

# **COST AND MANAGEMENT ACCOUNTING - I**

**( For Undergraduate Classes)**

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**UNITED PUBLISHERS**

**MANGALORE-575 001.**

Edition : June, 2015

**Price Rs. 240.00**

Publishers : **UNITED PUBLISHERS**  
Alaiman Compound  
Jeppu Market Road  
Mangalore - 575 001  
Ph.: 0824-2406160  
Mob.: 9591042660

Type Set : **UNITED PUBLISHERS**  
Mangaluru.

## **PREFACE**

This Text-Book of **Cost and Management Accounting – I** is specially prepared for the undergraduate Students. It is prepared in accordance with the syllabus given in this book.

I do not claim any originality in the subject-matter of this book. I have drawn immense material from many standard books on this subject. Yet, this book is original in the exposition and presentation of the subject-matter. The subject-matter has been dealt with exhaustively and in very simple language.

I express my profound gratitude to my well-wishers for their encouragement in the preparation of this book. I am also thankful to **United Publishers, Mangalore**, for bringing out this book.

I shall consider my efforts amply rewarded if this book is found useful by the teachers and the students.

Suggestions for improvement of this book will be gratefully accepted.

**Mangalore,**

**B.S. Raman**

# **SYLLABUS**

## **Chapter- I : Basic Concepts:**

**10 Hrs.**

Meaning and definition : Cost, costing, Cost Accounting, cost accountancy and management accounting, Objectives of cost accounting, Limitations of Financial accounting, Relationship between Cost accounting and Financial accounting, Advantages of cost accounting Systems, Methods and Techniques of cost accounting.

## **Chapter- II : Introduction of Costing System:**

**10 Hrs.**

Cost unit and cost centre, Classification of costs on the basis of elements, functions and behaviour.

## **Chapter- III : Cost Sheet:**

**10 Hrs.**

Cost Sheet – Tenders and Quotations.

## **Chapter – IV : Material Control:**

**10 Hrs.**

Material control: meaning and objectives, Purchase of Materials: Types of purchasing– centralized and decentralized purchasing, purchase procedure. Pricing of material purchases – simple problems, Stores control – Meaning – Types of Stores. Inventory control – Meaning and techniques, Fixation of stock levels – Economic Order Quantity, ABC Analysis. Physical stock verification: Periodical and continuous stock verification - merits, problems on stock levels, EOQ and Bin Card.

## **Chapter- V : Pricing of Material Issues:**

**10 Hrs.**

Methods of pricing the material issues – Theory and Problems on FIFO and Weighted Average Methods.

## **Chapter – VI : Labour:**

**10 Hrs.**

Labour : Meaning – Direct and Indirect labour, Time keeping and Time booking– Meaning and objectives,

Idle time and Overtime : Causes and control, Labour Turnover : Meaning, causes and measurement of labour turnover-systems of wage payment – Theory and problems: Time wage: Merits and demerits, Piece rate system : Merits and demerits, Taylor's differential piece rate system, Halsey's Incentive plan, Rowan's Incentive Plan.

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# **CHAPTER I**

# **BASIC CONCEPTS**

## **DEFINITION AND MEANING**

### **COST**

#### **Definition and Meaning of Cost:**

In ordinary language, cost means price. Even the Oxford Dictionary defines cost as the price paid for something. But, in cost accounting, cost is considered different from price.

Gordon Shillinglaw defines the term 'cost' as "the resources that have been or must be sacrificed to attain a particular objective".

The I.C.M.A., London has defined cost as "the amount of expenditure (actual or notional) incurred on or attributable to a specified thing or activity".

In the words of Anthony and Welsh, "Cost is a measurement, in monetary terms, of the amount of resources used for some purpose".

According to W.H. Harper, "Cost is the value of economic resources used as a result of producing or doing the thing costed".

The Committee on Cost Terminology of the American Accountancy Association has defined the term 'cost' as "the foregoing, measured in monetary terms, incurred or potentially to be incurred to achieve a specific objective" .

Cost is also defined as "an exchange price, i.e., foregoing, a sacrifice made to secure benefit."

From the above definitions, it is clear that cost means the total amount of expenditure, actual or notional, paid and outstanding, incurred on a particular thing, say, on the production and sale of some goods or on the provision of some service or on the completion of some work. In other words, cost is the sum total of all the expenditures incurred in

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**producing and selling a product or in rendering a service or in performing a job.** For instance, for the making of a wooden table, money has to be spent on materials like wood, nails and polish, wages to carpenters and other expenses, such as the rent and lighting charges of the workshop. The total sum spent on materials like wood, nails and polish, wages to carpenters and other expenses, such as the rent and lighting charges of the workshop constitutes the cost of the wooden table.

