



PRESENTING

CA RAHUL GARG's

The SPARKLE

COST & MANAGEMENT ACCOUNTING



CA Rahul Garg

Gold Medalist | AIR IN CA, CS, CMA





P R E F A C E

Dear Students,

It gives me immense pleasure and heartfelt satisfaction to present to you '**THE SPARKLE**' - a book specially designed for you, the CA Intermediate students, for the subject Cost & Management Accounting.

This book is not just a compilation of theoretical aspects of **COSTING**; it's a thoughtfully crafted learning companion. It brings together the **most relevant and frequently asked concepts** from each chapter, organized systematically to ensure conceptual clarity and practical understanding. Each topic is presented in a simple, lucid manner, making even the most complex concepts easier to grasp.

What makes 'THE SPARKLE' truly stand out is its **student-centric approach**. To help you learn efficiently and revise effectively, we've put in smart features like Color Coding Scheme, Tabular Presentation, Most Imp. Points specially highlighted. These elements are carefully interlinked to give you a **seamless and structured learning experience**—an approach that aims to boost your confidence and performance.

While every effort has been made to ensure the content is accurate and error-free, any inadvertent mistakes are sincerely regretted. As we believe that the path to excellence is always under construction, your suggestions, feedback, and constructive criticism are warmly welcomed.

Wishing you all great success and bright future.

Let 'THE SPARKLE' be the light that guides your preparation journey!

With Best Wishes

RAHUL GARG

Gold Medalist

B.Com, FCA, FCMA, LCS, DISA, CFA, MBA

5 Times AIR in CA, CS, CMA



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COST & MANAGEMENT ACCOUNTING

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BASIC CONCEPTS



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Some Basic Terms

Cost	✓ Cost is the amount of resource given up in exchange for some goods or services.
Costing	✓ Costing is the technique and process of ascertaining costs of products or services.
Cost Accounting	✓ Cost Accounting is the process of accounting for cost which begins with the incurrance of cost and ends with the control of cost. Thus, Cost Accounting is a formal mechanism of cost ascertainment.
Cost Accountancy	✓ It has been defined as "the application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control and the ascertainment of profitability. It includes the presentation of information derived there from for the purpose of managerial decision making."

Objectives of Cost Accounting

1.	Ascertainment of Cost
2.	Determination of Selling Price
3.	Cost Control
4.	Cost Reduction

Difference between Cost Control & Cost Reduction

No.	Basis	Cost Control	Cost Reduction
1.	Meaning	It is the achievement of planned or standard performance set in advance of production.	It is a real and permanent reduction in the cost of goods or services product.
2.	Main focus	Cost control aims at maintaining the costs in accordance with the established standards.	It challenges all standards and endeavours to better them continuously.
3.	Emphasis	In case of Cost Control, emphasis is on past and present.	In case of cost reduction, it is on present and future.
4.	End	Cost control ends when targets are achieved.	Cost reduction has no visible end.





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5.	Product Quality	Quality Maintenance is not a guarantee .	Product's Utility, Quality & Characteristics are retained .
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Lightbulb Difference between Cost Accounting and Management Accounting

No.	Basis	Cost Accounting	Management Accounting
1.	Nature	It records the quantitative aspect only.	It records both qualitative and quantitative aspect.
2.	Objective	It records the cost of producing a product and providing a service .	It provides information to management for planning and co-ordination.
3.	Area	It only deals with cost ascertainment .	It is wider in scope as it includes F.A., budgeting, Tax, Planning .
4.	Recording of data	It uses both past and present figures.	It is focused with the projection of figures for future .
5.	Rules and Regulations	It follows certain principles and procedures for recording costs of different products.	It does not follow any specific rules and regulations .

Lightbulb Difference between Cost Accounting and Financial Accounting

No.	Basis	Financial Accounting	Cost Accounting
1.	Objective	It provides information about the financial performance .	It provides information of cost ascertainment for the purpose of cost control and decision making.
2.	Access	Anybody can have access to financial statements of companies.	Outsiders generally have no access to cost records.
3.	Nature of Transaction	Only monetary information is recorded in financial records.	Both kinds of information (monetary and physical) are recorded in cost records.
4.	Users of Information	The users of financial accounting statements are shareholders, creditors, financial analysts and government and its agencies etc.	The cost accounting information is used by internal management .



BASIC CONCEPTS



5.	Analysis of costs and profits	It shows the Profit or loss of the organization.	It provides the details of cost and profit of each product, process, job etc.
6.	Time period	Financial Statements are prepared usually for a year.	Its reports and statements are prepared as and when required.

Users of Cost and Management Accounting

Internal Users	External Users
Policy Makers	Regulatory Authorities
Managers	Auditors
Operational level staff	Shareholders
Employees	Creditors and Lenders

Essentials of a Good Cost Accounting System

Informative & simple	✓ Cost accounting system should be tailor-made, practical, simple and capable of meeting the requirements of a business concern.
Accurate & authentic	✓ The data to be used by the system should be accurate and authenticated; otherwise, it may distort the output and a wrong decision may be taken.
Uniformity	✓ There should be uniformity and consistency in classification, treatment and reporting of cost data and related information.
Integrated and inclusive	✓ The cost accounting system should be integrated with other systems like financial accounting, taxation, etc. to have a complete overview and clarity in results.
Flexible and adaptive	✓ The cost accounting system should be flexible enough to make necessary amendment and modifications in the system to incorporate changes.
Trust	✓ Management should have faith in the Costing System.
Economical	✓ It should be economical to install and operate.

