

**Textbook of**  
**COST AND MANAGEMENT**  
**ACCOUNTING – I**

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## **PREFACE**

Cost Accounting has assumed a great importance in the present century and with the growth of business and complexity in its machinery; this subject is introduced in almost all the universities for management and commerce courses.

This textbook of Cost Accounting is the outcome of our teaching experience in this subject to the B.B.M, B.Com, M.B.A and C.A students.

The present book has got some special features. The language used throughout this book is simple and easily understandable. Varieties of problems have been presented in a quite intelligible manner, making the subject more clearly to the students. This book contains sufficient number of worked out problems.

We are highly indebted to Edwise Publishers, Mangalore, who have readily consented to bring out this book.

We would feel amply rewarded if the book could meet the expectations of the readers. Any suggestions to augment the usefulness of the book would be welcome and gratefully acknowledged.

**2022**

**Dr. UMESH MAIYA**

**&**

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# **SYLLABUS**

## **COST AND MANAGEMENT ACCOUNTING – I**

### **CHAPTER - I : BASIC CONCEPTS**

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### **CHAPTER - VI : LABOUR**

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# CHAPTER - I

## BASIC CONCEPTS

### INTRODUCTION

Cost accounting system is developed mainly because of limitations of financial accounting. Both financial accounting and cost accounting are the branches of accounting whose primary objective is to provide information for decision-making. Financial accounting mainly intends to serve external purposes while cost accounting is concerned with detailed analysis of cost to provide facts required by internal decision-makers. Thus, in the words of L.W. Hawkins, **“The ordinary trading account is a locked store-house of most valuable information to which cost system is the key”**. Cost Accounting, as a subject, was developed during 1920s. The most logical way of defining cost accounting is to start with the term ‘cost’.

### MEANING AND DEFINITION

#### COST

The term **‘cost’** refers to sacrifice or release something of value. The term ‘cost’ can also be defined as “resources that have been or must be sacrificed to obtain a particular objective”.

So, the term cost may be referred to the amount of total expenses or expenditure incurred on a given thing. Hence, the cost may be expenses or expenditure or both.

#### COSTING

ICMA defines costing in most simple way as “the techniques and the process of ascertaining the cost.”

Cost accounting is a process of accounting for cost which starts with the recording and ends with the preparation of cost report. Cost accounting can also be defined as “the application of accounting and costing principles, methods and techniques in the ascertaining of cost, cost controlling and the profitability”.

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## **COST ACCOUNTING**

Cost accounting is defined as “the application of accounting and costing principles, method and techniques in the ascertaining of cost, cost controlling and the profitability”.

### **COST ACCOUNTANCY:**

CIMA, 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 there from for the purpose of managerial decision making”.

According to this definition, cost accountancy refers to costing and cost accounting principles, methods and techniques applied for controlling the cost and profitability ascertainment. The information obtained will be used for managerial decision making.

### **MANAGEMENT ACCOUNTING:**

CIMA, London, defines management accounting as “the application of professional knowledge and skill in the preparation of accounting information in such a way as to assist management in the formulation of policies, and in the planning and control of the operations of the undertaking”.

According to this definition, management accounting is presentation of accounting information in such a way that it will help the management to form the policies, to plan and to control the operations of the undertaking.

### **OBJECTIVES OF COST ACCOUNTING**

The primary objective of cost accounting as a branch of accounting is the ascertainment of the cost of a unit, process, department or job. In this process, it supplies diverse information for managerial decision-making. Thus, the important aims, objectives or purposes of cost accounting are the following:

**1. Cost determination:** Determination of cost of the product is the main objective. It includes, collection, classification recording and analysis of all the items of cost of every unit.

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**2. Price fixing:** Cost accounting provides a factual basis for price fixation. Cost data are the most reliable basis for fixing the prices, especially in case of quotations and tenders, new products and changes to be made in the prices of existing products. Cost is a fact, price is a policy. Hence, while fixing a price of a commodity cost accounting helps a lot.

