Management Accounting

The process of providing information including financial accounting information to managers for their use of **planning, decision making, performance evaluation, control, management of cost and cost determination**.

Note : Below is a summary of activities considered to be involved in managementaccounting.

- Budgeting, planning and forecasting
- Calculating the profitability of products, services or operations.
- Measuring organizational, divisional and departmental performance.
- Comparing results and performance within and between organizations.
- Assisting in increasing the effectiveness and efficiency of performance.
- Assessing the performance of past and future capital investments.
- Advising on decisions about optimal products mix, markets to be served and selling prices.
- Advising on decisions on whether to outsource products, components, activities and services.
- Advising on decisions involving the investment of scarce funds between arange of possible alternatives

5.1.7 Financial Accounting Vs Management Accounting

In respect of	Management Accounting	Financial Accounting
(01) Scope	Comparatively narrow.	Scope is widely defined.
(02) Legal requirements	Not governed by any statutes, rules laws, regulations and accounting standards.	Governed by company act, Income tax act, accounting standards etc.
(03) Dealings	An internal process.	Mainly an external process.
(04) Reporting	Prepares reports to the management.	Prepares reports mainly to external parties.
(05) Format	Presents information in detailed formats	Presents information in summarized form.
(06) Representation	Information covers a particular area	Covers the whole business.
(07) Input data	Uses present, past and future data	Uses business's past data only.

Cost Accounting

Cost Accounting

A process of **collecting, classifying, recording, analyzing, allocating and interpreting** the cost data in order to provide the management with reports for their planning and controlling process.

Costing

A technique or process of ascertaining the cost.

Financial Accounting & Cost Accounting differences

In respect of	Financial Accounting	Cost Accounting
Time span	Transactions are recorded and statements are prepared for a definite period.	Transactions are identified with cost unit / cost object.
Coverage of transactions	It covers transactions of the whole business.	It covers only a part of the transactions. Viz: manufacturing
Purpose	It is prepared to present operational results and financial position of the business.	It aims to help the management for proper planning, control and decision making.
Analysis of expenditure	It analyses the expenditure according to the function.	It analyses expenditure on different bases. Eg: Direct and indirect variable and fixed. Etc.
Efficiency	The overall results and financial position of the business is revealed by financial statements.	It analyses the profitability of each department, cost unit, job or process.
Material control	It does not say anything about the efficiency / inefficiency of material handling. (because figures are in total)	It provides a system of good inventory control by prescribing procedures for purchases, storage, issues etc.
Independence of the system	It is independent of cost accounting. i.e: it can work even in the absence of cost accounting system.	It depends upon financial accounting data.
Reconciliation of results	It does not need any reconciliation	It needs reconciliation of its profit with that of financial records.
Wastages	There are no such categories.	Wastages or losses are identified and categorized into normal and abnormal.
Transactions	It deals with actual facts and figures.	It deals partly with actual facts and figures, and partly with estimates.
Stock valuation	Stocks are valued at "Cost price" or "Net realizable value" whichever is less.	Stocks are valued at cost.
Legal requirements	Should adhere to various legislatives. Eg: companies act, income tax act, accounting standards... etc.	These records are generally kept to meet the requirements of the management.

Cost Accounting
Vs
Management Accounting

In respect of		Cost Accounting	Management Accounting
(01)	Scope and objective	To determine / ascertain the cost of the unit.	To assess the profitability, To measure the efficiency and effectiveness
(02)	Inputs	Uses basically financial accounting information. E.g.- Raw material purchased, salaries / wages paid, expenses incurred... etc.	Uses financial accounting and cost accounting information as well as information from other sources.
(03)	Methods	Uses various costing systems. E.g.- Job costing / Batch costing / Process costing Contract costing... etc.	No specific systems are used.
(04)	Representation	Provides management with cost information only	Provides management with all the information required by them.

Objectives of Cost Accounting

01. Ascertainment of cost

02. Planning and Controlling the cost

03. Presentation of the cost

Arguments for Cost Accounting

(01) It is expensive

The cost accounting system may be costly and small organizations may notfind it profitable and economical. I.e. The collection, analysis, allocation andmaintenance of cost data is a time consuming and a difficult task which requires an extra manpower. Further a double set of account books has to be maintained.

(02) It is unnecessary

it is argued that this is recently originated and in past businesses have prospered well without cost accounting.

(03) Not applicable to many industries

Modern methods of costing can not be applied to certain type of industries. Moreover, there is no ready-made system of cost accounting applicable to all concerns.

(04) It is not reliable

It is argued that cost accounting is based on estimates and therefore cannot be relied upon.

Costing	Cost Unit	Cost Center
A technique or process of ascertaining the cost.	A particular good / service / function that is used to calculate the cost.	A particular item, department, person or a function that is used to collect, report and analyze the cost.

Cost Unit

- A particular good / service / function that is used to calculate the cost.