Limitations of Cost Accounting

Expensive
Requirement of Reconciliation
Duplication of Work due to 2 sets of accounts



BASIC CONCEPTS



Cost Objects

Meaning	<ul style="list-style-type: none"> ✓ Cost object is anything for which a separate measurement of cost is required. ✓ Cost object may be a product, a service, a project, a customer, a department etc. 	
Examples	Product	Smart phone, Tablet computer, SUV Car, Book etc.
	Service	A Flight from Delhi to Mumbai, Concurrent audit assignment etc.
	Project	Metro Rail project, Road project etc.

Cost Units

Meaning	<ul style="list-style-type: none"> ✓ It is a unit of product or service in relation to which costs may be ascertained or expressed. It is basically a unit of measurement like number, weight, length, volume, time etc. 	
Example	Industry or Product	Basis of Cost Unit
	Automobile	Number
	Pencils	Per dozen
	Transport of Passengers	Passenger kilometer
	Telephone service	Per call
	Building Construction	Per square foot
	Cement	Tonne/ per bag etc.
	Cars	Per car
	Petrol	Per litre
	Chemicals	Litre, gallon, kilogram, tonne etc.
	Power	Kilo-watt hour (KWH)
	Gold	Per 10 gram
	Gas	Cubic Feet
	Industry Sector	Cost Unit
	Brewing	Barrel
	Brick-making	1,000 bricks
	Electricity	KWH
	Engineering	Contract/ job
	Hotel	Room
	Professional services	Chargeable hour, job, contract
	Education	Course, enrolled student, successful student
Hospital	Patient day	



BASIC CONCEPTS



Cost Drivers

Meaning	✓ A Cost driver is a factor or variable which effects level of cost. Generally, it is an activity which is responsible for cost incurrence. Level of activity or volume of production is the example of a cost driver.	
Example	Function	Cost Drivers
	Research and Development	Number of Research Projects Personnel Hours on a project
	Marketing	Number of Advertisements / Insertions Number of Sales Personnel

Responsibility Centre

Cost Centre	✓ The responsibility centre which is held accountable for incurrence of costs which are under its control. The performance of this responsibility centre is measured against pre-determined standards or budgets.
Revenue Centre	✓ The responsibility centres which are accountable for generation of revenue for the entity.
Profit Centre	✓ These are the responsibility centres which have both responsibility of generation of revenue and incurrence of expenditures.
Investment Centre	✓ These are the responsibility centres which are not only responsible for profitability but also have the authority to make capital investment decisions.

Classification of Costs

By Nature or Element	
Direct Materials	✓ Materials which are present in the finished product (cost object) or can be economically identified in the product are called direct materials. For example, cloth in dress making.
Direct Labour	✓ Labour which can be economically identified or attributed wholly to a cost object is called direct labour. For example, labour engaged on actual production of the product.
Direct Expenses	✓ It includes all expenses other than direct material or direct labour which are specially incurred for a particular cost object. For example, hire charges for some special machinery.
Indirect Materials	✓ Materials which do not normally form part of the finished product are known as indirect materials. For Example, stores used for maintaining machines like lubricants.
Indirect	✓ Labour costs which cannot be allocated but can be apportioned to





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BASIC CONCEPTS



Labour	or absorbed by cost units or cost centres is known as indirect labour. For Example, salary paid to foreman and supervisors.
Indirect Expenses	✓ Expenses other than direct expenses are known as indirect expenses, that cannot be directly, conveniently and wholly allocated to cost centres. For Example, Factory rent and rates.
Overheads	✓ It is the aggregate of indirect material costs, indirect labour costs and indirect expenses. Main groups into which overheads may be subdivided are following :
Production or Works Overheads	✓ These are incurred in the factory and for running of the factory. For Example : Factory rent.
Administration Overheads	✓ These relate to management and administration of business. For Example : Office rent.
Selling Overheads	✓ These are incurred for marketing of a commodity. For Example : Advertisement.
Distribution Overheads	✓ These are incurred in despatch of the goods. For Example : Warehouse, packing charges.

By Functions

Prime Cost

Factory Cost or Works Cost

Cost of Production

Cost of Goods Sold

Cost of Sale

By Variability or Behaviour

Fixed costs	Meaning	✓ These costs do not vary with the change in the volume of production but varies on per unit basis.
	Example	✓ Rent and Insurance of Building.
Variable Costs	Meaning	✓ These costs vary in direct proportion to the volume of production but remains fixed on per unit basis.
	Example	✓ Direct Material, Direct Labour & Direct Expenses.
Semi-variable costs	Meaning	✓ These contain both the components, fixed as well as variable. One part of these costs remain fixed upto a given range and the other part varies with the change in the volume of production.
	Example	✓ Telephone expenses of which hire part is fixed and fee for calls is variable, depreciation, delivery van expenses.

By Costs for Managerial Decision Making

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Relevant Costs	<ul style="list-style-type: none"> ✓ These are those future costs which differ under different alternatives. ✓ These can be changed by the decisions of the management.
Irrelevant Cost	<ul style="list-style-type: none"> ✓ These are those costs which are not relevant. ✓ These can't be changed by the decisions of the management.
Sunk Cost	<ul style="list-style-type: none"> ✓ Historical costs incurred in the past are known as sunk costs. ✓ These are irrelevant because these can't be changed by decision.
Opportunity Cost	<ul style="list-style-type: none"> ✓ Opportunity cost is the cost of selecting one course of action and losing of other opportunities to carry out that course of action. ✓ Thus, it is the cost of next best alternative.
Shut down Costs	<ul style="list-style-type: none"> ✓ These are the costs, which continue to be incurred even when a plant is temporarily shutdown.
Explicit Costs	<ul style="list-style-type: none"> ✓ These costs are also known as out of pocket costs and refer to costs involving immediate payment of cash.
Implicit Costs	<ul style="list-style-type: none"> ✓ These costs do not involve any immediate cash payment. ✓ They are not recorded in the books of account.

