Cost accounting is a form of managerial accounting that aims to capture a company's total cost of production by assessing the variable costs of each step of production as well as fixed costs, such as a lease expense.

- Cost accounting is used internally by management in order to make fully informed business decisions.
- Unlike financial accounting, which provides information to external financial statement users, cost accounting is not required to adhere to set standards and can be flexible to meet the needs of management.
- Cost accounting considers all input costs associated with production, including both variable and fixed costs.
- Types of cost accounting include standard costing, activity-based costing, lean accounting, and marginal costing.

Types of Costs

- Fixed costs are costs that don't vary depending on the level of production. These are usually things like the mortgage or lease payment on a building or a piece of equipment that is depreciated at a fixed monthly rate. An increase or decrease in production levels would cause no change in these costs.
- Variable costs are costs tied to a company's level of production. For example, a floral shop ramping up their floral arrangement inventory for Valentine's Day will incur higher costs when it purchases an increased number of flowers from the local nursery or garden center.
- Operating costs are costs associated with the day-to-day operations of a business. These costs can be either fixed or variable depending on the unique situation.
- Direct costs are costs specifically related to producing a product. If a coffee roaster spends five hours roasting coffee, the direct costs of the finished product include the labor hours of the roaster and the cost of the coffee beans.
- Indirect costs are costs that cannot be directly linked to a product. In the coffee roaster example, the energy cost to heat the roaster would be indirect because it is inexact and difficult to trace to individual products.

1.4 Difference between Financial Accounting & Cost Accounting :

Points	Financial Accounting	Cost Accounting
1. Subject Matter	It deals with the whole of the business.	It is a part of financial accounting. It deals with the various costs of the products manufactured by the unit.
2. Objectives	It seeks to measure the financial performance of the business as a whole.	Its main objectives are : (i) Ascertainment of cost, (ii) Cost control and (iii) Cost analysis for decision making.
3. Applicability	It is applicable to all types of business.	It is applicable to Manufacturing Concern.
4. Accounting System	Double Entry System.	System useful to the management is applied.
5. Application of Accounting principles	It adheres to generally accepted accounting principles.	It adheres to costing concepts and principles.
6. Types of Data used	It makes use of historical, quantitative, monetary and objective data.	Cost Accounting uses descriptive, statistical, subjective data.
7. Transactions	Financial accounts are concerned with external transactions.	Cost Accounting is concerned with internal transactions.
8. Control	It does not lay emphasis on control.	It provides a detailed system of control for materials, labour, overheads.
9. Frequency of reporting	Generally reporting is done at the end of the financial year.	Cost control reports are submitted daily, weekly or fortnightly as required by the management.
10. Unit of measurement	Historical value i.e. Rupees.	Any monetary or physical unit such as labour hour rate, machine hour rate, etc.
11. Valuation of Stock	Stocks are valued at cost or market price whichever is less.	Stocks are always valued at cost.
12. Kind of Information	Financial accounts fail to provide information on relative efficiencies of Workers, Plants and Machineries.	It provides valuable information on the relative efficiencies of Labour & Plant and Machineries.

Difference between cost centre and cost unit

BASIS FOR COMPARISON	COST CENTRE	COST UNIT
Meaning	Cost centre refers to a subdivision or any part of the organization, to which costs are incurred, but does not contribute to the company's revenues directly.	Cost unit implies any measurable unit of product or service, with respect to which costs are assessed.
Use	It is used as a basis for classifying costs.	It is used as a standard for making a comparison.
Cost	Costs are collected and absorbed by cost units.	Measured and Expressed in terms of cost units.
Ascertainment	Ascertained as per the nature and technique of production process, organization size and structure.	Ascertained as per the nature of the final output and the existing trade practices.
Sequence	First	Second
How many?	Several cost centres are there, even if there is just one product or service offered.	Different cost units for different products or services.

COST SHEET — How to prepare
[When goods are produced and sold]

Direct Materials
+ Direct Wages
+ Direct Expenses

⇒ **PRIME COST**

+

Factory Indirect Materials
+ Factory Indirect Wages
+ Factory Indirect Expenses

⇒ **FACTORY OVERHEADS**

=

WORKS COST

+

Indirect Materials used in office
+ Indirect Wages paid to office and Administrative staff.
+ Indirect Expenses for office and Administration.

⇒ **OFFICE AND ADMINISTRATIVE OVERHEADS**

=

COST OF PRODUCTION

+

OPENING STOCK OF FINISHED GOODS

−

CLOSING STOCK OF FINISHED GOODS

=

COST OF GOODS SOLD

Indirect Materials used in sales department.
+ Indirect Wages paid to staff of sales dept.
+ Indirect Expenses for sales dept.

