2. **Standard costing:** Here, costs are predetermined. Actual costs are compared with predetermined standard costs and variances are analysed to obtain maximum efficiency.
3. **Marginal costing:** It refers to the segregation of costs into fixed and variable. Only variable costs are charged to products or services. Fixed costs are charged to profit and loss account.

Cost accounting differs from costing; however, both are used interchangeably. Cost accounting is a specialised branch of accounting which involves classification, recording, analysing, standardising, comparing, reporting and recommending. The terminology of CIMA defines cost accounting as "the establishment of budgets, standard costs, and actual costs of operations, processes, activities or products; and the analysis of variances, profitability or the social use of funds".

1.2 OBJECTIVES OF COST ACCOUNTING

The main objectives of cost accounting are:

1. To determine the cost of a product, process or service
2. To analyse, classify and record all expenditures with respect to the cost of product, process or service in order to determine its cost
3. To provide necessary information to the management in time
4. To provide data needed for periodical preparation of profit and loss account and balance sheets
5. To serve as a guide by providing actual data for comparison
6. To facilitate price fixation and offering quotations
7. To assist budgetary control
8. To assist cost control and cost reduction
9. To record the relative production results in each unit of plant to examine efficiency
10. To provide the basis for production planning and for avoiding wastages of materials and stores
11. To provide data for different periods and various volumes of output for effective planning and future expansion of business
12. To provide the basis for making decisions such as:
    (a) To shut down or operate
    (b) To make or buy
    (c) To continue with existing plant/machinery or to replace it
    (d) To determine cost–volume–profit relationship
13. To assist the management in devising suitable policy decisions in other key areas

1.3 ADVANTAGES OF COST ACCOUNTING

1. **Helps in adverse periods:** Cost accounting helps in the periods of economic recession, trade depression and trade competition. In such periods, the management should concentrate on measures to be taken to minimize loss. While taking decision during such periods, cost accounting extends a helping hand to the management to resolve crisis.
2. **Price fixation, Floating tenders, Quotations etc.:** Cost records play a vital role in fixing the price of a product, service or process. Cost accounting facilitates such task.
3. **Makes estimates:** Proper cost-accounting records provide the basis to prepare estimates and tenders.
4. **Eliminates wastages:** Cost of the article or process at each and every stage can be determined with the help of cost records, thereby minimizing wastages that occur.
5. **Maximizes profit:** Cost accounting helps in maximizing profit, choosing apt approach for its production. Non-profitable lines may be avoided.
6. **Facilitates comparison:** Cost records provide data to compare different periods, which in turn helps the management to take future course of action promptly.
7. **Preparation of final accounts:** Cost records provide the necessary accounting information for the preparation of profit and loss account and balance sheet at specified periods promptly.

8. **Inventory control:** Costing helps to a great extent with respect to control of stock of raw materials, work-in-progress and finished goods.
9. **Increasing productivity:** Productivity of material and labour is inevitable for any organization to attain growth and expansion. Costing helps in these areas to increase productivity.
10. **Enhancing efficiency:** As costs are determined at each stage, wastages can be detected and remedial measures can be taken without delay; efficiency of an organization is enhanced, which in turn maximizes the profitability.
11. **Boon to creditors:** Costing records serve as a reliable and authentic document by which creditors (investors, banks and money-lending institutions etc.) can repose faith on business organizations and extend advances without any hesitation and with confidence.
12. **Beneficial to employees:** Costing records are easily accessible and transparent to employees because of which they are benefitted monetarily by way of incentive, bonus etc. This strengthens the cordial relationship between the employer and employee, and industrial peace environment prevails.
13. **Boost to national economy:** Prosperity in industrial sector will reflect in the general economy of any nation by way of increased revenue to the government. Better system of cost accounting paves the way to achieve higher GDP growth of the nation.