Methods of Costing

These are the techniques and processes employed in the ascertainment of costs. Different industries follow different methods of costing because of the differences in the nature of their work.

Job Costing	<ul style="list-style-type: none"> ✓ It is that form of specific order costing under which each job is treated as a cost unit and costs are accumulated and ascertained separately for each job.
Batch Costing	<ul style="list-style-type: none"> ✓ It is that form of specific order costing under which each batch is treated as a cost unit and costs are accumulated and ascertained separately for each batch.
Contract Costing	<ul style="list-style-type: none"> ✓ It is that form of specific order costing under which each contract is treated as cost unit and costs are accumulated and ascertained separately for each contract.
Unit or Single or Output Costing	<ul style="list-style-type: none"> ✓ This method is used where a single article is produced by continuous manufacturing activity. The cost per unit is arrived at by dividing the total cost with the number of units produced.
Process Costing	<ul style="list-style-type: none"> ✓ Under this, all costs are accumulated for each stage of production and the cost per unit of product is ascertained at each stage of production.
Operating	<ul style="list-style-type: none"> ✓ It is used in the case of concerns rendering services like transport,





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BASIC CONCEPTS



Costing	supply of water, electricity companies, hospital services etc.
Multiple or Composite Costing	<ul style="list-style-type: none"> ✓ It is a combination of two or more methods of costing outlined above. ✓ It is used in industries where a number of components are separately produced and then assembled into a final product.

Techniques of Costing

These are the different ways of analysing and presenting costs for the purposes of controlling costs and making managerial decisions irrespective of the method of costing being used.

Uniform Costing	<ul style="list-style-type: none"> ✓ When a number of firms in an industry agree among themselves to follow the same system of costing in detail, adopting common terminology for various items and processes they are said to follow a system of uniform costing.
Marginal Costing	<ul style="list-style-type: none"> ✓ It is defined as the ascertainment of marginal cost by differentiating between fixed and variable costs.
Standard Costing	<ul style="list-style-type: none"> ✓ It is the name given to the technique whereby standard costs are predetermined and subsequently compared with the recorded actual costs. ✓ It is thus a technique of cost ascertainment and cost control.
Historical or Costing	<ul style="list-style-type: none"> ✓ It refers to the determination of costs after they have been actually incurred. ✓ It means that cost of a product can be calculated only after its production.

जिस काम में काम करने की हद पार ना हो,
वो काम किसी काम का नहीं! ”

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COST SHEET



Basics of Cost Sheet

Meaning	✓ It is "a document which provides a detailed cost information. It is a periodical statement of cost designed to show in detail the various components of cost.
Classification	✓ Cost information is presented on the basis of functional classification.
Periodicity	✓ It may be prepared weekly, fortnightly, monthly, quarterly, half-yearly or yearly.
Uses	<ul style="list-style-type: none"> ✓ It provides the total cost figure as well as cost per unit of production. ✓ It facilitates the preparation of cost estimates required for submitting tenders. ✓ It provides sufficient help in arriving at the figure of selling price. ✓ It helps in ascertainment of profitability.

राह संघर्ष की जो चलता है; वो ही संसार को बदलता है, जिसने रातों से जंग जीती, सूर्य बनकर वहीं निकलता है।



3 MATERIAL COSTING



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Material Control

Meaning	✓ Material Control involves planning, organising and controlling the procurement, storage & usage of materials so as to achieve the objectives of efficiency & economy.
Objectives (Advantages) of Material Control	
1.	✓ Avoid under stocking
2.	✓ Avoid over stocking
3.	✓ Minimum cost to purchase
4.	✓ Avoid wastages
5.	✓ Proper records
6.	✓ Timely fulfilment of orders
Essential Requirements of Material Control	
1.	✓ Proper co-ordination of all departments.
2.	✓ Proper purchase system to ensure the procurement of materials of the required quality at minimum cost.
3.	✓ Proper storage system to ensure avoidance of losses.
4.	✓ Proper system for issue of materials to ensure delivery of required materials at the required time.
5.	✓ Perpetual inventory system to determine the quantity and value of each item of materials in stock at any point of time.
6.	✓ Continuous stock taking system to ensure accuracy of perpetual inventory records.

Material Procurement Procedure

1.	✓ Purchase Requisition
2.	✓ Inviting Quotation/ Request for proposal (RFP)/ Notification Inviting Tender (NIT)
3.	✓ Selection of Quotation/ Proposal
4.	✓ Purchase Order
5.	✓ Receipt and inspection of materials
6.	✓ Goods Received Note or Material Inward Note
7.	✓ Material Returned Note or Material Outward Return Note
8.	✓ Checking and passing of bills for payment



3 MATERIAL COSTING



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Bill of Materials Vs. Material Requisition Note

S.No.	Basis	Bill of Materials	Material Requisition Note
1.	Meaning	It is a complete schedule of component parts and raw materials required for a particular job or work order.	It is a document authorizing storekeeper to issue materials to the consuming department.
2.	Prepared by	It is the document prepared by engineering or planning dept.	It is prepared by the production or other consuming department.
3.	Use	It can be used for the purpose of quotations.	It is useful in arriving historical cost only.
4.	Contents	It helps in keeping a quantitative control on materials drawn from stores.	It shows the material actually drawn from stores.

