

# STRATEGIC COST MANAGEMENT



# Branches of accounting

- (a) Financial Accounting
  - (b) Cost Accounting
  - (c) Management Accounting
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# Financial Accounting

- ▶ It is largely concern with financial statements for external use by investors, creditors, financial analysts, government agencies and other interested groups.
  - ▶ It deals with historical data & it involves recording, classifying, and analysing the financial transactions.
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# Cost Accounting

It is defined as the process of accounting for costs from the point of which expenditure is incurred or committed.

It involves classification, allocation, absorption, and control of costs.

It also evaluates the total costs and cost per unit of a product, service and operation.

Cost accounting helps in cost reduction and cost control .

# Management Accounting

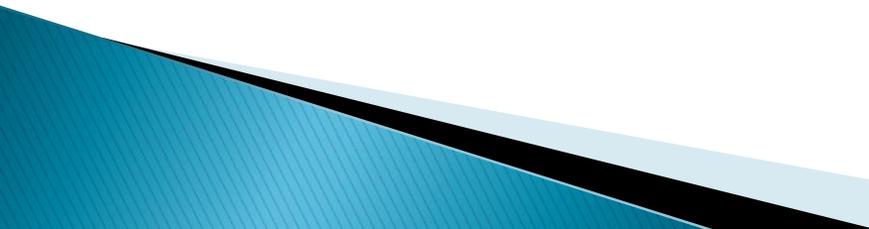
- ▶ It provides information for management activities such as decision making, planning and controlling.
  - ▶ It is a system of accounting which is concern with internal reporting of information to management for (a) planning, controlling, operating (b) Decision making in special matter (c) Formulating long range planning.
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# Scopes of Management Accounting

- ▶ Financial Accounting
  - ▶ Cost Accounting
  - ▶ Financial Management
  - ▶ Budgeting & Forecasting
  - ▶ Inventory Control
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- ▶ Reporting to Management
  - ▶ Interpretation of Data
  - ▶ Internal audit
  - ▶ Tax planning
  - ▶ Control procedures & methods
  - ▶ Office services
  - ▶ Statistical tools
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# Functions of Management Accounting

- ▶ Planning and forecasting.(Budgeting,Standard costing, marginal costing, probability, correlation and regression, etc.)
  - ▶ Coordinating
  - ▶ Financial analysis and interpretation.( Ratio analysis, cash flow and funds flow statements, trend analysis)
  - ▶ Facilitates managerial control.(Standard costing, budgetary control, ratio analysis, internal audit.)
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- ▶ Helpful in taking strategic decisions. ( Pricing of products, make or buy, capital expenditure)
  - ▶ Supplying information to various levels of management
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# Difference Between Management Accounting and Financial Accounting

## ▶ **Objective**

MA is essential to help management for formulating Policy and Plan.

FA records various transactions in respect to maintain accounts to know the financial position and performance of the company.

## ▶ **Nature**

MA is concern with the projection of figure in future.

FA deals only with historical data.

## ▶ **Scope**

MA area is very wide.

FA finds the position and performance of the company.

## ▶ **Useful**

MA is very useful in management decision-making.

FA is useful to both external and internal people for the reference.

- ▶ **Quickness**

  - MA is very quick.

  - FA used to prepare time to time generally once in a year.

- ▶ **GAAP ( Generally accepted accounting principles)**

  - No GAAP but certain rules follows in MA.

  - FA follows the GAAP.

- ▶ **Period**

  - MA used to prepare for period to period.

  - FA uses to prepare for particular period.

# Terminology of CA

## Cost–

The price paid for something.

Cost is a measurement of the amount of resources used for the purpose of production of goods or rendering of services in monetary terms.

# Costing

It is the technique and process of ascertaining costs .

# Cost Unit

It is a unit of product or service in relation to which costs are ascertained .

Ex. In sugar mill , the cost per tonne of sugar  
cost per meter of cloth  
cost unit is unit of measurement of cost.

# Cost Centre

- ▶ For the purpose of ascertaining Cost, the whole organisation is divided into small parts or sections .
- ▶ Each small section is treated as a Cost center of which cost is ascertained .
- ▶ It may be a location (a department, a sales area), an item of equipment (a machine, a delivery van), a person ( a salesman, a machine operator) or a group of these (two automatic machines operated by one workman) .

Cost centres are primarily of 2 types .

(a) Personal Cost Centre .

(b) Impersonal cost centre .

From a functional point of view :

- (a) Production cost Centre
- (b) Service Cost Centre

# Cost Object

Cost Object may be defined as “anything for which a separate measurement of cost may be desired . Object may be a product, service, activity or process etc.