1.4 COST ACCOUNTING AND OTHER BRANCHES OF ACCOUNTING

Accounting is classified into:

1. Financial accounting and
2. Management accounting

First, we shall look into the relationship between cost accounting and financial accounting. Notwithstanding the fact that both are concerned with systematic recording and presentation of data based on the same records and on the same principles of debit and credit rules, they differ widely in the aspects shown in Table 1.1.

Table 1.1 Differences between Financial Accounting and Cost Accounting

Basis of Distinction	***Financial Accounting***	***Cost Accounting***
1. Aim	Financial accounting aims at strengthening the interests of the business, proprietors and all others associated with it.	Cost accounting aims at strengthening the management for proper planning, operation, control and decision-making.
2. Statutory requirement	These accounts have to comply with statutory requirements such as company act and income tax act.	Cost accounts have to comply with the requirements of management. Of late, certain industries have to meet the requirements of company act (only obligatory).
3. Emphasis	This emphasizes the measurement of profitability.	Cost accounting emphasizes ascertainment of costs.
4. Profit analysis	This analyses accounts and discloses the profit of the firm as a whole.	This discloses profit made on each product, process, job or service.
5. Nature of recording transactions	Transactions are recorded, classified and analysed in a subject manner, i.e., according to the nature of expenditure.	Transactions are recorded and analysed in an objective manner, i.e., according to the purpose for which costs are incurred.
6. Facts and estimates	Financial accounts deal mainly with facts and figures only.	Cost accounting deals with facts and figures besides estimates.
7. Valuation of stock	Stocks are valued at cost or market price whichever is less.	Stocks are valued at cost price.
8. Nature of report of costs	Costs are reported in aggregate in financial accounts.	Costs are broken into unit basis in cost accounting.
9. Relative efficiency	This does not provide information on the relative efficiency of workers, plant, machinery etc.	Cost accounting provides information on relative efficiency of workers, plant and machinery.

(*Continued*)

Table 1.1 (*Continued*)

Basis of Distinction	*Financial Accounting*	*Cost Accounting*
10. Type of transactions and basis	Financial accounts are concerned with external transactions, which form the basis of payment or receipt of cash.	Cost accounts are concerned with internal transactions, which do not form the basis of payment or receipt of cash.
11. Periodicity of report	Financial statements are prepared and reported only at specified period, usually once in a year.	Cost reports are prepared and reported most frequently, whenever management requires it.
12. Degree of accuracy	Financial statements are more accurate as they are subject to scrutiny by statutory authorities.	These are comparatively less accurate as they are intended mainly for the management.
13. Classification	Financial accounts do not classify accounts, expenses etc.	In cost accounting, they are classified properly and analysed perfectly.
14. Information	Proper and adequate information on each aspect of business is not provided to outsiders, though it extends information to outsiders.	Proper and adequate information on each and every aspect of business is provided to outsiders.

1.4.1 Cost Accounting and Management Accounting

Some accounting professionals are of the view that cost accounting is a branch of management accounting. Such a close relationship exists between the two categories of accounting. Both are internal to the organization. Both have the same objectives—for instance, both assist management in its functions of planning, controlling and decision-making. Both use more or less similar techniques such as marginal costing and budgetary control. But cost accounting and management accounting differ in certain areas. The main points of distinction between cost accounting and management accounting are shown in Table 1.2.

Table 1.2 Difference between Cost Accounting and Management Accounting

Basis of Distinction	*Cost Accounting*	*Management Accounting*
1. Objective	Cost accounting is concerned with the ascertainment, allocation, distribution and accounting aspects of costs.	This is mainly concerned with (i) the impact (ii) effect aspects of costs.
2. Hierarchy level	In an organization, cost accountant is placed at a lower hierarchy level than management accountant.	Management accountant is placed at a higher hierarchy level than cost accountant.
3. Accounting data	Cost accounting data are generally derived by using management accounting techniques.	Management accounting data are derived from cost accounts and financial accounts.
4. Relevance and objectivity	Relevance and objectivity of data is not higher in cost accounting compared to management accounting.	Relevance and objectivity of data is higher than cost accounting.
5. Usage of tools and techniques	Tools and techniques used in cost accounting are limited such as standard costing, budgetary control, break-even analysis.	A wide range of tools and techniques are used such as ratio analysis, cash flow in addition to tools and techniques used in cost accounting.
6. Period of planning	Cost account is generally concerned with short-term planning.	Management account is concerned both with short-term and with long-term planning.
7. Evaluation of performance	It is mainly concerned with assisting in management functions and in the evaluation of performance.	It is concerned with both assisting management in its functions and in evaluating the performance of the management.
8. Approach	Cost accounting is generally historical in its approach. It projects the past.	It is generally futuristic in its approach.
9. Inclusion of other branches of accounting.	Cost accounting does not include financial accounting and tax accounting.	It includes cost accounting as well as tax accounting.