Store Records

BI : Bin Card/ Stock Card									
Meaning	<ul style="list-style-type: none"> ✓ It is a quantitative record of inventory which shows the quantity of inventory available in a particular bin. ✓ A card is tied to or placed outside each bin to record the quantity of materials received, issued, returned and in hand in the bin. ✓ This card also contains particulars regarding maximum level, minimum level, reorder level, Bin no, name and code of material, location and stores ledger folio. 								
Maintained by	✓ Bin cards is maintained and kept by the store keeper in store department.								
Advantages	<table border="1"> <tr> <td>Less mistakes</td> <td>✓ There would be fewer chances of mistakes being made as entries will be made at the same time as goods are received or issued by the person actually handling the materials.</td> </tr> <tr> <td>Optimum stock</td> <td>✓ It prevents the situation of under/ over stocking by keeping the stock within the maximum and minimum levels.</td> </tr> <tr> <td>Upto date records</td> <td>✓ It provides upto date record of materials received, issued, returned and in hand.</td> </tr> <tr> <td>Ease in reorder</td> <td>✓ It facilitates to know when the fresh order should be placed when the balance stock reaches re-order level.</td> </tr> </table>	Less mistakes	✓ There would be fewer chances of mistakes being made as entries will be made at the same time as goods are received or issued by the person actually handling the materials.	Optimum stock	✓ It prevents the situation of under/ over stocking by keeping the stock within the maximum and minimum levels.	Upto date records	✓ It provides upto date record of materials received, issued, returned and in hand.	Ease in reorder	✓ It facilitates to know when the fresh order should be placed when the balance stock reaches re-order level.
	Less mistakes	✓ There would be fewer chances of mistakes being made as entries will be made at the same time as goods are received or issued by the person actually handling the materials.							
	Optimum stock	✓ It prevents the situation of under/ over stocking by keeping the stock within the maximum and minimum levels.							
	Upto date records	✓ It provides upto date record of materials received, issued, returned and in hand.							
Ease in reorder	✓ It facilitates to know when the fresh order should be placed when the balance stock reaches re-order level.								





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MATERIAL COSTING



	Ease in identifying materials	✓ Identification of the different items of materials is facilitated by reference to the Bin Card.
Disadvantages	Huge space	✓ Store records are dispersed over a wide area.
	Defacing of cards	✓ The cards are liable to be smeared with dirt and grease because of proximity to material and also because of handling materials.
	Difficulty in clerical work	✓ People handling materials are not ordinarily suitable for the clerical work involved in writing Bin Cards.

B2 : Stock Control Cards or Stores Material Control Card

Meaning	<ul style="list-style-type: none"> ✓ Stores Control Card is a quantitative record which is maintained by stores department for each item of material to record the quantity of materials received, issued, returned, in hand and on order. ✓ These cards are kept at one place in cabinets or trays or loose binders. ✓ This card also contains particulars regarding maximum level, minimum level, reorder level, Name and Code number of material, location and Bin No. 	
Maintained by	✓ These are maintained by the store keeper in store department.	
Advantages	Easy reference	✓ Records are kept in a more compact manner so that reference to them is facilitated.
	Neat & clean records	✓ Records can be kept in a neat and clean way by men solely engaged in clerical work.
	Easy monitoring	✓ As the records are at one place, it is possible to get an overall idea of stock position without the necessity of going around stores.
Disadvantages	Immediate comparison not possible	✓ On the spot comparison of the physical stock of an item with its book balance is not facilitated.
	Difficult to identify materials	✓ Physical identification of materials in stock may not be as easy as in the case of bin cards, as the Stock Control Cards are housed in cabinets or trays.
	Possibility of mistake	✓ There may be chances of mistakes because the entries are made by record keeper and goods are received or issued by the person handling the materials.

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3 MATERIAL COSTING



B3 : Stores Ledger	
Meaning	✓ A Stores Ledger is maintained to record both quantity and cost of materials received, issued and those in stock.
Maintained by	✓ It is maintained by the Cost Accounting Department.
Objective	✓ The basic objective of stores ledger is to provide a continuous record of both the quantity and cost of the materials received, issued, returned and in hand.

Lightbulb icon: Difference between Bin Card & Stores Control Card

S.No.	Basis	Bin Card	Stores Control Card
1.	Place of keeping	It is kept outside each bin.	It is kept at one place in cabinets or trays or loose binders.
2.	Who writes?	It is written by person handling materials.	It is written by person solely engaged in clerical work.
3.	Condition of Record	It is likely to be smeared with dirt and grease because of proximity to materials.	It is kept in neat and clean way.
4.	Physical Identification	It facilitates an easy physical identification of an item of materials because of proximity to materials.	It does not facilitate an easy physical identification of an item of materials because of no proximity to materials.
5.	Physical verification	It facilitates on the spot comparison of physical stock of an item with its book balance as shown by Bin Card because of proximity to materials.	It does not facilitate on the spot comparison of physical stock of an item with its book balance because of no proximity to materials.

Lightbulb icon: Difference between Bin Card & Stores Ledger

S.No.	Basis	Bin Card	Stores Ledger
1.	Meaning	It is the card tied to or placed outside each bin to record the quantity of materials received, issued, returned and in hand in the bin	A Stores Ledger is maintained to record both quantity and cost of materials received, issued and those in stock.
2.	Maintained by	It is maintained by the storekeeper.	It is maintained by costing department.

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MATERIAL COSTING



3.	Kept at	It is kept outside the bin in store.	It is kept outside the store generally in costing department.
4.	Recording aspects	It contains only quantitative details of material received, issued and returned to stores.	It contains information both in quantity and value.
5.	Time of recording	Entries are made when transactions take place.	It is always posted after the transaction.

