

Introduction to Cost Accounting

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Designed as a quick-reference guide for students and beginners.

1. What Is Cost Accounting?

Aspect	Description
Definition	The systematic recording, analysis, and reporting of the costs incurred in producing goods or services.
Purpose	• Help management control expenses • Support pricing and profitability decisions • Provide data for budgeting, forecasting, and performance evaluation • Direct costs (materials, labor)
Scope	• Indirect costs (overheads, administrative expenses) • Fixed, variable, and semi-variable costs
Users	Internal stakeholders: managers, executives, product engineers, and accountants. External users (e.g., investors) typically rely on financial accounting, not cost accounting.

2. Key Concepts & Terminology

Term	Meaning
Cost	Monetary value of resources used to produce a product or service.
Cost Object	Anything for which a cost is measured (product, department, project, customer).
Cost Driver	Factor that causes a change in the cost of an activity (e.g., machine hours, number of setups).
Direct Cost	Traceable directly to a cost object (e.g., raw material, assembly labor).
Indirect Cost (Overhead)	Not directly traceable; allocated to cost objects (e.g., factory rent, utilities).
Fixed Cost	Remains constant within a relevant range, regardless of output (e.g., depreciation).

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Variable Cost	Changes in direct proportion to output (e.g., raw material).
Semi-Variable Cost	Contains both fixed and variable components (e.g., telephone bill).
Standard Cost	Predetermined cost for material, labor, or overhead based on efficient performance.
Variance	Difference between actual cost and standard cost; analyzed as favorable or unfavorable.

3. Cost Classifications

Classification	Examples	Typical Use
By Nature	Material, labor, overhead	Cost control, budgeting
By Function	Production, selling, administrative	Profitability analysis
By Behavior	Fixed, variable, mixed	Break-even analysis, CVP (Cost-Volume-Profit)
By Controllability	Controllable (direct labor), non-controllable (depreciation)	Performance evaluation
By Relevance	Relevant (future, incremental), irrelevant (sunk)	Decision making

4. Major Cost Accounting Systems

System	How Costs Are Assigned	Best Fit For
Job-Order Costing	Costs accumulated per individual job or order.	Custom-made products, services, construction projects.
Process (or Operation) Costing	Costs averaged over identical units flowing through processes.	Continuous-flow industries (chemicals, oil, food processing).
Activity-Based Costing (ABC)	Costs allocated to activities, then to cost objects using cost drivers.	Complex, multi-product firms where overhead is significant.
Standard Costing	Uses predetermined standards; tracks variances.	Manufacturing environments seeking tight cost control.

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System	How Costs Are Assigned	Best Fit For
Marginal (Variable) Costing	Only variable production costs assigned to products; fixed overhead treated as period cost.	Short-term decision making, CVP analysis.

5. The Cost Accounting Cycle (Typical Steps)

1. **Identify Cost Objects** – Define the products, services, or departments to be