1.5 CONCEPTS OF COST

It is difficult to define the term "cost". The term "cost" is ambiguous and uncertain. In general, cost means the amount of resource used in exchange for goods or services. The resources used shall be money or money's worth, which is usually expressed in monetary units. The terminology of CIMA defines cost as "the amount of expenditure (actual or motional) incurred on, or attributable to, a specified thing or activity". It may also be defined as Cost is a foregoing, measured in monetary terms, incurred or potentially to be incurred to achieve a specific objective. A cost has to be looked in relation to (i) the nature of business (ii) purpose, (iii) different conditions and (iv) the context in which it is used.

As already said, cost is measured in terms of money. However, costs which do not give rise to actual cash outlay, namely, imputed (actual) or notional cost, are to be considered while decision-making. But these are not available from accounting records—for instance, interest on capital invested by the owner in the firm in notional cost.

1. **Nature of business:** A cost has to be studied in relation to its nature of business. For example, a manufacturing organization is interested in knowing the cost per unit of its product, whereas the organizations rendering services such as electricity and transport are interested in ascertaining The costs of services they undertook. The cost per unit can be easily ascertained by dividing the total expenditure by number of units produced or quantum of services rendered. This is relatively easy if the organization produces only a single product. But if more than one product is produced, other factors have to be considered for determining the cost.
2. **Purpose:** A cost has to be studied in relation to its purpose. For example, the purpose is fixation of selling price cost. All items of expenditure relating to production, administration and selling will have to be included. But if the purpose is valuation of inventories, only cost of production will have to be taken into account. Hence, the concept of cost varies according to the purpose. It differs from purpose to purpose and has different denotations.
3. **Conditions:** A cost has to be ascertained under different conditions also. For instance, while dealing with inventory, work-in-progress is valued at factory cost, whereas stock of finished goods is valued at production cost. Different conditions lead to different modes of valuation of cost. Concept of cost varies thus.
4. **Context:** The term "cost" may not stand on its own and has to be qualified. It is a generic term. It is generally used to include all the various types of costs. However, when the term is used specifically, it is always modified with reference to the context costed by such descriptions as prime cost, fixed cost, variable cost, opportunity cost and sunk cost. Each such modification implies a certain attribute which is important in computing and measuring the cost.

Concept of cost is not precise and cannot be pinpointed. It is ever-widening. It has its own terminology. Hence, different costs are to be used for different purposes.

1.6 CLASSIFICATION OF COSTS

Costs may be classified on different bases. They can be classified as follows:

1. By time (historical, predetermined)
2. By nature of elements (material, labour, overhead)
3. By association (product or period)
4. By traceability (direct, indirect)
5. By changes in activities or volume (fixed, variable, semi-variable)
6. By function (manufacturing, administration, selling, research and development)
7. Controllability (controllable, non-controllable)
8. Analytical and decision-making (marginal, uniform, opportunity, sunk, differential etc.)
9. By nature of expense (capital, revenue)
10. Miscellaneous (conversion, traceable, normal, total)

1.6.1 Classification on the Basis of Time

Costs can be classified into historical costs and predetermined costs.

1. **Historical costs:** Historical costs are determined after they are incurred actually. When production is completed, i.e., products reached their final stage of finished status, costs are available and on that basis costs