

UNIT THREE

COST ACCOUNTING TERMINOLOGIES

Objectives

At the end of this chapter, students should be able to understand:

- The meaning of cost.
- The meaning of different terminologies in cost accounting.
- The difference between Accountant's and economist view of cost.
- The difference between cost unit and cost center

Learning Outcome:

At the end of this chapter, students should be able to:

- Explain the meaning of cost.
- Explain different terminologies in cost accounting.
- Different between accountant's and economist's view of cost.
- Analyze the difference between cost unit and cost center.

M1.3.1. Cost

Cost is the amount of cash or cash equivalent or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction (IAS 16).

Cost(ing) in Lucey (2009) is defined as gathering of cost information and its attachment to cost objects, the establishment of budgets, standard costs and actual costs of operation, processes, activities or products, and the analysis of variances, profitability or the social use of funds.

Cost in simple term therefore is the expenses incurred to acquire an item. Cost may connote different definitions when used in different profession. The economists and Accountants have divergent but still converging views

about cost. Economics view of cost is not exactly the same as Accountants but both convey similar meaning.

Economist View of Cost

The Economist view cost as a combination of losses of any goods that have a value attached to them. Economist view of cost is broader as it includes explicit cost just like in accountant's view and also includes implicit cost. Implicit costs are those that are not listed in the accounting books. They are assumed by the business to utilize resources. The entity could have gained more if such cost is given up.

Accountants View of Cost

In accountant's view, cost is the actual monetary costs as recorded in the books of account. While the Accountant's view of cost does not include implicit costs but rather only the explicit cost, economists consider both the explicit and implicit cost in its definition of cost. Accounting cost is therefore the explicit costs that are seen as monetary disbursements such as production cost, administrative and marketing cost. They are the real cost. It has monetary value easily identified in the accounting books. Such costs are deductible from the revenue in any given accounting period.

It is imperative to note that accounting costs are used as a very traditional means to determine the firm's financial health. The management will be interested to know the fund coming in and how they are disbursed. Accountant's point of view about cost becomes more appropriate to assist management in getting its information need. The economic cost is applied to determine the long-term strategies. It provides a high-level overview of what the company is really valued and what it could be valued; if it changed the way it uses its resources and assets.

Cost Object

Cost object is any item which cost is being separately measured. It can be a product or department for which costs are accumulated or measured. A cost object can be a customer, a machine, geographic territories, or anything else for which management would like to quantify cost. Summarily, a cost object

is anything for which a cost is to be ascertained or calculated or that makes an entity to incur cost. It could be anything for which a firm plans to calculate cost separately. Cost per unit of the cost object is called **unit cost** that is the naira attributable to one unit of cost object.

Cost Units

A cost unit is simply defined as a unit of quantity of product, service, time or combination of the three in relation to which cost can easily be ascertained. It is the standard or unit of measurement of the product or services.

The following features are attributable to cost units.

- a. It must be certain and not change over time.
- b. It must be appropriate or natural to business operation and the product.
- c. It must be one that expenditure can be conveniently associated with.
- d. It must be simple to understand and refer to.

Cost units can be measured in number, area, volume, value, weight, time etc depending on nature of business operation. The cost unit of transporters carrying a passenger can be measured in terms of distance travelled in miles while that of steel is usual measured in per ton.

Cost Center

The Institute of Cost and Management Accountants (ICMA), defined a cost center as a location, person, or item of equipment (or a group of these) for which costs may be ascertained and used for the purposes of cost control. Simply put, a cost center refers to any item, activity or function to which costs are allocated. It can be referred to as a convenient division of an undertaking that helps to measure and understand operational costs and apply costs to products. If costs are accumulated for a person, machine, or department, then this entity will be treated as a cost center.

M1.3.2. Differences between Cost Center and Cost Unit.

The major differences between cost center and cost units includes but not limited to

- a. Costs are accumulated by cost centers, whereas these are measured and expressed in terms of cost units.
- b. Cost centers may be used as the basis for cost classification, but this is not the case for cost units.
- c. Different cost centers may be involved in the production of a product, whereas a product will have only one cost unit in which its costs are expressed.
- d. The formulation of cost centers depends on production processes and techniques, as well as organizational size and structure. By contrast, determining cost units depends on the final product or final output, as well as current trade practices.
- e. Cost centers are created to help management in the functions of budgeting and controlling, but this is not the case with cost units.
(Wikipedia).