

### Management Accounting:

### Chapter 1



What is Management Accounting?

### Accounting for Planning, Control, and Evaluation



#### **Accounting Systems**

- Accounting systems are artifacts. They are created by men to help accomplish tasks. Audited statement reduce investors risk.
  - Audited statements allow a company to borrow capital from someone else.
  - Records and internal financial controls safeguard the company's assets
  - Balance Sheets allow the comparison of Assets, Liabilities and Owner's Equity.
  - Income Statements describe the change in Owners' Equity from operations.



### the Form of Accounting Data

- Managers need changing information to meet changing needs!
  - Types of Accounting Systems
    - Financial Accounting
      - Rules and procedures
      - Accounting information systems and internal controls
      - Auditing
    - Cost Accounting
      - Product costing
      - Activity-based costing



#### Management Accounting

- Decision support
- Organizational control
- Cost management
- Profit management
- Investment management

#### Tax Accounting

- Individuals
- Partnerships and corporations
- Estate and trusts
- International taxation
- Special tax issues and topics

### **COST ACCOUNTING**

- ELEMENTS OF COST
- COSTING TECHNIQUES

- Classification of Cost.
- Controllable Costs.
- Concept of Cost.
- Analysis of Cost
- Elements of Cost.
- Preparation of Cost Sheet.

### Cost

- I.C.M.A. London: "Cost means the amount of expenditure (actual or notional) incurred on, or attributable to, a given thing."
- For example:
- X purchased a chair for Rs.500.
- Y manufactured a chair by paying Rs.150 for timber, Rs.50 for rent, Rs. 150 for color and other articles, Rs.150 to carpenter.

- From the above two examples it is clear that cost dose not mean the same thing under all circumstances.
- In other words cost is a flexible concept which can't be exactly defined. It depends on:-
- a) The nature of business and industry, and
- b) The context in which it is used.

### Classification of Cost

 Classification is the process of grouping costs according to their common features.

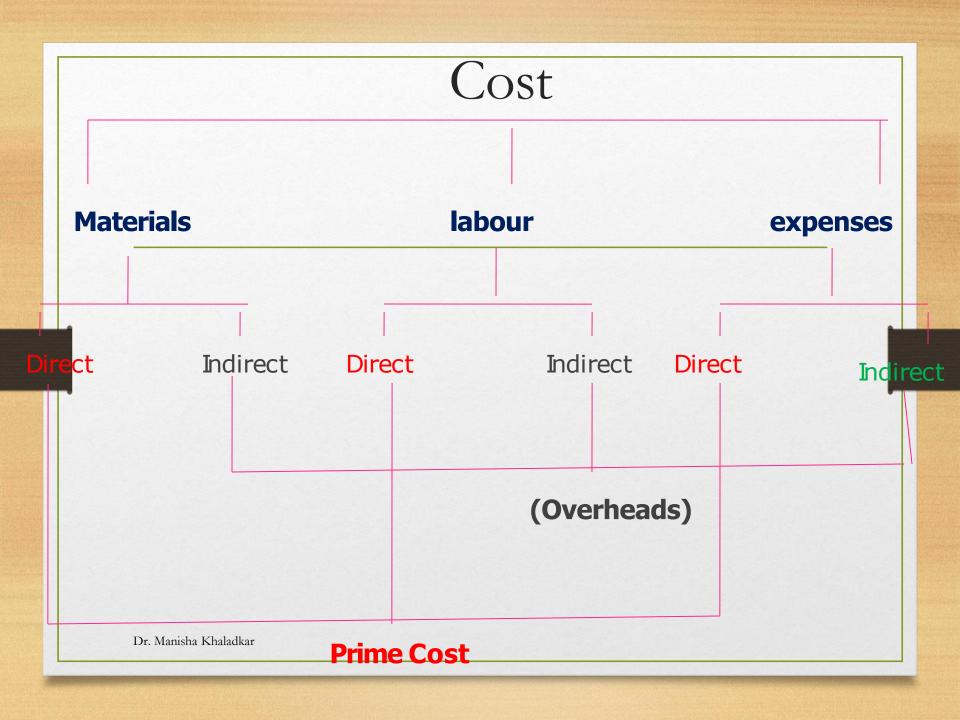
 There are various bases of classifying costs. Some important classifications are discussed below.