⇒ **SELLING & DISTIBUTION OVERHEADS**

=

COST OF SALES

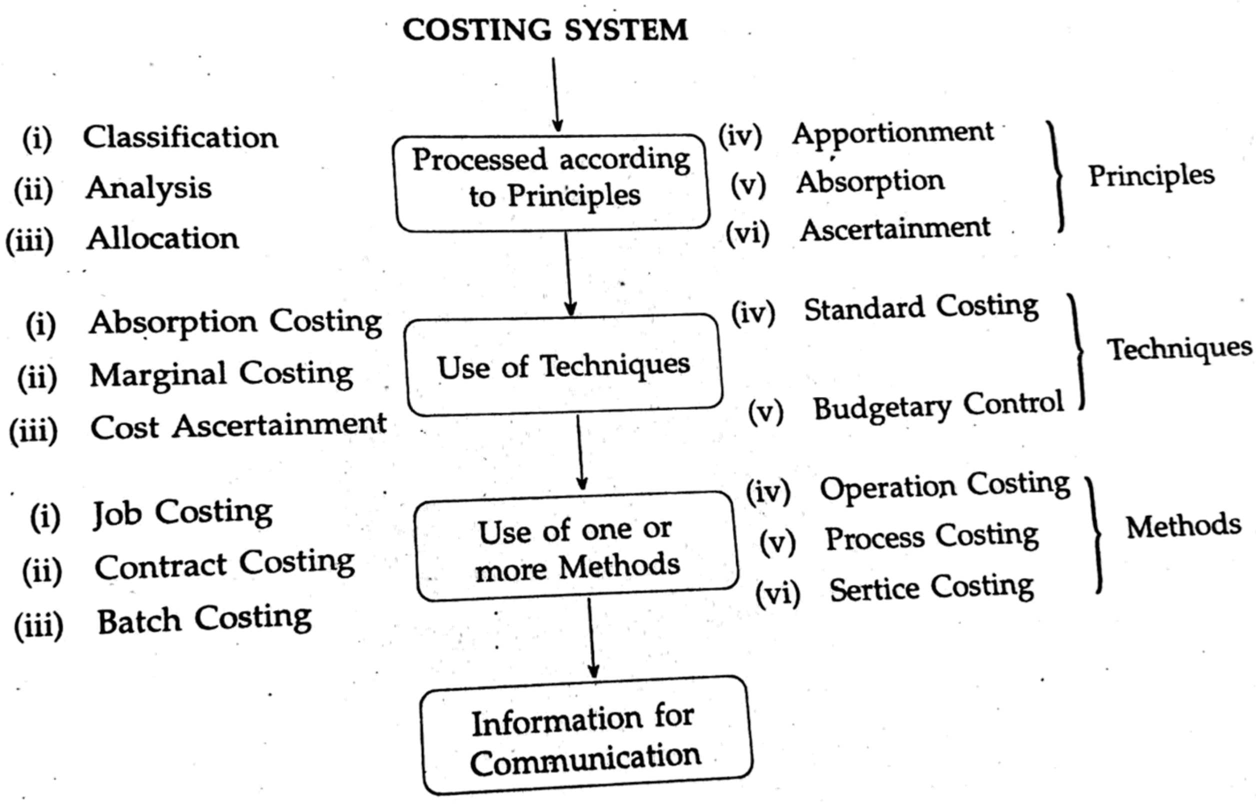
+

PROFIT

=

SALE PRICE

CHART SHOWING COSTING SYSTEM



1. A truck starts with a load of 10 tonnes of goods from station P. It unloads 4 tonnes at station Q and rest of the goods at station R. It reaches back directly to station P after getting reloaded with 8 tonnes of goods at station R. The distance between P to Q, Q to R and then from R to P are 40 kms., 60 kms, and 80 kms respectively.

[C.A. (Inter.) May, 1990]

Ans. : 1,440 tonne km.

2. Calculate the cost per km of a vehicle from the following data :

	Rs.
Value of vehicle	15,000
Road licence fee per year	500
Insurance charges per year	100
Garage rent per year	600
Driver's wages per month	200
Cost of petrol per litre	Re 0.80
Kilometres per litre	8
Proportionate charge for tyre and maintenance per km.	Re 0.20
Estimated life	1,50,000 kms.
Estimated annual kilometreage	6,000
Ignore interest on capital	

Ans. : Cost per km. Re. 1.00

3. A transport company maintains a flet of buses as follows :

No. of Busses	*Carrying Capacity*
10	60 passengers each
5	40 passengers each

Each bus makes 4 trips (both upward and downward) in a day, covering a distance of 5 kilometres in each trip. On an average 75% of the seats are occupied in each trip. Assuming that the company operates its fleet 25 days in a month, ascertain operating cost per passenger kilometre, taking into account the following further information :

Wages of 5 drivers Rs. 250 each p.m., petrol oil and grease Rs. 3,000 p.m.; Repairs Rs. 1,500 p.m.; tyre-tube etc. Rs. 375 p.m.; Depreciation Rs. 90,000 p.a.; Garage rent Rs. 9,000 p.a.; Interest on capital Rs. 12,000 p.a.; General supervision charges Rs. 3,000 p.a.

[Adapted—C.U. M.Com.]

Ans. : Re. 0.030208

Activity-Based Costing

Activity-based costing (ABC) identifies overhead costs from each department and assigns them to specific cost objects, such as goods or services. The ABC system of cost accounting is based on activities, which is any event, unit of work, or task with a specific goal, such as setting up machines for production, designing products, distributing finished goods, or operating machines. These activities are also considered to be cost drivers, and they are the measures used as the basis for allocating overhead costs.

Traditionally, overhead costs are assigned based on one generic measure, such as machine hours. Under ABC, an activity analysis is performed where appropriate measures are identified as the cost drivers. As a result, ABC tends to be much more accurate and helpful when it comes to managers reviewing the cost and profitability of their company's specific services or products.

For example, cost accountants using ABC might pass out a survey to production line employees who will then account for the amount of time they spend on different tasks. The cost of these specific activities are only assigned to the goods or services that used the activity. This gives management a better idea of where exactly time and money is being spent.

To illustrate this, assume a company produces both trinkets and widgets. The trinkets are very labor intensive and require quite a bit of hands-on effort from the production staff. The production of widgets is automated, and it mostly consists of putting the raw material in a machine and waiting many hours for the finished good. It would not make sense to use machine hours to allocate overhead to both items, because the trinkets hardly used any machine hours. Under ABC, the trinkets are assigned more overhead related to labor and the widgets are assigned more overhead related to machine use.