Product – Car , Computers

Service – Telephone , medical  
service

Process – Melting process in a steel mill  
weaving process in a textile mill

Activity – Developing a website

# Profit Centers

- ▶ When a responsibility center's financial performance is measured in terms of profit (i.e. by the difference between the revenues & expenses), the center is called a profit center .

# Objectives of Cost accounting

1. Ascertainment of Cost : In cost accounting, Cost of each unit of production, job, process or department etc. is ascertained . Not only actual Costs incurred are ascertained but costs are also predetermined for various purposes .



## 2. Cost Control and Cost reduction

It aims at improving profitability by controlling and reducing costs. For this purpose, various specialized techniques like standard costing, budgetary Control, inventory control are used .

# 3. Guide to business Policy

Cost data provide guidelines for various managerial decisions like make or buy, selling below cost, utilization of idle plant capacity, introduction of a new product etc.

# 4.Determination of Selling Price

It provides Cost information on the basis of which selling prices of products or services may be fixed .

# 5. Disclose Sources of Wastage

It discloses sources of wastage whether of material, time or expense or in the use of machinery , equipment and tools and to prepare such reports which may be necessary to control such wastage .

## 6.To provide specialized services of cost audit

It organizes the internal audit system to ensure effective working of different departments. It prevents the errors, frauds, facilitates prompt and reliable information to management .

# Advantages

1. Profitable and unprofitable activities are disclosed.
  2. It enables a concern to measure the efficiency and then to maintain and improve it .
  3. It provides information upon which estimates and tenders are based .
  4. It guides future production policies .
  5. It helps in increasing profits.
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- 6 . It furnishes reliable data for comparing costs .
  7. The exact cause of a decrease or an increase in profit or loss .
  8. It discloses the relative efficiencies of different workers.
  - 9 . Helpful to the government.
  10. Helpful to consumers.
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# Difference between financial accounting & Cost accounting

## Purpose

- FA provides information about the profit and loss and financial position of the business .
- CA provides information to management for proper planning, operation, control & decision making .

# Control

- ▶ FA does not give emphasis on control .  
CA gives emphasis on control by using standard costing & budgetary control .

# Reporting of Cost

- ▶ In FA the costs are reported in aggregate but in CA the costs are broken down as a unit basis .

# Information

- ▶ FA uses only monetary information .
- ▶ CA uses monetary as well as non monetary information like units .

# Nature

- ▶ FA deals with historical data. CA deals with both past and predetermined figure.

# Usefulness

- ▶ FA is useful for both external and internal purpose .
- ▶ CA is useful, mainly for the internal purpose .

# Format

- ▶ FA has a single uniform format of presenting information. CA has varied forms of presenting cost information .

# Period

- ▶ Financial reports are prepared periodically, usually on an annual basis. But cost reporting is a continuous process and may be daily, weekly , monthly , etc.

# Essentials of a good cost Accounting System

- ▶ Suitability : The method of costing adopted, i.e. job or process costing, should be suitable to the industry and serve the objectives of installing the system .

# Support of executives

- ▶ If a costing system is to be successful, it must be supported by executives of various departments .

# Cost of the System

- ▶ The cost of installing and operating the system should be justified by the results produced .

# Clearly defined cost centres

- ▶ In order to derive maximum benefits from a costing system, well defined cost centre and responsibility centre should be identified within the organisation .

# Controllable costs

- ▶ Controllable and non-controllable costs of each responsibility centre should be separately shown .

# Integration with financial accounts

- ▶ There should be cooperation & coordination between cost accounting & financial accounting departments .

# Continuous education

- ▶ Well trained and educated staff should be employed to operate the system.
  - ▶ In order to educate the costing staff, written manuals and meetings etc. should be arranged on a continuous basis.
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# Practical Difficulties in installing a costing system .

1. Lack of support from top management :  
In most of the cases, the cost accounting system is introduced without the support of the top management .
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# Resistance from the existing accounting staff .

- ▶ Whenever a new system is introduced resistance is natural, as the existing staff may feel that they would lose their importance and may be unsure of their position in the organisation .

# Shortage of trained Staff

- ▶ There may be shortage of cost accountants to handle the work of Cost analysis, cost control and cost reduction .

# Heavy cost of operating the system

- ▶ The cost of operating a system will be high unless the costing system is properly designed according to the requirements of each case specially .

# Steps to overcome practical difficulties

- ▶ Support from the top management
- ▶ Utility of system to existing Staff .
- ▶ Workers' confidence for cooperation .

- ▶ Training of existing accounting staff .
  - ▶ Cost system according to specific requirements of the concern .
  - ▶ Proper supervision .
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