**In the context of expenditure or expenses incurred on the production and sale of an article, on the provision of a service or on the completion of a work, it may be noted that the expenses may be actual or notional. The expenses are actual, if cash outlay (i.e., expenditure in cash) is involved, and the same is shown in accounting records. On other hand, if the expenses do not involve any cash outlay, and so, are not shown in accounting records, but yet are taken into consideration for the purpose of comparison and managerial decisions, they are considered notional expenses.** For instance, the cost of materials purchased for money, the wages paid to workers and the other expenses paid in cash constitute the **actual expenses**. On the other hand, the costs of land and buildings, labour and capital owned by the proprietor and supplied to the business free of charge constitute the **notional expenses**.

### **Distinction between Cost and Expense:**

**Before we discuss the distinction between cost and expense, let us have some idea about expense. When a portion of the service potential of an asset is consumed, that portion of its cost is termed as an expense. In other words, expenses denote all expired costs which are deductible from revenues of a particular period.** Examples of expenses are factory expenses, office expenses, selling expenses, etc. Expenses are charged against revenues that they helped to generate in the period in which they are incurred.

**Now, let us consider the distinction between cost and expense.**

**In practice, the terms ‘cost’ and ‘expense’ are sometimes used interchangeably. But these two terms differ from each other. The main differences between the two terms are:**

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- (a) Cost refers to the total amount of expenditure incurred on a particular thing, say, on the production and sale of some goods or on the provision of some service or on the completion of some work. But an expense refers to only expired costs which are deductible from revenues.
  - (b) Cost is not always chargeable against the revenue of the period in which it is incurred. On the other hand, an expense is always chargeable against the revenue that it has helped to generate in the year in which it is incurred.
  - (c) A cost may be expired cost or unexpired cost or deferred cost (i.e., the cost for which the economic benefit is to be received), e.g., prepaid expenses. But an expense is always an expired cost.
  - (d) The economic benefit of an expense has already been realised. But the economic benefit of only the expired cost is already realised, and the economic benefit of the unexpired cost is yet to be realised.
  - (e) Cost may be charged against revenue (i.e., shown in the income statement) or may be shown in the balance sheet. Expired cost is charged against the revenue of the period in which it is incurred, and the unexpired cost is shown as an asset in the balance sheet. But an expense is charged only against the revenue (i.e., shown only in the income statement).

### **Distinction between Cost and Loss:**

**Before we take up the distinction between cost and loss, let us know the meaning of loss.**

**“Losses are reduction in firm’s equity, other than by withdrawals of capital, for which no compensating value has been received.”**

**A loss can also be defined as an expired cost resulting from the decline in the service potential of an asset that has generated no benefit to the firm.** Destruction of stock by fire, obsolescence of stock, theft of stock, etc. are examples of losses.

**Now, let us consider the distinction between cost and loss.**

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**The terms ‘cost’ and ‘loss’ are not identical. There are some differences between the two. The main differences between cost and loss are:**

- (a) Cost may be expired cost or unexpired cost. But loss is always expired cost.
- (b) Cost may or may not generate a benefit to the firm. But loss does not generate any benefit to the firm.
- (c) Cost may be charged against revenue or may be shown in the balance sheet. Expired cost is charged against revenue, and unexpired cost is shown in the balance sheet. But loss is always charged against revenue.

**Importance of Cost in Cost Accounting:**

**Cost is an important factor in cost accounting. Cost data about a product, a service or a job is useful in several respects. The importance of cost data is as follows:**

- (a) Cost is one of the factors taken into account in the fixation of the price of a product, a service or a job.
  - (b) Actual cost is the basis of making an estimate of the probable cost of a product, service or job at a future date.
  - (c) Cost is an essential factor for ascertaining the profit of a product, service or job.
  - (d) Cost data about a product, service or job throws light on the wastage and losses that arise in the production and sale of a product or provision of a service or performance of a job.
  - (e) Cost data is helpful in evaluating the efficiency of a concern.
  - (f) The behavior of cost in relation to the scale of operations helps a firm in determining the optimum level of operations.
  - (g) Cost data is helpful in choosing from among alternative courses of action.
  - (h) It is helpful in deciding whether to sell a product in semi-finished form or to process it further and sell it in finished form.
  - (i) Cost data is helpful in taking ‘**make or buy**’ decisions (i.e., to decide whether it is profitable to make a component within the concern or buy the same from outside).
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