

Course: BBA Part III

Paper: XVI

Topic: Advantages of Cost Accounting

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Advantages of Cost Accounting

1. Measurement and Improvement of Efficiency:

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Of course, the increase may only be due to increase in price of materials; it may also be due to greater wastage in use of materials or inefficiency at the time of buying so that unnecessary high prices were paid. Comparisons may also be made with average figures for the whole industry (if such figures are available) and with ideal figures which may have been determined before hand.

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prices were paid. Comparisons may also be made with average figures for the whole industry (if such figures are available) and with ideal figures which may have been determined before hand.

In any case it is this sort of comparison which tells management about the going up or coming down of efficiency. The study will certainly indicate the steps to be taken to remove the causes of inefficiency or to consolidate a factor which leads to greater efficiency.

2. Profitable and Unprofitable Activities:

It will throw light upon those activities which bring profits and those activities which result in losses. This will be done only if the cost of each product or each job is ascertained and compared with the price obtained.

3. Fixation of Prices:

In many cases a firm is able to fix a price for its products on the basis of the cost of production. In such a case, price cannot be properly fixed if no proper figures of cost are available. In case of big contracts, no quotation can be made unless the cost of completing that contract can be ascertained.

If prices are fixed without costing information, it is possible that the price quoted may either be too high, in which case orders cannot be obtained, or it may be too low, in which case an order will result in a loss. It is a mistake on the part of any management to believe that mere increase in sales volume will result in profits; increased sales at prices lower than the cost may well lead the concern to the bankrupt court. Only Cost Accounting will reveal what price will be profitable.

4. Guide in Reducing Prices:

In certain periods it becomes necessary to reduce the price even below the total cost. This will be so when there is a depression or slump. Costs, properly ascertained, will guide management in this direction.

5. Information for Proper Planning:

For a proper system of Costing, it is necessary to have detailed information about the facilities available about machine and labour capacity. This helps in proper planning of work so that no section is overworked and no section remains idle.

6. Control over Materials etc.:

Information about availability of stocks of various materials and stores must be constantly available if there is a good system of Cost Accounting. This helps in two ways. Firstly, production can be planned according to the availability of materials and fresh stocks can be arranged in time when old stocks are exhausted. Secondly, loss due to carelessness or pilferage or any other mischief will be known and, therefore, put down.

7. Decision Regarding Machine vs. Labour:

Some of the important questions before management can be solved only with the help of information about costs. For example, if there is the problem of replacement of labour by machinery, Cost Accounting will at least guide management in finding out what the cost of production will be if either machinery or labour is used.

8. Expansion in Production:

Sometimes it is necessary to decide whether production of one product or the other is to be increased. This problem can also be solved only if proper information about costs is available.

9. Reasons for Losses Detected:

Exact causes of existence of profits or losses will be revealed by a system of Cost Accounting. For example, a concern may suffer not because the cost of production is high or prices are low but because the output is much below the capacity of the concern. It is only Cost Accounting which will reveal this reason for loss. It also helps in distinguishing between expenditure and loss which is necessary and that which is unnecessary, that is to say, between normal and abnormal losses.

10. Helps in Taking Decisions:

Cost Accounting inculcates the habit of making calculations with pencil and paper before taking a decision. It will certainly check recklessness. Also some of the silly mistakes that sometimes occur can be avoided if there is a good Cost Accounting system. To give an instance, a well-

known firm once quoted for supply of mosquito nets to the Government at a very low price. It was only after the order was obtained that the firm found that, by mistake, the price of materials was not included in the quotation.

11. Check on Accuracy of Financial Accounts:

A good system of Cost Accounting affords an independent and most reliable check on the accuracy of financial accounts. This check operates through reconciliation of profits shown by Cost Accounts and by Financial Accounts. On the basis of various advantages of Cost Accounting, it can be easily said that 'a good system of costing serves as a means of control over expenditure and helps to secure economy in manufacture'.