EasyChair Preprint

№ 10687

COST Accounting and it's management

N.Durga Someswara Rao

EasyChair preprints are intended for rapid dissemination of research results and are integrated with the rest of EasyChair.

August 14, 2023

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Cost Accounting and it's management

Abstract: 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 particular needs of management.

As such, cost accounting cannot be used on official financial statements and is not GAAP-compliant.

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.

KEYWORDS: Cost,Price,Variable Cost,Fixed Cost,Overheads,Wages,Machine and materials, Product control and cost control.

METHODS AND MATERIALS: Cost accounting is used by a company's internal management team to identify all variable and fixed costs associated with the production process. It will first measure and record these costs individually, then compare input costs to output results to aid in measuring financial performance and making future business decisions. There are many types of costs involved in cost accounting, which are defined below.

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 its 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.

Types of Cost Accounting

Standard Costing

Standard costing assigns "standard" costs, rather than actual costs, to its cost of goods sold (COGS) and inventory. The standard costs are based on the efficient use of labor and materials to produce the good or service under standard operating conditions, and they are essentially the budgeted amount. Even though standard costs are assigned to the goods, the company still has to pay actual costs. Assessing the difference between the standard (efficient) cost and the actual cost incurred is called variance analysis.

If the variance analysis determines that actual costs are higher than expected, the variance is unfavorable. If it determines the actual costs are lower than expected, the variance is favorable. Two factors can contribute to a favorable or unfavorable variance. There is the cost of the input, such as the cost of labor and materials. This is considered to be a rate variance.

Additionally, there is the efficiency or quantity of the input used. This is considered to be a volume variance. If, for example, XYZ company expected to produce 400 widgets in a period but ended up producing 500 widgets, the cost of materials would be higher due to the total quantity produced.

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 refer to 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 costs 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 the time and money are being spent.

Lean Accounting

The main goal of lean accounting is to improve financial management practices within an organization. Lean accounting is an extension of the philosophy of lean manufacturing and production, which has the stated intention of minimizing waste while optimizing productivity. For example, if an accounting department is able to cut down on wasted time, employees can focus that saved time more productively on value-added tasks.

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By ALICIA TUOVILA Updated March 09, 2023

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Cost Accounting

Investopedia / Theresa Chiechi

What Is Cost Accounting?

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 not GAAP-compliant, and can only be used for internal purposes.

KEY TAKEAWAYS

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 particular needs of management.

As such, cost accounting cannot be used on official financial statements and is not GAAP-compliant.

Cost accounting considers all input costs associated with production, including both variable and fixed costs.

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Cost Accounting

Understanding Cost Accounting

Cost accounting is used by a company's internal management team to identify all variable and fixed costs associated with the production process. It will first measure and record these costs individually, then compare input costs to output results to aid in measuring financial performance and making future business decisions. There are many types of costs involved in cost accounting, which are defined below.

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Cost Accounting vs. Financial Accounting

While cost accounting is often used by management within a company to aid in decision-making, financial accounting is what outside investors or creditors typically see. Financial accounting presents a company's financial position and performance to external sources through financial statements, which include information about its revenues, expenses, assets, and liabilities. Cost accounting can be most beneficial as a tool for management in budgeting and in setting up cost-control programs, which can improve net margins for the company in the future.

One key difference between cost accounting and financial accounting is that, while in financial accounting the cost is classified depending on the type of transaction, cost accounting classifies costs according to the information needs of the management. Cost accounting, because it is used as an internal tool by management, does not have to meet any specific standard such as generally accepted accounting principles (GAAP) and, as a result, varies in use from company to company or department to department.

Cost-accounting methods are typically not useful for figuring out tax liabilities, which means that cost accounting cannot provide a complete analysis of a company's true costs.

Types of Cost Accounting

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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 costs 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 the time and money are 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.

Lean Accounting

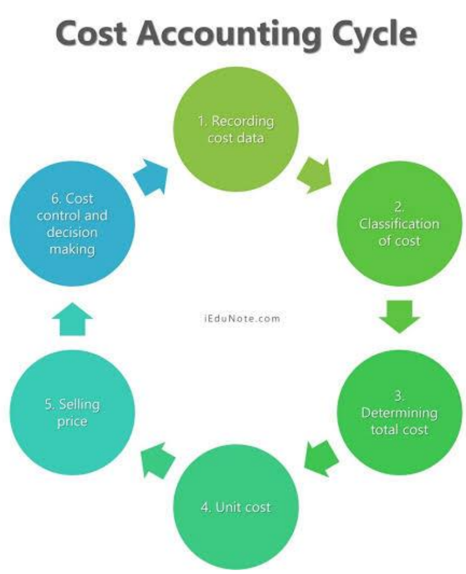
The main goal of lean accounting is to improve financial management practices within an organization. Lean accounting is an extension of the philosophy of lean manufacturing and production, which has the stated intention of minimizing waste while optimizing productivity. For example, if an accounting department is able to cut down on wasted time, employees can focus that saved time more productively on value-added tasks.

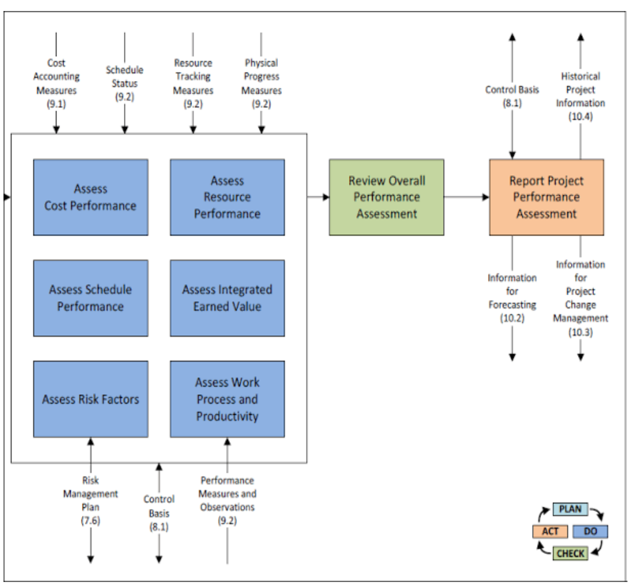
When using lean accounting, traditional costing methods are replaced by value-based pricing and lean-focused performance measurements. Financial decision-making is based on the impact on the company's total value stream profitability. Value streams are the profit centers of a company, which is any branch or division that directly adds to its bottom-line profitability.

Marginal Costing

Marginal costing (sometimes called cost-volume-profit analysis) is the impact on the cost of a product by adding one additional unit into production. It is useful for short-term economic decisions. Marginal costing can help management identify the impact of varying levels of costs and volume on operating profit. This type of analysis can be used by management to gain insight into potentially profitable new products, sales prices to establish for existing products, and the impact of marketing campaigns.

The break-even point—which is the production level where total revenue for a product equals total expense—is calculated as the total fixed costs of a company divided by its contribution margin. The contribution margin, calculated as the sales revenue minus variable costs, can also be calculated on a per-unit basis in order to determine the extent to which a specific product contributes to the overall profit of the company.





Cost management is the process of planning and controlling the costs associated with running a business. It includes collecting, analyzing and reporting cost information to more effectively budget, forecast and monitor costs.

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