter-service department reciprocal services are negligible.
- **2. Step-Ladder (Non-Reciprocal):** Service departments arranged sequentially based on the breadth of services rendered.
- **3. Simultaneous Equation Method:** ; The Most Accurate Method: When service departments render mutual, reciprocal services to each other.
- **4. Repeated Distribution Method:** ; Practical continuous apportionment in complex multi-service factories.

Master Overhead Absorption Methodologies

- **1. Direct Material % Rate:** (Production Overheads ÷ Direct Material Cost) × 100; Only when raw material prices are stable and uniform across all jobs.
- **2. Direct Labour % Rate:** (Production Overheads ÷ Direct Labour Wages) × 100; Suited for labor-intensive shops where wage rates are uniform.
- **3. Direct Labour Hour Rate:** Production Overheads ÷ Total Direct Labour Hours; The Standard for Manual Operations: Reflects the time element perfectly.
- **4. Machine Hour Rate (MHR):** Production Overheads ÷ Total Productive Machine Hours; The Gold Standard for Automated amp; Mechanized Manufacturing.

Simple Machine Hour Rate vs. Comprehensive Machine Hour Rate: 1. Simple Machine Hour Rate: Includes only machine-specific direct running expenses (Depreciation, Power, Machine Maintenance, Consumables).

- **2. Comprehensive Machine Hour Rate:** Integrates both direct machine running expenses and general factory standing fixed charges (plus direct machine operator wages if dedicated exclusively to one machine) into a single composite hourly rate.

Under/Over Absorption of Overheads Master Cost Sheet Formulation: Because overhead absorption rates are predetermined at the beginning of the year based on estimated budgets and forecasted capacity, actual overheads incurred almost never match the absorbed overheads charged to production.

The Supplementary Overhead Rate: Formula Disposal

Production Account vs. Cost Sheet Ledger Control Accounts

- **1. Document Format:** ; A formal double-entry ledger account prepared in traditional 'T' shape (Debit: Costs; Credit: Output/Sales).
- **2. Double-Entry Integration:** ; Forms an integral part of double-entry cost accounting ledgers.
- **3. Unit Cost Disclosure:** ; Shows only aggregate lump-Sum of totals; per-unit breakdown is typically omitted.

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- **4. Future Estimation Role:** ; Strictly prepared post-facto for past completed accounting periods.

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