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DEPARTMENT OF COMMERCE

T.Y.B.COM

SEM-VI

Subject
Cost and Works Accounting-III

Chapter 3
Cost Accounting Standards
&
Cost Management for Specific Sector

Chapter 3rd
COST ACCOUNTING STANDARDS
&
COST MANAGEMENT FOR SPECIFIC SECTOR

INTRODUCTION

The Institute of Cost Accountants of India, recognizing the need for structured approach to the measurement of cost in manufacture or service sector and to provide guidance to the user organizations, government bodies, regulators, research agencies and academic institutions to achieve uniformity and consistency in classification, measurement and assignment of cost to product and services, has constituted Cost Accounting Standards Board (CASB) with the objective of formulating the Cost Accounting Standards.

Keeping in view latest legal and contemporary developments, the Cost Accounting Standards Board develops Cost Accounting Standards. To explain the requirements of Standards and provide the guidance with practical examples and illustrations on technical issues relating to Cost Accounting Standards issued by the Institute, CASB also issues Guidance Notes. The Cost Accounting Standard Board set up by the Council of the Institute of Cost and Works Accountants of India during 1980 later was reconstituted in 1988 as per a permanent and independant board to develop Cost Accounting standards with an exclusive authority to make cost acouunting standards and regulation.

COST ACCOUNTIG STANDARDS

Cost Accounting Standards (CAS) are a set of standards that are designed “to achieve uniformity and consistency in cost accounting practices.”

Features of Cost Accounting Standards

1. Provide a structured approach to measurement of costs in manufacturing process or service industry;
2. Integrate, harmonize, and standardize cost accounting principles and practices;
3. Provide guidance to users to achieve uniformity and consistency in classification, measurement, assignment, and allocation of costs to products and services;
4. Arrive at the basis of computing the cost of product, activity, or service where required by legal or regulatory bodies;
5. Enable practicing members to make use of cost accounting standards in the attestation of general purpose cost statements;
6. Assist in clear and uniform understanding of all the related issues by various user organizations, government bodies, regulators, research agencies, and academic institutions.

COST ACCOUNTING STANDARDS (CAS) 6- MATERIAL COST

A) Introduction

This standard deals with principles and methods of determining the Material Cost. Material for the purpose of this standard includes raw materials, process materials, additives, manufactured / bought out components, sub-assemblies, accessories, semi finished goods, consumable stores, spares and other indirect materials. This standard does not deal with Packing Materials as a separate standard is being issued on the subject. This standard deals with the principles and methods of classification, measurement and assignment of material cost, for determination of the Cost of product or service, and the presentation and disclosure in cost statements.

The Standard deals with the following issues.

• Principle of Valuation of receipt of materials.
• Principle of Valuation of issue of materials.
• Assignment of material cost to cost objects.

B) Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the material cost with reasonable accuracy.

C) Scope

This standard should be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of material costs including those requiring attestation.

D) Definitions

The following terms are being used in this standard with the meaning specified.

1. Abnormal cost
2. Administrative overheads
3. Cost Object
4. Defectives
5. Imputed Costs
6. Intermediate Product
7. Materials
8. Material Cost
9. Production overheads
10. Scrap
11. Standard Cost
12. Waste and spoilage

E) Principles of Measurement

1. Principle of valuation of receipt of materials
2. Principle of valuation of issue of material

F) Assignment of costs

1. Assignment of costs – Materials
2. Assignment of costs – Direct Expenses
3. Assignment of costs– Indirect materials

G) Presentation

Cost Statements governed by this standard, shall present material costs as detailed below:

1. Direct Materials shall be classified in the cost statement under suitable heads. E.g.

• Raw materials,

• Components,

• Semi finished goods and

• Sub-assemblies

2. Direct Materials shall be classified as Purchased - indigenous, imported and self manufactured.

3. Indirect Materials shall be classified in the cost statement under suitable heads like tools, stores and spares, machinery spares, jigs and fixtures, consumable stores, etc., if they are significant.

H) Disclosures

The following information should be disclosed in the cost statements dealing with determination of material cost.

