UNIT-V
BOOK KEEPING IN COST ACCOUNTING

1. Name the methods of maintaining cost accounts.

Ans. There two methods/systems of maintaining cost accounts as follows:
(i) Non-integral System/Non-integrated System/Inter-locking System.
(ii) Integral System/Integrated System.

2. What is Non-integral System of accounting? State its features.

Ans. Non-integral system is a system of accounting under which two separate sets of account books are maintained—one for cost accounts and the other for financial accounts. Non-integral system of accounting is also known as non-integrated system or Inter-locking system or Cost Ledger Accounting system.

CIMA, London defines Non-integral system as a system in which the cost accounts× are distinct from financial accounts, the two sets of accounts being kept continuously in agreement by the use of control accounts or made readily reconcilable by other means.

Features of Non-integral System of Accounting: The basic features of Non-integral System of Accounting are as follows:

(i) Separate ledgers are maintained for cost and financial accounts.

(ii) Like financial accounting, it is also based on double entry× system.

(iii) There are no personal accounts because cost accounts do× not show relationship with outsiders.

(iv) Cost accounts are concerned with impersonal accounts× i.e., real and nominal accounts.

(v) In real accounts, only stocks are shown in cost accounts

(vi) Transactions affecting the nominal accounts are recorded× separately in detail. Thus cost accounting department is concerned mainly with the ascertainment of income and expenditure of business,

(vii) Under this system one main ledger (i.e., Cost Ledger) and× various subsidiary ledgers are maintained,

(viii) Since the system is not properly integrated, some items may× appear in financial ledgers only, while some other items appear only in cost ledger,

(ix) The profit or loss disclosed by the two sets of accounts for a× particular period will never be the same and as such a reconciliation of costing profit or loss with that of financial accounts is essential.

3. Name and explain the ledgers maintained in cost books under non-integral system.

Ans. The following four important ledgers are maintained in cost books under non-integral system:

(i) Cost Ledger: It is the principal ledger in cost books which controls all other ledgers in the costing× department. It contains all impersonal accounts and is similar to General Ledger of financial accounts.

(ii) Stores Ledger: It is a subsidiary ledger. It contains all stores accounts.

(iii) Work-in-Progress Ledger: It is a subsidiary ledger. It contains a separate account for each job in progress. Each such account is debited with the materials costs, wages and overheads chargeable to the jobs and credited with the cost of work completed. The balance in this account shows the cost of uncertified work.

(iv) Finished Goods Ledger: It is a subsidiary ledger. It contains accounts of completely finished goods and jobs. The cost ledger is made self-balancing by opening a control account for each of the above subsidiary ledgers.

4. What is Control Accounts? Explain the important control accounts in the cost ledger.

Ans. Control Accounts are the total/summary accounts which are maintained for the subsidiary ledgers in the Cost Ledger under non-integral system. It is prepared on the basis of periodic total of transactions in the respective subsidiary ledgers. Control accounts are maintained in the Cost Ledger to complete the double entry.

Following are the important accounts in the cost ledger:

(i) General Ledger Adjustment (or Cost or Financial Ledger Control) Account: This account is maintained to make the cost ledger self-balancing. All items of income or expenditure which have been extracted from the financial accounts are posted into this account. It is important to note that no entry should be made direct from the financial books to the cost books ; entries must pass through the General Ledger Adjustment Account. The balance in this account represents the total of all the balances of the impersonal accounts.

(ii) Stores Ledger Control Account: This account deals with materials transactions. It records a summary of the value of stores received, issued and balance in hand.

(iii) Wages Control Account: This account deals with transactions relating to wages. Direct wages will be transferred to Work-in-progress Account and indirect wages to respective Overhead accounts. Postings are made in this account from wages analysis sheet.

(iv) Production/Works/Manufacturing Overhead Account: This account deals with factory expenses. This account is debited with indirect material cost, indirect wages and indirect factory expenses and is credited with the amount of overhead recovered. The balance represents overhead under- or over-absorbed and is transferred to Costing Profit and Loss Account.

(v) Work-in-Progress Control Account: This account shows the cost of work-in-progress at any time. This is debited with opening balance of work-in-progress, direct materials, direct labour, direct expenses (as royalty paid), production overheads recovered and credited with the value of finished goods completed and transferred. The balance of this account will show total balance of jobs which are in progress as per various individual job accounts.

(vi) Administration Overhead Account: Administration costs are debited to this account and credited with overhead recovered from finished goods. The difference of this account is transferred to Costing Profit and Loss Account.