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Order Quantity

Re-Order Quantity	
✓ Re-order quantity is the quantity for which order is placed when the stock reaches re-order level.	
Economic Order Quantity (EOQ)	
Meaning	✓ When the order placed is for such a quantity, which results in most economical purchase, such quantity is called Economic Order Quantity.
Factors	<ul style="list-style-type: none"> ✓ Annual demand of the inventory ✓ Ordering Cost ✓ Carrying Cost
Assumptions	<ul style="list-style-type: none"> ✓ Ordering cost per order and carrying cost per unit per annum are known and they are fixed. ✓ Anticipated usage of material in units is known. ✓ Cost per unit of the material is constant and is known as well. ✓ The quantity of material ordered is received immediately i.e. the lead time is zero.

Inventory Control- By Setting Quantitative Levels

A: Stock Levels	
The main purpose of setting various stock levels is to avoid the situation of under and over stocking.	
Re-Order Level	<ul style="list-style-type: none"> ✓ It is the level at which fresh order should be placed for replenishment of stock. ✓ Time gap between placing an order and receiving the stock is known as Re-order period. It is also known as Delivery Period or Lead Time.
Minimum level	✓ It indicates the minimum figure of inventory to be maintained in hand at all times, so that there is no stoppage of production due to non-availability of inventory.



3 MATERIAL COSTING



Maximum level	✓ Maximum Stock Level is that level of stock above which the stock in hand should not normally be allowed to exceed, to avoid the costs of over-stocking.
Average Inventory Level	✓ It is the quantity of material which is normally held in stock over a period. It is also known as normal stock level.
Danger level	✓ It is the level at which normal issues of raw material inventory are stopped and only emergency issues are made.
Buffer Stock	✓ Some quantity of stock may be kept for contingency to be used in case of sudden order, such stock is known as buffer stock.

B : Inventory Stock-Out

Meaning	✓ Stock out is said to be occurred when an inventory item could not be supplied due to insufficient stock in the store.
Solution	✓ While deciding on the level of inventory, a trade-off between the stock out cost and carrying cost is made so that overall inventory cost can be minimized.

C : Just In Time (JIT) Inventory Management

Meaning	✓ JIT is a system of inventory management with an approach to have zero inventories in stores. According to this approach, material should only be purchased when it is actually required for production.
Principles	<ul style="list-style-type: none"> ✓ JIT is based on two principles <ul style="list-style-type: none"> ❖ produce goods only when it is required and ❖ the products should be delivered to customers at the time only when they want.

💡 Inventory Control-On the basis of Relative Classification

A : ABC Analysis

Meaning	<ul style="list-style-type: none"> ✓ This system exercises discriminating control over different items of stores classified on the basis of the investment involved. ✓ Usually, the items are divided into three categories according to their importance, namely, their value and frequency of replenishment during a period. 			
Categorisation	Category	% of Total Value	% of Total Items	Control
	A	These require large investments (say about 70% of total value of stores) because	These constitute a small percentage (say about	High degree of control is exercised by use of various techniques such as

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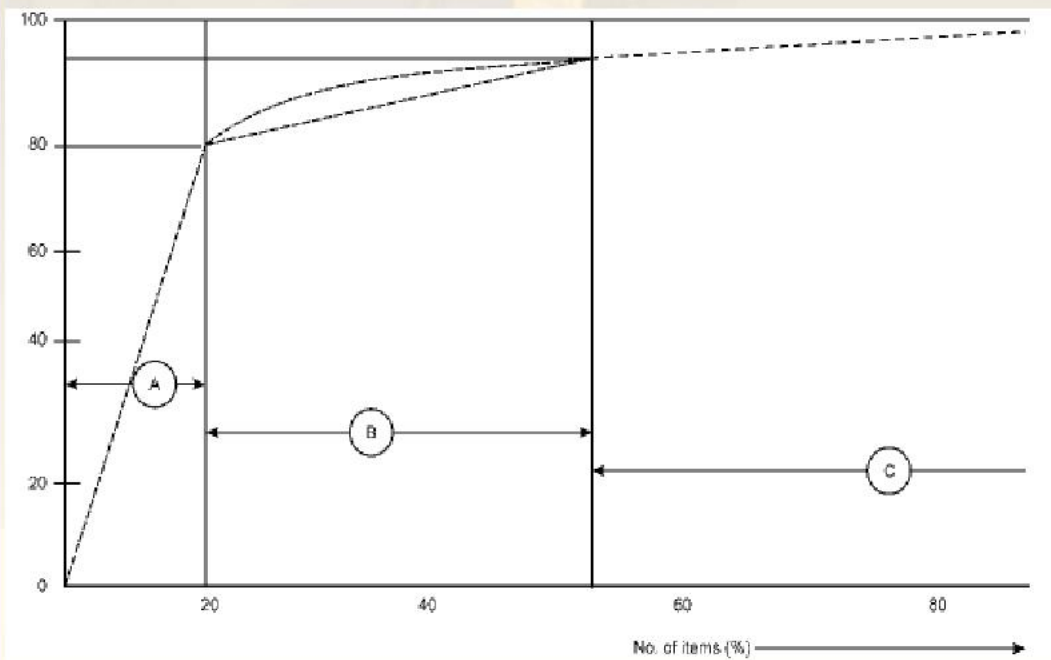


MATERIAL COSTING



		of their high prices or heavy requirement or both.	10%) of total items of stores.	Fixing Stock Levels, determining EOQ.
B	These require relatively moderate investment (say about 20% of total value of stores).	These constitute relatively moderate percentage (say about 20%) of total items of stores.		Moderate degree of control is exercised.
C	These require small investment (say 10% of total value of stores).	These constitute a large percentage (say about 70%) of total items of stores.		For these category of items, there is no need of exercising constant control.

Graphical Presentation



B : Fast Moving, Slow Moving and Non-Moving (FSN) Inventory

Under this system, inventories are controlled by classifying them on the basis of frequency of usage.



