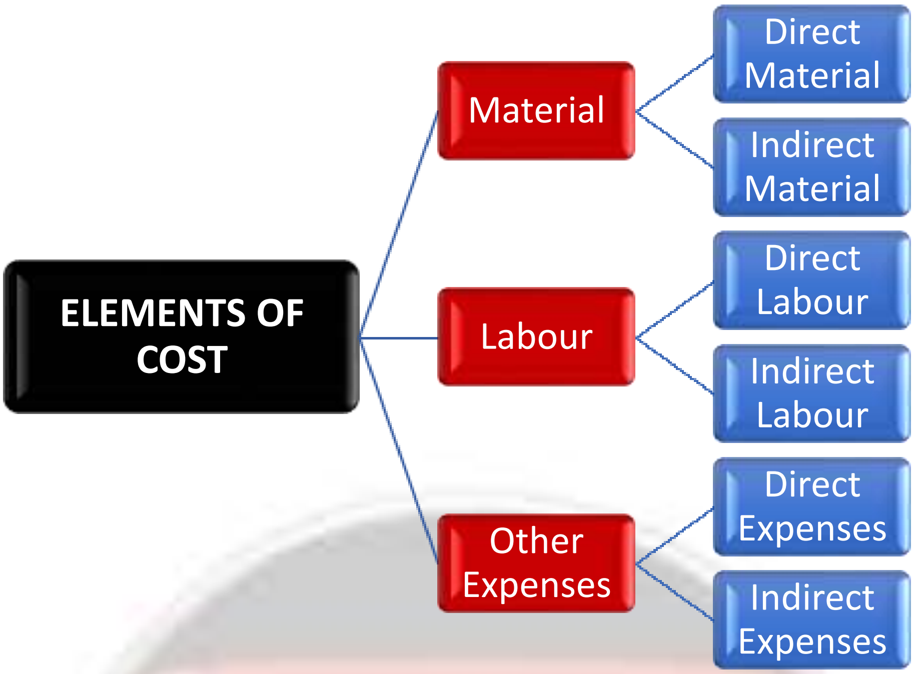
AN OVERVIEW OF COST & MANAGEMENT ACCOUNTING

COST

Cost refers to the amount of **money required to produce or acquire something.** It can represent expenses related to production, operations, materials, labour, or services,

ELEMENTS OF COST

- It refers to the **different components or factors** that **make up the total cost** of a product, service, or project.
- These elements help in **analysing and understanding the cost structure** and determining the cost of production or provision.



MATERIAL COST

This element represents the **cost of the materials** used in the production process. It includes the cost of **raw materials, components, and any other material inputs required**.

Direct Materials

These are the materials that are **directly and visibly incorporated into the final product**. They can be easily traced and allocated to specific products or projects.

Example

Raw materials, Components, and Sub-assemblies used in manufacturing.

Indirect Materials

They are those materials that are **not directly incorporated into the final product** but are necessary for the production process. They are typically used in **maintenance, repair, and operating activities. Examples**

Lubricants, Cleaning supplies, Tools, and other consumables.

LABOUR COST

It refers to the cost of the human effort involved in the production process. It includes **wages, salaries, benefits, and other expenses** associated with the workforce.

Direct labour costs

- It refers to the expenses d**irectly associated with the employees** who are **directly involved in the production process** or the delivery of a service.
- These costs can be **easily traced and allocated** to a specific product, project, or service.

Indirect Labour Cost

It refers to the **expenses associated with employees** who provide support to the overall operations of an organization but **are not directly involved in the production process or service delivery**.

OTHER EXPENSE

In addition to direct and indirect labour costs, there are **other types of expenses that organizations** incur in their operations known as other expense.

Direct expenses

These are costs that can be directly **attributed to a specific product, project, or service.**

Indirect expense

These are costs that are **not directly attributable to a specific product, project, or service**. Instead, they are incurred for the overall functioning of the organization or to **support multiple cost objects**.

TYPES OF COST

Fixed Costs

These are expenses that d**o not change with the level of production or sales**. They remain constant over a specific period regardless of the volume of output.

Example

Rent, Salaries of permanent employees, Insurance premiums.