(vii) Finished Goods Ledger Control Account: This account is maintained for finished goods and shows in total the result of all the entries maintained in all individual accounts in the stock ledger. This account is debited with the opening balance of finished goods, the cost of finished goods from Work-in-progress Control Account and the amount of administration overheads, if recovered at this point. It is credited with the cost of sales (by transferring to Cost of Sales Account) and the balance represents the value of goods unsold in stock.

(ix) Selling and Distribution Overhead Account: This account is debited with selling and distribution cost and credited with overhead recovered from goods sold. Difference, if any, is transferred to Costing Profit and Loss Account.

(x) Cost of Sales Account: This account is debited with the cost of goods sold and selling and distribution overheads recovered and are closed by transfer to Sales Account.

(xi) Overhead Adjustment Account: It is a summary account which summarises all the under or over-absorbed overheads.

(xii) Sales Account: This account is debited with the cost of sales and credited by the sales, the difference being profit or loss will be transferred to Costing Profit and Loss Account.

(xiii) Costing Profit and Loss Account: This account records the transfer of under- or over recovered overheads, abnormal losses or gains and profit or loss transferred from Sales Account. The closing balance represents net profit or loss and is transferred to General Ledger Adjustment Account.

5. What is Integral or Integrated system of Accounting? State its features.

Ans. Integral or Integrated system is a system of accounting under which only one set of account books is maintained to record both the Cost and Financial transactions. The system implies the merger of both cost and financial accounts in one× set of books. The two sets of account books merge into a composite system.

CIMA, London defines Integral system as a system in which the financial and cost accounts are interlocked to ensure that all relevant expenditure is absorbed into the cost accounts.

Features of Integral or Integrated system Accounting:

(i) There is no need for cost ledger because all control accounts are maintained in the financial ledger.

(ii) There is no need to open a Cost Ledger Control Account because both the aspects (i.e., debit and credit) of all transactions are recorded in respective accounts.

(iii) Subsidiary ledgers i.e., Stores Ledger, Work-in-Progress Ledger and Finished goods ledger are maintained as is done in non-integrated accounting.

(iv) A Sales Ledger (containing personal accounts for each customer) and a Purchase Ledger (containing personal accounts for each supplier) are also maintained.

(v) Overhead ledger is maintained to contain separate accounts for factory, administration and selling and distribution overhead.

(vi) A control account for each subsidiary ledger is maintained in the general ledger.

(vii) The balances of overheads Control Accounts represent under or over absorption of overheads which are transferred to Profit and Loss Account.

(viii) The profit or loss as per Profit and Loss Account is transferred to Profit and Loss Appropriation Account.

(ix) The degree of integration must be determined in advance. Some business firms may integrate the cost and financial accounts up to the stage of prime cost or factory cost while other firms integrate the two completely.

(x) A suitable coding system is generally developed to serve the purposes of× both cost accounts as well as financial accounts.

6. Distinguish between integral and non-integral system of accounting.

Ans. Non-integral System differs from Integral System in the following respects:

Basis	Non-integral System	Integral System
1. No. of Sets of Books	Two separate sets of books are maintained - one to record cost transactions and the other to record financial transactions.	Only one set of books is maintained to record both the cost transactions and financial transactions.
2. Cost Ledger	Cost Ledger is maintained.	Cost Ledger is not maintained.
3. Control Accounts	Control Accounts are opened in the Cost Ledger.	Control Accounts are opened in the General Ledger.
4. Figure of Profit/ Loss	There are two figures of profit/ loss - one as per cost books and another as per financial books.	There is only one figure of profit/loss because only one set of books is maintained.
5. Need for Reconciliation	There is need for reconciliation of cost accounts and financial accounts because there are two figures of profit/loss as there are two sets of books.	There is no need for reconciliation because there is only one figure of profit/loss as there is only one set of books.
6. Balances of Overheads Control Accounts	Balances of Overhead Control Accounts which represent under/ over absorption of overheads are transferred to Costing Profit & Loss Account.	Balances of Overhead Control Accounts which represent under/over absorption of overheads are transferred to Profit & Loss Account.
7. Economical	It is expensive because of duplication of recording the transactions in two sets of books.	It is economical because it avoids the duplication of recording the transactions in two sets of books.

7. What is Reconciliation Statement of Cost and Financial Accounts? Explain the need/importance of reconciliation of cost and financial accounts.

Ans. A reconciliation statement is a statement reconciling the profits or losses shown by cost accounts and financial accounts. It is a statement wherein the causes responsible for the difference in net profit or loss between cost and financial accounts are established and suitable adjustments are made to remove them.