- Examples:
  1. Bakery – A bread
  2. Apparel company – A shirt / A frock
  3. Hospital – Per patient
  4. Education Institute – Per student

Cost Center

- A particular item, department, person or a function that is used to collect, report and analyze the cost.

Apparel company	Purchasing department, Cutting department, sewing department, packing department
Hotel	Restaurant, Spa & Wellness, Rooms
Bakery	Mixing department, baking department, packing department

Cost Classification

Basis	
(01)	According to their nature
(02)	According to their purpose / traceability
(03)	According to their behavior
(04)	Degree of association with the product
(05)	According to the related function
(06)	According to their controllability
(07)	According to their relevance to the management decisions
	Others

01. According to the nature

(a) Material costs

This include the cost of obtaining the materials and maintaining them within the organization. In other words, materials costs are the cost of commodities used in manufacturing.

(b) Labour costs

These are the costs which are incurred in the form of remuneration such as wages, salaries, bonuses and other benefits to employees.

(c) Other Cost

These are the cost of other services provided. Moreover the external costs such as rent, rates, electricity, gas, depreciation, water, telephone and similar items.

02. According to the purpose

Direct Cost

The cost that can be easily identify with a product / cost unit.

1. Direct Material
2. Direct Labour
3. Direct Other

Indirect Cost

The cost that cannot be easily identify with a product / cost unit.

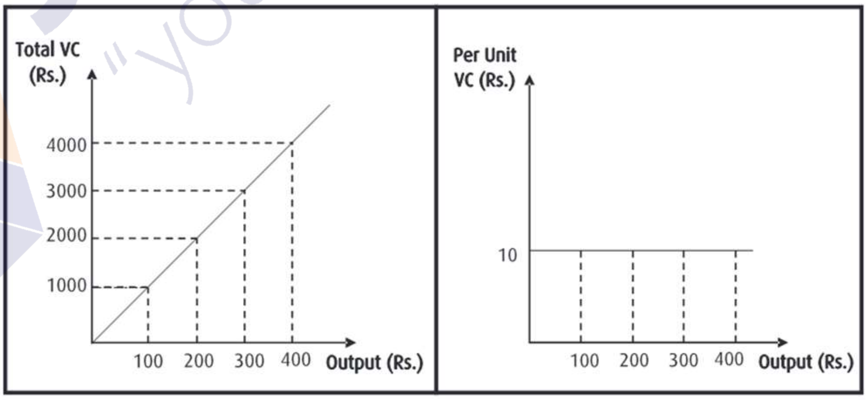
1. Indirect Material
2. Indirect Labour
3. Indirect Other

03. According to the behavior

Variable Cost	Fixed Cost	Mixed Cost
The cost that is vary according to the output level. Ex: Direct material Direct Labor Direct Other	The cost that is not vary according to the output level. Ex: Rent Expense Lease payments	Also say semi-variable or semi-fixed cost.

Variable Cost

Below figure exhibits the behavior pattern of Variable Costs (VC)

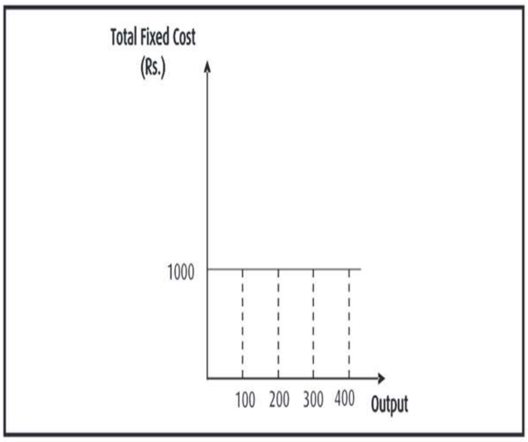


Behaviour pattern of variable costs

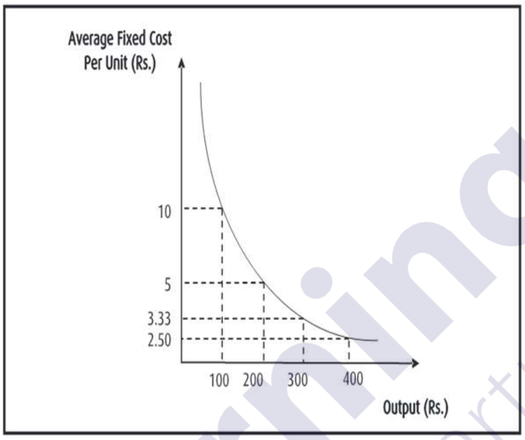
Level of Activity (units)	Total variable cost (Rs.)	Per unit variable cost (Rs.)
100	1,000	10
200	2,000	10
300	3,000	10
400	4,000	10

Fixed Cost

Level of Activity (units)	Total fixed cost (Rs.)	Average fixed cost (Rs.)
0	1,000	N/A
100	1,000	10
200	1,000	5
300	1,000	3.33
400	1,000	2.50