Variable Costs

These are expenses that **vary in direct proportion to the level of production or sales.** They increase or decrease as the volume of output changes.

Example

Cost of raw materials, Direct labour wages, packaging costs.

Semi-Variable Costs

Semi-variable costs, also known as mixed costs, **have both fixed and variable components**. They consist of a **fixed portion that remains constant** and a variable portion that varies with production or sales.

Example

A utility bill that includes a fixed monthly charge plus a variable charge based on usage.

Direct Costs

These are expenses that can be **directly traced to a specific product, service, or project.** They are incurred specifically **for that particular item.**

Example

Cost of raw materials used in manufacturing a product, wages of workers directly involved in production, and direct sales commissions.

Indirect Costs

These are expenses that are **not directly attributable to a specific product or service**. They are incurred to support overall operations and cannot be easily allocated to specific items.

Example

Rent for a factory building, administrative salaries, Maintenance costs.

Period Cost

These are expenses that are **not directly tied to the production or acquisition of goods**. They are incurred during a specific period and are expensed immediately.

COST ACCOUNTING

- It is a branch of accounting that focuses on **analysing, recording, and reporting the costs incurred by a business.**
- Its primary purpose is to **provide management with relevant and accurate information** for decision-making, cost control, and performance evaluation.

OBJECTIVES

- To ascertain the Costs under **different situations using different techniques and systems of costing**.
- To determine the **selling prices under different circumstances.**
- To **determine and control efficiency** by setting standards for Materials, Labour, and Overheads
- To determine the **value of closing inventory for preparing financial statements** of the concern.
- It provides information for evaluating the performance **of various departments, products, or projects** within an organization.
- Cost accounting information is crucial for making strategic decisions. Whether it's **pricing decisions, make-or-buy analysis, product mix decisions.**

MANAGEMENT ACCOUNTING

- It refers to the process of **analysing and providing financial and non-financial information to managers** within an organization to support decision-making, planning, and control.
- It focuses on providing **relevant and timely information to managers**, enabling them to make **informed decisions and achieve organizational objectives.**

OBJECTIVES

Planning and Forecasting

- It helps in setting **financial targets and formulating plans** to achieve them.
- It involves preparing **budgets, financial forecasts, and strategic plans** that guide the organization's activities and resource allocation.

Decision-making

- It provides managers with **accurate and relevant information to support decision-making.**
- This includes evaluating investment opportunities, analyzing costs and benefits, assessing the financial impact of different options, and identifying potential risks and uncertainties.

Performance Measurement

- It provides **tools and techniques** to measure and **evaluate the performance** of various organizational units, projects, or activities.
- Key performance indicators (KPIs) are developed to assess **financial and non-financial metrics**, enabling managers to monitor performance.

Cost Control and Cost Management

This involves **identifying and analyzing costs**, implementing cost reduction initiatives, and monitoring cost variances to **ensure efficient resource utilization and maximize profitability.**

Financial Reporting and Analysis

It involves **generating financial information**, such as **income statements, balance sheets, and cash flow statements**, and providing insights into the financial performance and position of the organization.

Risk Management

- It assists in **identifying and managing risks** that may impact the organization's financial health and objectives.
- It involves assessing and quantifying risks, developing risk mitigation strategies, and monitoring risk exposure.

Tools and Techniques of Management Accounting

Budgeting

- Budgets are formal financial plans that outline an organization's expected **revenues, costs, and expenses over a specific period**.
- They help in setting **targets, allocating resources, and monitoring performance** against the budgeted figures.

Costing Methods

Different costing methods, such as **job costing, process costing, and activity-based costing,** are used to **allocate and trace costs to products, services, or processes.**

Variance Analysis

- **It compares the actual performance** of an organization with the **budgeted or standard performance**.
- It helps **identify and analyse** the **reasons for deviations** from the expected results, enabling management to take corrective actions.

Forecasting and Projections

This tool uses various techniques, such as **trend analysis, regression analysis, and time-series modelling**, to forecast future financial performance.

Capital Budgeting

This technique, such as **Net Present Value (NPV), Internal Rate of Return (IRR), and Payback Period**, are used to evaluate investment opportunities and determine the **financial feasibility of long-term projects or acquisitions.**