

Advantages and limitations of costing

1. Elimination of Wastes, Losses and Inefficiencies:-

A good cost accounting system eliminates wastes, losses and inefficiencies by fixing standard for everything.

2. Cost Reduction:-

New and improved methods of production are followed under cost accounting system. It leads to cost reduction.

3. Identify the reasons for Profit or Loss:-

A good cost accounting system highlights the reasons for increasing or decreasing profit. If so, the management can take remedial action to maintain profitability of the concern. There is no possibility of shutting down of any product or process or department.

4. Advises on Make or Buy Decision:-

On the basis of cost information, the management can decide whether make or buy a product in open market. The management can rightly choose the best out of many alternatives. Sometimes, spare capacity can be used profitably.

5. Price Fixation:-

The total cost of a product is available in the costing records. It is highly useful for price fixation of a product.

6. Cost Control:-

Budgets are prepared and standards are fixed under cost accounting system. The expenses are not permitted beyond the budget amount. The actual performance is compared with standard to find the variation. If there is any variation, reasons are find out and the management can exercise control. Period to period cost comparison also helps cost control.

7. Assist the Government:-

Government can collect reasonable tax from the company and exercise price control.

8. Help the Trade Union:-

Bonus calculation is very easy to the trade union. Reasonable remuneration is also fixed on the basis of cost accounting information.

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9. Marginal Analysis of Cost:-

It is done for facilitating the short-term decisions especially during depression period.

10. Fixation of Responsibility:-

Responsibility centers is fixed under cost accounting system. If responsibility is fixed, it becomes difficult to evade responsibility of performance and leads to effective performance.

11. Helps to Prepare Financial Accounts:-

The information like value of closing materials, work in progress and finished goods are necessary to prepare financial accounts. This information is supplied by the costing records and helps to prepare financial accounts without any further delay.

12. Prevention of Frauds:-

Introducing cost audit can prevent frauds. If so, correct and reliable data was available from the costing records which are highly useful to the government, share holders, the creditors and the like.

Disadvantages or Limitations of Cost Accounting

The limitations or disadvantages of cost accounting are listed below:

1. Only past performances are available in the costing records but the management is taking decision for future.
2. The cost of previous year is not same in the succeeding year. Hence, cost data are not highly useful.
3. The cost is ascertained on the basis of full utilization of capacity. If capacity is partly utilized, the cost may not be true.
4. Financial character expenses are not included for cost calculation. Hence, the calculated cost is not correct always.
5. In cost accounting, costs are absorbed on pre-determined rate. It leads to over absorption or under absorption of overheads.

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6. Cost Accounting fails to solve the problems relating to work study, time and motion study and operation research.
7. Installation of Cost Accounting System requires the maintenance of many costing records. If results in heavy expenditure.
8. Delay in receiving costing information does not result in taking quality decision by the management.
9. Rigid Cost Accounting System does not serve all purposes.