1. Quantity and rates of major items of materials shall be disclosed. Major items are defined as those who form 5% of cost of materials.
2. The basis of valuation of materials shall be disclosed.
3. Any abnormal cost excluded from the material cost shall be disclosed.
4. Any demurrage or detention charges, penalty levied by transport or other authorities excluded from the material cost shall be disclosed.
5. Any Subsidy/Grant/Incentive or any such payment reduced from material cost shall be disclosed.
6. Cost of Materials procured from related parties5 shall be disclosed
7. Any cost imputed in arriving at the material cost shall be disclosed.
8. Disclosures shall be made only where significant, material and quantifiable.
9. Disclosures may be made in the body of the Cost statement or as a footnote or as a separate schedule.

COST ACCOUNTING STANDARDS (CAS) 7- EMPLOYEE COST

A) Introduction

This standard deals with the principles and methods of determining the Employee cost.This standard deals with the principles and methods of classification, measurement and assignment of Employee cost, for determination of the Cost of product or service, and the presentation and disclosure in cost statements.

B) Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the Employee cost with reasonable accuracy.

C) Scope

This standard should be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of Employee cost including those requiring attestation.

D) Definitions

The following terms are being used in this standard with the meaning specified.

1. Abnormal cost
2. Abnormal Idle time
3. Administrative overheads
4. Cost Object
5. Distribution Overheads
6. Direct Employee Cost
7. Employee cost
8. Idle time
9. Imputed Costs
10. Indirect Employee Cost
11. Marketing overheads
12. Overtime Premium

E) Principles of Measurement

Some principles are as follows

1. Employee Cost shall be ascertained taking into account the gross pay including all allowances payable along with the cost to the employer of all the benefits.

2. Bonus whether payable as a Statutory Minimum or on a sharing of surplus shall be treated as part of employee cost. Ex gratia payable in lieu of or in addition to Bonus shall also be treated as part of the employee cost.

3. Separation costs related to voluntary retirement, retrenchment, termination etc. shall be amortised over the period benefitting from such costs.

4. Employee cost shall not include imputed costs.

5. Any abnormal cost where it is material and quantifiable shall not form part

of the Employee cost.

6. Penalties, damages paid to statutory authorities or other third parties shall not form part of the Employee cost.

7. Any recovery from the employee towards any benefit provided e.g. housing shall be reduced from the employee cost

F) Assignment of costs

1. While determining whether a particular Employee cost is chargeable to a separate cost object, the principle of materiality shall be adhered to.

2. Where the Employee costs are not directly traceable to the cost object, these may be assigned on suitable basis like estimates of time based on time study.

3. Recruitment costs, training cost and other such costs shall be treated as overheads and dealt with accordingly.

4. Overtime premium shall be assigned directly to the cost object or treated as overheads depending on the economic feasibility and the specific circumstance requiring such overtime.

5. Idle time cost shall be assigned direct to the cost object or treated as overheads depending on the economic feasibility and the specific circumstances causing such idle time.

G) Presentation

1. Direct Employee costs shall be presented as a separate cost head in the cost statement.

2. Indirect Employee costs shall be presented in cost statements as a part of overheads relating to respective functions e.g. manufacturing, administration, marketing etc.

3. The cost statement shall furnish the resources consumed on account of Employee cost, category wise such as wages salaries to permanent, temporary, part time and contract employees piece rate payments, overtime payments, Employee benefits (category wise)etc wherever such items form a material part of the total Employee cost.

H) Disclosures

The cost statements shall disclose the following:

1. Employee cost attributable to capital works or jobs in the nature of deferred revenue expenditure indicating the method followed in determining the cost of such capital work.

2. Separation costs payable to employees.

3. Any abnormal cost excluded from Employee cost.

4. Penalties and damages paid etc excluded from Employee cost.

5. Any Subsidy, Grant, Incentive and any such payment reduced from Employee cost

6. The Employee cost paid to related parties

7. Employee cost incurred in foreign exchange.

COST MANAGEMENT FOR SPECIFIC SECTOR

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.

While cost management is viewed as a continuous process, it helps to split the function into four steps: resource planning, estimation, budgeting and control.