3 MATERIAL COSTING



Fast Moving	✓ This category of items is placed nearer to store issue point and the stock is reviewed frequently for making of fresh orders.
Slow Moving	✓ This category of items is stored little far and stock is reviewed periodically for any obsolescence, and may be shifted to Non-moving category.
Non Moving	✓ This category of items is kept for disposal. This category of items is reported to the management and an appropriate provision for loss may be created.

C : Vital, Essential and Desirable (VED)

Under this system of inventory analysis, inventories are classified on the basis of its criticality for the production and final product. Generally, it is done for spare parts which are used for production.

Vital	✓ Items are classified as vital when its unavailability can interrupt the production process and cause a production loss.
Essential	✓ Items under this category are essential but not vital. The unavailability may cause sub standardisation and loss of efficiency in production process.
Desirable	✓ Items under this category are optional in nature, unavailability does not cause any production or efficiency loss.

D : High Cost, Medium Cost, Low Cost (HML) Inventory

Meaning	✓ Under this system, inventory is classified on the basis of the cost of an individual item, unlike ABC analysis where inventories are classified on the basis of overall value of inventory.
Category	✓ High-Cost inventories are given more priority for control, whereas Medium-cost and Low-cost items are comparatively given lesser priority.

Inventory Control-Using Ratio Analysis

A : Input-Output Ratio

Meaning	✓ Input-output ratio is the ratio of the quantity of input of material to production and the standard material content of the actual output.
Use	✓ It enables comparison of actual consumption and standard consumption, thus indicating whether the usage of material is favourable or adverse.

B : Inventory Turnover Ratio

Meaning	<ul style="list-style-type: none"> ✓ It expresses the relationship between the cost of material consumed and the average stock held. ✓ It indicates the speed with which the inventory is consumed.
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MATERIAL COSTING



Use	<ul style="list-style-type: none"> ✓ The objective is to find out - <ul style="list-style-type: none"> ❖ Fast Moving Stock i.e. stock in great demand ❖ Slow Moving Stock i.e. stock in low demand ❖ Dormant Stock i.e. stock having no demand at present ❖ Obsolete Stock i.e. stock no longer in demand
Analysis	<ul style="list-style-type: none"> ✓ High inventory turnover ratio indicates that the material in the question is a fast moving one and vice-versa.

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Inventory Control-Physical Control

A : Two Bin System or Double Bin System	
Two parts	<ul style="list-style-type: none"> ✓ Under this system each bin is divided into two parts - <ul style="list-style-type: none"> ❖ one, smaller part, should stock the quantity equal to the minimum stock or even the re-ordering level, and ❖ the other to keep the remaining quantity.
Procedure	<ul style="list-style-type: none"> ✓ Issues are made out of the larger part. ✓ As soon as it becomes necessary to use quantity out of the smaller part of the bin, fresh order is placed. ✓ By the time the order placed is received, issues are made out of the smaller part. ✓ As soon as the order is received, quantity already issued out of smaller part of the bin is replaced out of fresh supply.
B : Use of Perpetual Inventory Records	
Meaning	<ul style="list-style-type: none"> ✓ Perpetual inventory represents a system of records maintained by the stores department. ✓ It in fact comprises: (i) Bin Cards, and (ii) Stores Ledger
Advantages	<ul style="list-style-type: none"> ✓ Physical stocks can be counted and book balances adjusted as and when desired without waiting for the entire stock-taking to be done. ✓ Quick compilation of Profit and Loss Account (for interim period) due to prompt availability of stock figures. ✓ Discrepancies are easily located and thus corrective action can be promptly taken to avoid their recurrence.
C : Continuous Stock Verification	
Meaning	<ul style="list-style-type: none"> ✓ The system of continuous stock-taking consists of counting and verifying the number of items daily throughout the year so that during the year all items of stores are covered three or four times. ✓ The stock verifiers are independent of the stores, and the stores staffs have no prior knowledge as to the particular items that would be checked on particular day.



3 MATERIAL COSTING



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Valuation of Material Issues

Cost Price Methods	<ul style="list-style-type: none"> ✓ Specific Price Method ✓ First-in-First out Method (FIFO) ✓ Last-in-First out method (LIFO) ✓ Base Stock Method
Average Price Methods	<ul style="list-style-type: none"> ✓ Simple Average Price Method ✓ Weighted Average Price Method
Market Price Methods	<ul style="list-style-type: none"> ✓ Replacement Price Method ✓ Realisable Price Method
Notional Price Methods	<ul style="list-style-type: none"> ✓ Standard Price Method ✓ Inflated Price Method ✓ Re-use Price Method

Material Losses

Waste			
Meaning	✓ It is the portion of raw material which is lost during storage or production and discarded.		
Value	✓ The waste may or may not have any value.		
Scrap			
Meaning	<ul style="list-style-type: none"> ✓ It is the incidental material residue from certain types of manufacturing processes. ✓ It represents the materials which are discarded and disposed-off without further treatment. 		
Value	✓ Generally, scrap has either no value or insignificant value.		
Spoilage			
Meaning	✓ It is the term used for materials which are badly damaged in manufacturing operations, and they cannot be rectified economically and hence taken out of the process to be disposed off in some manner without further processing.		
Defectives			
Meaning	✓ It signifies those units or portions of production which do not meet the quality standards.		
Reason	✓ Defectives arise due to sub-standard materials, bad-supervision, bad-planning, poor workmanship, inadequate-equipment and careless inspection.		
Types	<table border="1"> <tr> <td>Reworks</td> <td>✓ The defectives which can be re-made as per the quality</td> </tr> </table>	Reworks	✓ The defectives which can be re-made as per the quality
Reworks	✓ The defectives which can be re-made as per the quality		





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MATERIAL COSTING



		standard by using additional materials are known as reworks. Reworks include repairs, reconditioning and refurbishing.
	Rejects	✓ Defectives which cannot be brought up to the quality standards are known as rejects. The rejects may either be disposed-off or re-cycled for production process.
Obsolescence		
Meaning	✓	Obsolescence refers to the loss in the value of an asset due to technological advancements.
Treatment	✓	In all the cases, the value of the obsolete material held in stock is a total loss and immediate steps should be taken to dispose it off at the best available price.