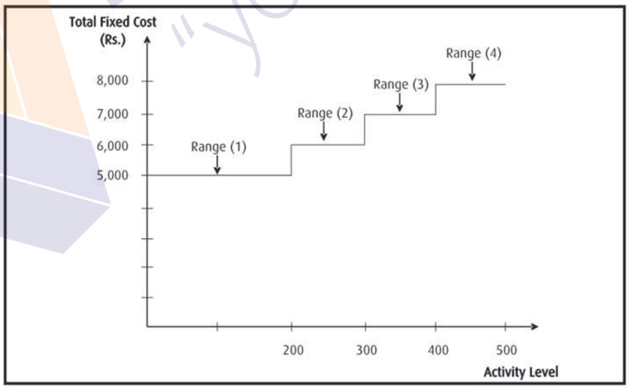
Behaviour pattern of total fixed cost



Per unit fixed cost

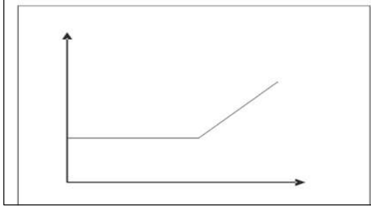
Step-up fixed cost

- Sometime the fixed cost can be increase after a certain level/ range. In that case we say it is Step-up fixed cost.

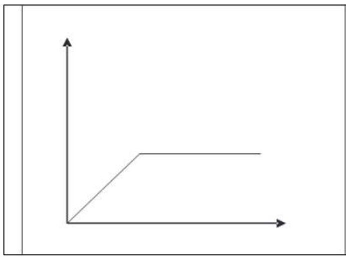


Step-up fixed costs

Mixed Cost



This cost remains constant up to a certain level of activity and then it increases as the variable cost element is incurred.
(i.e. a production is possible within the fixed cost)



This cost is variable up to a certain level of activity and then it will tend to be constant.
(This is a very rare form)

04. According to the degree of association with the product

- Product Cost
- Period Cost

Product Cost

- The cost that incurred to produce a product.

Direct Material	X	product costs
Direct Labour	X	
Direct Expenses	X	
Prime Cost	X	
(+) Production Overheads	X	
Total production cost (Manufacturing cost)	X	

Period Cost

- The cost that not included in the production cost. Typically treated as expenses.
- Ex: 01. Sales & Distribution cost
  02. General administration cost

05. Functional cost classification

(a) Manufacturing costs are all production costs incurred to manufacture the products and to bring them to a saleable condition

(b) Selling and distribution costs are the costs incurred on selling and distribution of the product.

(c) Administration expenses are those that are incurred on administrative affairs of the concern.

06. According to the controllability

Controllable costs are those which can be influenced by the action of a personnel of an undertaking or a concern. In other words, controllable costs are the costs over which a manager has a direct control. (i.e. That can be minimized by using their skills)

Uncontrollable costs (also known as non-controllable costs) are the costs which can not be influenced by the action of a personnel of an undertaking. No manager has a direct control over these costs. (i.e. they can not be minimized on their skills)

07. According to the relevance in the management decisions

1. Relevant Expense

- The expenses that are relevant when taking a decision.
- They are only **future cost**.
- They are **incremental & avoidable** in nature.

2. Irrelevant Expense

- The expenses that are not affect by the decisions taken.
- Ex : Sunk Cost

08. Other

1. Opportunity Cost

- The cost of the next best alternative available

2. Sunk Cost

- The cost that has already been incurred and therefor it is unavoidable and irrelevant. (Historicala cost)

Let’s do some past papers

<u>2025 July</u>

1.2 Which one of the following is an example for a cost unit?

(1) A bakery. (2) A canteen. (3) A hotel. (4) A bread.

(02 marks)

1.7 State three(03) differences between the financial accounting and the cost accounting.

(03 marks)

2025 January

1.2 Which one of the following statements is correct with reference to the cost accounting?

(1) It covers transactions of the whole business.
(2) According to purpose, cost can be divided into direct costs and indirect costs.
(3) Only historical transactions are used in cost accounting.
(4) All of the above. (02 marks)

2024 July

1.8 Differentiate Cost Accounting Vs Financial Accounting under each of the following point:

(i) Purpose.
(ii) Coverage of transactions.
(iii) Stock Valuation. (03 marks)

2024 January

1.1 Which one of the following is correct with reference to the Cost Accounting?

(1) According to the behavior, cost can be classified as direct costs and indirect costs.
(2) Prime cost consists of indirect cost.
(3) Cost ascertainment is a main objective of cost accounting.
(4) A cost that has already been incurred is called as incremental cost. (02 marks)

2023 July

1.2 Which one of the following statement is correct relating to the cost accounting?

(1) Prime cost consists of direct material cost, direct labour costs & other direct costs.
(2) Only historical transactions and events are used in cost accounting.
(3) According to the nature, cost can be divided into direct costs and indirect costs.
(4) A cost that has already been incurred is called as opportunity cost. (02 marks)

1.7 State three(03) objectives of cost accounting. (03 marks)