**3. Cost control:** Cost accounting provides useful data and information for control of different activities of business. A good cost accounting system is always an integral and vital part of management control. It includes comparison of actual business performances with budget and estimates; analysis of variances and management responsibility for variances; and reporting the performance to the managers. Thus, it directs the attention of management to the specific area where control measures are to be taken.

**4. Providing basis for decision-making:** Cost accounting is increasingly used as a tool of decision-making. It provides data to analyze the effects of various alternative courses of action. Especially in case of non-recurring decisions involving high cost and unique opportunities (e.g., developing new products or changing the method of production etc.), appropriate cost information is a basic prerequisite.

**5. Other specific objectives:** Apart from the above primary purposes, cost accounting is also adopted for the following specific purposes:

- a. Ascertaining profitability and efficiency of different products, jobs, operation etc. in relation to the capital investment.
  - b. Ascertaining optimum level of output, product or material mix.
  - c. Preparation of comparative cost schedules of different jobs, processes and methods at different conditions to select the best course of action.
  - d. Preparation of interim statements of closing stock of W-I-P, materials and finished goods without physical verification of stock. Such information is used to prepare interim financial statement of profit and efficiency etc.
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## LIMITATIONS OF FINANCIAL ACCOUNTING

Both financial and cost accountings are the branches of accounting but in different ways, serve their own purpose.

Cost accounting has taken birth only on account of the inability of financial accounting to meet the needs of modern complex and large scale industrial enterprises. Thus, it is rightly said that **“The ordinary trading account is a locked store-house of most valuable information to which costing is the key”**. Financial accounting treats cost very broadly while cost accounting does this in much greater detail. In order to illustrate this fact, let us examine the following two statements:

### Trading Account

#### (Financial Accountant's statement)

To Purchases	25,000	By Sales	40,000
To Wages	8,000	By Closing Stock of	
To Other expenditures	8,000	raw materials	5,000
To Gross Profit	4,000		
	<b>45,000</b>		<b>45,000</b>

### Cost Sheet

#### (Cost accountant's statement)

Particulars	Product X	Product Y	Product Z	Total
Material Consumed (25000-5000)	10,000	6,000	4,000	20,000
Wages	3,000	2,500	2,500	8,000
Other Expenses	3,500	3,000	1,500	8,000
Cost of production	16,500	11,500	8,000	36,000
<b>Profit/Loss</b>	<b>2,500</b>	<b>(-) 1,500</b>	<b>3,000</b>	<b>4,000</b>
Sales	19,000	10,000	11,000	40,000

Financial accounting system gives the picture of the entire business in aggregate, but fails to provide information relating to the cost of each product line, the analytical study of sales figures, profitability of each product etc. Such detailed information can be obtained from cost records.

In the statement of costs, which is prepared by cost accountants, we observe that products X & Z earn profits and product Y shows loss. Cost of production of each product is ascertained if the number of units of respective product divides the total cost.

Cost accounting depends upon the data supplied by the financial accounting and studies the same transactions in detail. Cost accounting system is superior, more advanced and more useful when compared to financial accounting system. It can be made clearer from the following:

1. Financial accounting cannot serve as the proper yardstick for measuring the efficiency of a concern. The profit or loss disclosed by the profit and loss account cannot always be taken as a sure sign of the efficiency or inefficiency of a concern. This is because, sometimes, especially in times of war even the most inefficient concern may make huge profit, and sometimes, especially during trade depression, even the most efficient concern may incur loss. So, a concern requires some other yardstick to measure its performance at all times. Cost accounting can serve the purpose of measurement of efficiency at all times.

2. The data information revealed by financial accounting is generally inadequate. The profit and loss account discloses only the net result of the collective activities of the business as a whole. It does not indicate the profit or loss of each activity. But every management requires information not only on the total profit or loss of the whole concern, but also on the profit or loss of each activity so that it can determine the profitable and unprofitable activities, and take steps to improve the unprofitable activities or drop out such activities. Cost accounting serves this purpose of management very well.

3. Financial accounting deals only with the total expenditure, and not with the expenditure incurred on each of the products or services. As such, the cost of individual products or services cannot be determined and the prices of individual products or services cannot be fixed on the basis of information supplied by financial accounting. Cost accounting, on the other hand, allocates and apports the total

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