कुछ ज्यादा ख्वाहिशें नहीं ए-ज़िंदगी तुझसे,
बस मेरा अगला कदम पिछले से बेहतरीन हो!!

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4 LABOUR COSTING



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Employee (Labour Cost) & Control

Meaning	<ul style="list-style-type: none"> ✓ These are the benefits paid or payable to the employees of an entity, whether permanent, or temporary for the services rendered by them. ✓ Employee cost includes the following: <ul style="list-style-type: none"> ❖ Wages and salary; ❖ Allowances and incentives; ❖ Payment for overtimes; ❖ Employer's contribution to Provident fund and other welfare funds; ❖ Other benefits (leave with pay, free or subsidised food, leave travel concession etc.)
Cost Control	<ul style="list-style-type: none"> ✓ Labour cost control means control over the cost incurred on labour. The aim should be to keep the wages cost per unit of output as low as possible.

Role of Different departments

Department	Function
Personal Department	<ul style="list-style-type: none"> ✓ It ensures that the persons recruited possess the requisite qualification and skills required for the job. ✓ It arranges proper training for the newly recruited workers and existing workers. ✓ It maintains all personal and job related records of the employees.
Engineering and Work Study Department	<ul style="list-style-type: none"> ✓ It prepares plans and specifications for each job. ✓ It provides training and guidance to the employees. ✓ It supervises production activities. ✓ It conducts time and motion studies.
Time-keeping Department	<ul style="list-style-type: none"> ✓ It maintains the attendance records of the employees i.e. time keeping card.. ✓ It records the time spent by them on various jobs i.e. time booking etc.
Payroll Department	<ul style="list-style-type: none"> ✓ It prepares the payroll of employees. ✓ It disburses salary and wage payments.
Cost Accounting Department	<ul style="list-style-type: none"> ✓ This department accumulates and classifies all the labour costs. ✓ It charges direct labour cost to the concerned department. ✓ It allocates individual indirect labour cost to the concerned departments.



LABOUR COSTING



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Attendance Procedure or Time Keeping

It refers to correct recording of the employees' attendance time.

Objectives of Time-keeping

Insights	✓ Correct recording of employees' attendance time is of utmost importance where payment is made on the basis of time worked.
Objectives	<ul style="list-style-type: none"> ✓ For the preparation of payrolls. ✓ For calculating overtime. ✓ For ascertaining idle time. ✓ For disciplinary purposes.

Methods of Time-keeping

There are various methods of time-keeping, which may be categorized into manual and mechanical methods.

Manual Methods	<ul style="list-style-type: none"> ✓ Attendance Register Method ✓ Metal Disc/ Token Method
Mechanical/ Automated Methods	<ul style="list-style-type: none"> ✓ Punch Card Attendance ✓ Bio-Metric Attendance system

Time-Booking

Meaning	✓ Time booking refers to a method wherein each activity of an employee is recorded.
Purpose	✓ This data recorded is further used to measure the time spent on a particular job for costing, measurement of efficiency, fixation of responsibility etc.
Time or Job Card	✓ For the collection of all such data, a separate record, generally known as Time (or Job) card, is kept.

Payroll Procedure

Meaning of Pay Roll	<ul style="list-style-type: none"> ✓ Pay Roll is a periodic statement which shows: <ul style="list-style-type: none"> ❖ Gross wages earned by each worker ❖ Deductions from Gross wages, and ❖ Net wages payable to each worker
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Payroll procedure

Attendance and Time details	✓ A detailed sheet of time spent by employee are sent to the payroll department by the time keeping department.
List of	✓ A list of employees on roll and their wage rate is sent by the





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LABOUR COSTING



employees	personnel/ HR department.
Computation of wages and other incentives	<ul style="list-style-type: none"> ✓ On the basis of details provided by the time keeping department and personnel department, Payroll department calculates the wages payable to each employee. ✓ It prepares pay slip for all employees and forwards the same to the cost accounting department for further deductions and payment.
Payment to employees	<ul style="list-style-type: none"> ✓ Cost accounting department deducts all statutory deduction such as employee's contribution to provident fund and employee state insurance (ESI) scheme, TDS on salary etc. After all deductions wages/ salary is paid to the employees.
Deposit of all statutory liabilities	<ul style="list-style-type: none"> ✓ All statutory deductions are paid to the respective statutory bodies. Such deductions can be Statutory or otherwise.
Diagrammatic Presentation	<pre> graph TD TKD[Time-keeping Department] -- "1. Time and Attendance" --> PD[Payroll Department] HRD[Personnel/HR Department] -- "2. Employee Details" --> PD PD -- "3. Wage and Salary sheet" --> CAD[Cost/Accounting Department] CAD -- "4. Payment after deductions and contributions" --> EMP[Employees] CAD -- "5. Deposit of deductions and contributions" --> SB[Statutory Bodies] </pre>

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Idle Time

Meaning	✓ It is the time during which no production is carried out because the worker remains idle even though they are paid.	
Formula	✓ $\text{Time Recorded as per Time card} - \text{Time Booked on Job as per Job card}$	
Normal Idle Time	Meaning	✓ It is the time which cannot be avoided or reduced in the normal course of business.
	Causes	<ul style="list-style-type: none"> ✓ The time lost between factory gate and the place of work ✓ The interval between one job and the other