A) AGRICULTURE SECTOR

Features

1. Challenges associated with structure of the industry which is fragmented and unorganized
2. Lack of understanding of costs
3. Understanding the potential of working collaboratively
4. Use of target costing techniques for price determination
5. Imbalance of power across the supply chain
6.

Target cost Management

The target costing technique involves determining the cost by subtracting the required margin from the anticipated price for the agricultural produce. However, the anticipated price for the agricultural products fluctuates making the process of cost management using the target cost management system ineffective in the case of the agricultural sector Imbalance of power distribution With the fragmentation and the unorganized nature of the farmers operating in the agricultural sector, the power of bargaining seems to lie in the hands of the wholesalers purchasing the produce from the farmers resulting in overall low margins for farmers in comparisons to the margins earned by the wholesalers and the retailers operating in the said sector.

Cost Management

Cost Management focuses upon all the activities internal and external to the value chain process in order to help in cost reduction and cost control. In relation to the agricultural sector, the

Activity Based Costing technique is being increasingly accepted for the purpose of cost management.

Large scale enterprises engaged in the agriculture sector that are engaged in the investment of high scale capital expenditure require efficient utilization of technology as well as the efficient use of production technology that are available at their disposal.

Thus, the Activity Based Costing as the name suggests provides a better manner in which the indirect costs associated with the processes carried out in the agricultural sector can be carried out in an efficient manner.

It is a step up from the target cost management technique where the fluctuation in the anticipated price which forms part of the formula might not result in appropriate determination of the target costs.

Therefore, ABC costing can help in allocation of the costs in relation to the various activities associated with the production based upon the cost drivers identified in relation to each production activity.

- Benefits of using ABC for cost management in the agricultural sector
- Adjustable costing technique
- Faster and more accurate
- Enables carrying out a more detailed cost analysis

Major Categories of Costs in Managing Agriculture Business

1. Fixed Costs
2. Variable Costs
3. Cash & Non Cash costs
4. Marginal Cost
5. Other Cost
    - Average Fixed cost
    - Average Variable cost
    - Average Total cost

Minimum Support Price (MSP)

In India, Minimum Support Price (MSP) was introduced by the Government of India to protect farmers against sharp dip of agricultural prices, which was usually observed during the harvest seasons. The harvest seasons are associated with huge supply, which overshadows the demand, and hence, in most cases the commodity prices hit the bottom. This forces the farmers, in necessity of money for repayment of debts, in selling their produce at losses or very little profits.

Thus, the government fixes the MSP, as a part of government food grain procurement. Selling at MSP ensures profit margins for farmers and avoids distress selling situations.

B) INFORMATION TECHNOLOGY (IT) SECTOR

There are a number of challenges associated with the management of the costs associated with the Information Technology expenditures incurred by the Multi-National corporations. Thus, the complexity of the operating structure and the difficulty seen in the implementation of the cost allocation models, it is seen that in order to manage the IT costs, most organizations tend to develop centralized IT departments acting as cost centers for the purpose of managing the IT budgets as well as allocation of costs associated with along with the charging back of expenses that are incurred by the business units.

Basic Activites / Key Terms of I.T.Financial Management

Here is the 'ABC' of Financial Management for IT Services.

1. Accounting:

This is the process that enables the IT organization to account fully for the way its money is spent (particularly the ability to identify costs by customer, by service and by activity). It usually involves accounting systems, including ledgers, charts of accounts, journals etc and should be overseen by someone trained in accountancy.

2. Budgeting:

This is the process of predicting and controlling the income and expenditure of money within the organization. Budgeting consists of a periodic negotiation cycle to set budgets (usually annual) and the monthly monitoring of the current budgets.

3. Charging:

This is the process required to bill customers for the services supplied to them. This requires sound IT accounting practices and systems.

Specific Costs considered in Cost Management

1. Hardware
2. Software
3. Subscriptions
4. Services

Classfication of I.T.Opertational Costs

1. Current expenses
2. Fixed assets costs

Different types of I.T.Cost

1. Development cost
2. Production Cost

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