Reconciliation between the results of the Cost and Financial Accounts is necessary due to the following reasons:

(i)To find out the reasons for the difference in the profit or loss in cost and financial accounts and to indicate the position clearly and to be sure that no mistakes pertaining to accounts have been committed.

(ii) To ensure the mathematical accuracy and reliability of cost accounts in order to have cost ascertainment, cost control and to have a check on the financial accounts.

(iii) To contribute to the standardisation of policies regarding stock valuation, depreciation and overheads.

(iv) To facilitate coordination and promote better cooperation between the activities of financial and cost sections of the accounting department.

(v) To place management in better position to acquaint itself with the reasons for the variation in profits paving the way to more effective internal control.

8. Explain the reasons for disagreement in profit of financial and cost accounting.

Ans. The disagreement between the costing and financial profit is caused by the following:

(1) Items Shown only in Financial Accounts. There are a number of items which are included in financial accounts but find no place in cost accounts. The items may be classified as under:

(a) Purely Financial Charges:
(i) Loss arising from the sale of fixed assets,
(ii) Loss on investments,
(iii) Discount on debentures,
(iv) Interest on bank loan, mortgages and debentures,
(v) Expenses of the company's share transfer office,
(vi) Damages or Compensation payable,
(vii) Penalties and fines,
(viii) Losses due to scrapping of machinery,
(ix) Remuneration paid to the proprietor in excess of a fair reward for services rendered.
(x) Bad debts written off.

(b) Appropriations of Profit:
(i) Donations and Charities,
(ii) Taxes on income and profits,
(iii) Dividend paid,

(iv) Transfers to reserves and sinking funds,
(v) Additional provision for on fixed assets and for bad debts,
(vi) Capital expenditure specially charged to revenue..

(c) Writing off Intangible and Fictitious Assets: Goodwill, Patents and Copyrights, Advertisement, Preliminary Expenses, Organisation Expenses, Underwriting Commission, Discount on Issue of Shares/Debentures etc.

(d) Purely Financial Incomes:
(i) Rent receivable,
(ii) Profits on the sale of fixed assets,
(iii) Transfer fees received.
(iv) Interest received on bank deposits,
(v) Dividend received,
(vi) Brokerage received,
(vii) Discount, commission received etc.

(2) Items Shown only in Cost Accounts. There are certain items which are included in cost accounts but not in financial accounts. These items are very few and usually are notional charges. For example:
(i)Interest may be calculated on capital employed in production to show the nominal cost of employing the capital though, in fact, no interest has been paid.
(ii) Salary of the proprietor where he works but salary is not charged to Profit and Loss A/c.

(3) Over or Under-absorption of Overheads. Overheads absorbed in cost accounts on the basis of estimation like percentage on direct materials, percentage on direct wages, etc. may be more or less than the actual amount incurred. If overheads are not fully absorbed i.e. the amount in cost accounts is less than the actual amount, the shortfall is called under-absorption. On the other hand, if overhead expenses in cost accounts are more than the actual, it is called over absorption. Thus, under or over-absorption of overheads leads to difference in two accounts.

(4)Different Bases of Stock Valuation: The valuation of all stocks in financial accounts is done on the basic principle of cost or market value whichever is less. In Cost accounting value of stock of raw material will depend on whether FIFO or LIFO or Average method is adopted. Work-in-progress inventory may be valued at prime cost or works cost or cost of production basis. Finished goods are generally valued at total cost of production basis. Thus different bases adopted for valuation of raw materials, work-in-progress and finished goods may differ and cause disagreement in the results.

(5) Different Methods of Charging Depreciation: The methods of charging depreciation may differ in financial accounts and cost accounts and may cause disagreement in profits of the two books of accounts. For example, Straight Line or Diminishing Balance Method (as per provisions of the Companies Act or Income Tax Act) is adopted in financial accounts whereas in cost accounts machine hour rate or production hour or unit method may have been adopted.

(6) Abnormal Gains and Losses: Abnormal items as abnormal wastage of material by theft, wages of abnormal idle time, cost of abnormal idle facilities, exceptional bad debts, abnormal gain on manufacturing may be shown in financial accounts but are excluded from the cost accounts and are taken directly to the costing and profit and loss account. This causes difference in profits as per two books of accounts.

9. Name the methods of Reconciliation of costing and financial profits.

Ans. Reconciliation of costing and financial profits can be attempted either
(a) by preparing a Reconciliation Statement or
(b) by preparation a Memorandum Reconciliation Account.

10. What is Memorandum Reconciliation Account?

Ans. Memorandum Reconciliation Account is basically presentation of Reconciliation Statement in 'T Account Form. It is not part of double entry system because all items posted in this account do not have their corresponding debits/credits in the books of accounts