COST ACCOUNTING
(ACC 203)

LECTURE NOTE

By

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HISTORY, PRINCIPLES AND OBJECTIVES OF COST ACCOUNTING

Cost Accounting Definitions

There are several definitions of cost accounting, these include:

It is the recording of all the costs incurred in a business in a way that can be used to improve its management.

Cost Accounting Definitions (Cont.)

Cost accounting refers to the process of recording, classifying, summarizing, allocating and analyzing the different alternative measures to control costs. Its purpose is to guide the management on how to control costs effectively and maximize productivity. It provides detailed information of the costs that needs to be focused and find out the alternative course of actions to control the costs in the future.

Cost Accounting Definitions (Cont.)

Cost accounting is the systematic recording and analysis of the costs of material, labour, and overhead incident to production

Usefulness of Cost Accounting to Managers

The various advantages derived by managements on account of a good costing system can be put as follows:

1. Useful in periods of depression and competition: During trade depression the business cannot afford to have leakages which pass unchecked. The management should know where economies may be sought, waste eliminated and efficiency increased.

Usefulness Cost Accounting to Managers

2. Helps in pricing decisions

3. Helps in estimates

4. Cost Accounting helps managers to channel production on right lines: Costing makes possible for the management to distinguish between profitable

and non-profitable activities.

Usefulness Cost Accounting to Managers

5. Helps in reducing wastage: As it is possible to know the cost of the article at every stage, it becomes possible to check various forms of waste.

6. Provides data for periodical profit or loss accounts

7. Costing results into increased efficiency

History of Cost Accounting

Cost accounting, dated back to the ancient times, is one of the oldest managerial tools used to determine the amount of taxes that were taken by kings or used to determine the prices of the products that trading people of antiquity were selling. The trading people of ancient times such as the Chinese, Egyptians and Arabs had accountants in the service of the royal courts, some of whom were experts in the determination of costs (Perren, 1944).

In Egypt, 3,000 years before Christ, accountants had to present to the Pharaohs each year a detailed report on the net cost of harvest, so that just taxes on wheat could be levied. The ancient Code of Manu made obligatory the periodical auditing of trading profits by court auditors. ......

In Books VII and VIII of these sacred Laws we find the following two passages: `Merchandising experts will establish the sales price of goods, so that the king may levy 1/20 of the profit thereon' ...`the sales price of merchandise shall be evaluated according to the distance it has travelled, the time it is kept in storage, the expenses connected with it, the time it has to travel to reach its final destination, and the profit that can be anticipated.

The duty of calculating the costs of products in ancient times was performed by court officials and the whole essence was to be able to determine the value of taxes. At about 1100 BC in ancient China, there existed some form of government auditing, budgetary accounts, expenditure control, and periodic reporting. These were some of the costing techniques used by governments in ancient civilizations.

The nineteenth century saw the emergence of large business enterprises like the textile mills, iron and still works, which made extensive use of machinery in industrial production, hence the general belief that cost accounting is a product of the nineteenth century. For the systematic recording technique of cost accounting which was developed in the nineteenth century and extended later on, this belief holds sway. But there existed much older elements of costing in the form of industrial bookkeeping practices and techniques.

As early as the beginning of the fourteenth century, some industrial accounts, early and simple forms of cost accounting were in use, as shown by some medieval business records that exist in the twentieth century (DeRoover, 1968). To support this argument, Edwards and Newell (1990:41) state that the use of product costing is not a product of the nineteenth century.

The costing techniques that were practised earlier on in the medieval era, apart from their simple structures, were very similar to many of the techniques employed in cost accounting in the twentieth century. Take the evaluation of by-products as an example.

The Origin of Cost Accounting

Generally, in the accounting history, it is believed that the double entry system of accounting formally started with Luca Pacioli's Summa which was published in 1494. But facts in the accounting literature show that double entry bookkeeping was already in practice by the Venetian merchants and several others in Northern Italy long before Pacioli's treatise which only described the system. Though he never laid claim to the invention of the all embracing double entry system of accounting, researches have shown that he laid the stepping stone hence, his recognition as the father of modern bookkeeping (Adum, 2015b).

The Origin of Cost Accounting (Cont.)

Arabic numerals were introduced around the early thirteenth century as a result of the extensive trading arrangement which the Italian merchants were engaged in with Arabs living in the Middle East, North Africa and Spain (DeRoover, 1956). As businesses grew, accounts were used, though in a very simple way, to cost products. In the accounts of Garner (1988), a firm known as Del Bene was established to in Florence, Italy to convert raw wool into products.

The Origin of Cost Accounting (Cont.)

The system of accounting records adopted by this firm, though very crude when compared with later developments, represented some of the earliest examples of cost accounting. At about 1350, the firm was able to derive prime costs and operated accounting books for "the results of trading or mercantile activity" and "the central workshop data". Later on such other books as "the book of raw wool purchased", "the labourers wage book" and "the dyers wage book" were established and used. Those books were used to record every transaction relating to the purchase of wool, the labour expenses for manufacture of certain quality and quantity of woollen cloths, and of course, the cost of dyers.