### Basis of Classification of Cost

- **1.** By Nature or Element
- 2 By Functions
- 3. By Relation to Cost Center
- 4. By Variability/ Behaviour
- 5. By controllability
- 6. By Normality
- By Inventory
- 8. By Time
- 9. For Managerial Decision Making

### 1.By Nature or Element

- Materials Cost (Direct +Indirect)
- Labour costs (Direct +Indirect)
- Expenses (Direct +Indirect)
- Observations:
- Direct material +Direct Labour +Direct Expenses= Prime Cost
- Indirect material +Indirect Labour+Indirect Expenses= Overhead



### (ii) Classification of Costs by Functions

- 1. Production Cost
- 2. Administrative Cost
- 3. Selling Cost
- 4. Distribution Cost
- 5. Research Cost
- 6. Development Cost
- 7. Pre-production Cost

## 3.Classification of cost s by Relation to Cost Centers

Direct cost of the Cost Center

Indirect cost of the Cost Center

# 4. Classification of Costs by Variability/Behaviour

- Fixed Costs
- Variable Costs
- Semi variable Cost

# 5.Classification of cost by controllability

Controllable costExample: all direct costs

Uncontrollable Cost
 Example: Managerial remuneration, all fixed costs

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# 6.Classification of costs by Normality:

 Normal cost: It is the cost which is normally incurred at a given level of output. (Cost of production)

For example: cost of material or labour as per standard

 Abnormal Cost: These costs are incurred in and above the normal cost due to abnormal situation and these costs charged to costing profit and loss account

For example: cost of abnormal material losses or abnormal idle time

### 8.Classification of costs by time

- Historical costs: Actual costs incurred in a period. Ex-Cost of material consumed or labour cost in the financial year.
- Pre-determined costs: future costs ascertained in advance.

For example standard costs or budgeted costs.

# 9.Special costs used for managerial decision making

- a) Relevant costs: future costs, exdismantal cost of machinery
- b) Irrelevant costs: ex-written down value of old machine is irrelevant cost
- c) Sunk cost: Historical or past costs ex- written down value of old machine is sunk cost.
- d) Shut-down costs: costs at the time of shut down of factory (all fixed costs)

- e) Out of pocket costs: costs involve outlay of cash.
- f) Opportunity cost: Cost of next best alternative sacrificed. Rent of old building proposed to be used as new factory.
- g) Differential Costs: Increase or decrease in total Costs due to production of less or more output.
- h) Marginal Cost
- i) Replacement cost

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## ITEMS EXCLUDED FROM COST ACCOUNTS

- •Incomes: Profit on sale of fixed assets, profit on sale of investments, interest income, dividend income, rental income etc.
- Expenditures: Loss on sale of fixed assets and investments, interest on mortgages and loans, preliminary expenses written off, goodwill written off.
- Appropriations: Income tax, dividend distribution tax, transfer to general reserves and special reserves.

#### COMPONENTS OF TOTAL COST

- Prime Cost= Direct Material+ direct Labour+ Direct Expences.
- Works cost/Factory Cost= Prime cost + works/factory/production overhead +(opening work in progress- closing WIP)
- Cost of production or cost of goods produced = Works cost +Administrative overheads
- Cost of goods sold= cost of goods produced +opening stock of finished goods-closing stock of finished goods.
- Cost of sales = cost of goods sold+selling & Distribution overhead.

#### **COST SHEET:**

C.I.M .A. London: "A cost sheet is a document which provides for the assembly of the detailed cost of a cost center or cost unit.

a cost sheet is a statement showing various components of total costs in a classified manner. It shows prime cost, works (or factory) cost, cost of production, cost of goods sold and total cost. It is also called as a STATEMENTOF COST."

### Purpose of cost sheet

- (i) It shows total cost and unit cost of output.
- i.e. different elements of cost.
- **h** Ifacilitates comparison over the years
- (v) It helps in the estimation of costs for preparation of tenders and quotations.
- (v) It helps the management in fixing the selling price more accurately.
- (vi) Itacts as a basis for cost control as detailed costs in a classified manner are available.

### Proforma of a cost sheet

	Outout:	Units:
Particulars	TOTAL	Cost per
	COST(Rs.)	Unit(Rs.)
Direct Material		
Direct Labour		
Direct Expenses		
PRIME COST		
Add factory or works overheads		
WORKS COST		
Add Administrative overheads		
<b>COST OF PRODUCTION</b>		
Add selling and distribution overheads		
TOTAL COST OR COST OF SALES Dr. Manisha Khaladkar		
Add Profit (or minus loss)		
SALES		