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LABOUR COSTING



Abnormal Idle Time	Meaning	✓ It is that idle time which can be avoided or reduced in the normal course of business.	
	Causes	Controllable abnormal idle time	✓ It refers to the time which could have been put to productive use had the management been more alert and efficient i.e. such idle time could be controlled. Example : Non-availability of raw materials
		Uncontrollable abnormal idle Time	✓ It refers to time lost due to abnormal causes, over which management does not have any control. Example : Breakdown of Machine

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Overtime

Meaning of Basic Terms	✓ When a worker works for more than normal working hours, he is said to be done overtime.
	✓ The payment made for the extra hours worked (in excess of normal) is called Overtime payment.
	✓ The extra amount so paid over the normal rate is called overtime premium.
OT Rate & Conditions	✓ As per Factories Act 1948, where a worker works in a factory for more than 9 hours in any day or for more than 48 hours in any week, he shall, in respect of overtime work, be entitled to wages at the rate of twice his ordinary rate of wages.

Labour Turnover

Meaning and other Basics	
✓ Employee turnover or labour turnover in an organisation is the rate of change in the composition of employee force during a specified period measured against a suitable index.	
Causes of Labour Turnover	
Personal causes	<ul style="list-style-type: none"> ✓ Personal causes are those which induce or compel workers to leave their jobs at their will. ✓ Such causes include the following : <ul style="list-style-type: none"> ❖ Premature retirement due to ill health or old age ❖ Domestic problems and family responsibilities
Unavoidable causes	✓ Unavoidable causes are those under which it becomes obligatory on the part of management to ask one or more of their





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LABOUR COSTING



	<p>employees to leave the organization.</p> <ul style="list-style-type: none"> ✓ Such causes include the following : <ul style="list-style-type: none"> ❖ Seasonal nature of the business ❖ Disciplinary measures
<p>Avoidable causes</p>	<ul style="list-style-type: none"> ✓ Avoidable causes are those which could prevent the worker from leaving the job if timely action was taken by management. ✓ Such causes include the following : <ul style="list-style-type: none"> ❖ Dissatisfaction with job, remuneration, hours of work, working conditions, etc. ❖ Lack of training facilities and promotional avenues

Effects of Labour Turnover

High employee turnover increases the cost of production in the following ways:

- ✓ Efficiency of new workers is low.
- ✓ There is increased cost of training and induction.
- ✓ New workers cause increased breakage of tools, wastage of materials, etc.
- ✓ Cost of recruitment increases.

Cost of Labour Turnover

<p>Preventive costs</p>	<p>Meaning</p>	<ul style="list-style-type: none"> ✓ There are the costs which are incurred to keep the labour force contented so that high labour turnover may be prevented.
	<p>Inclusions</p>	<ul style="list-style-type: none"> ✓ Cost of Medical Services ✓ Cost of Welfare Activities such as canteen services etc.
<p>Replacement costs</p>	<p>Meaning</p>	<p>There are the costs which are incurred to meet the consequences of high labour turnover.</p>
	<p>Inclusions</p>	<ul style="list-style-type: none"> ✓ Loss of output between the time when worker left and new workers recruited ✓ Increased Cost of Recruitment ✓ Increased cost of Training ✓ Abnormal breakage

कहते है काला रंग अशुभ होता है।
पर स्कूल का वो ब्लैक बोर्ड लोगों की जिंदगी बदल देता है।

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OVERHEADS



Overheads

Meaning	✓ Overheads are the expenditure which cannot be conveniently traced to or identified with any particular cost unit. Such expenses are incurred for output generally and not for a particular work order.	
Classification	By Function	<ul style="list-style-type: none"> ✓ Production/ Manufacturing/ Factory Overheads ✓ Office and Administration Overheads ✓ Selling Overheads ✓ Distribution Overheads
	By Nature	<ul style="list-style-type: none"> ✓ Fixed Overheads ✓ Variable Overheads ✓ Semi-Variable Overheads
	By Element	<ul style="list-style-type: none"> ✓ Indirect Materials ✓ Indirect Employee Cost ✓ Indirect Expenses
	By Control	<ul style="list-style-type: none"> ✓ Controllable costs ✓ Un-controllable costs

Accounting and Control of Overheads

Estimation & collection of overheads	✓ The first stage is to estimate the amount of overheads, keeping in view the past figures and adjusting them for known future changes.
Cost allocation	✓ The term 'allocation' refers to assignment or allotment of an entire item of cost to a particular cost center or cost unit.
Cost apportionment	✓ There are some items of estimated overheads which cannot be directly allocated but to be spread over the various departments or cost centres on an appropriate basis. This is called apportionment.
Re-apportionment	✓ The process of assigning service department overheads to production departments is called reassignment or re-apportionment.
Absorption	✓ After completing the distribution as stated above, the overheads charged to department are to be recovered from the output produced in respective departments, which is absorption.

Concepts Related to Capacity

Capacity of a plant refers to its ability to produce with the available present resources and facilities.



OVERHEADS



Types of Capacity		
Rated or installed capacity	✓ It refers to the maximum capacity of producing goods or providing services. It is also known as theoretical capacity and is not achieved in normal operating circumstances .	
Practical capacity	✓ It is defined as actually utilised capacity of a plant . It is also known as operating capacity . This capacity takes into account loss of time due to repairs, maintenance, minor breakdown, idle time, etc. Generally, it is taken between 80 to 90% of the rated capacity .	
Normal capacity	✓ Normal capacity is the volume of production or services achieved or achievable on an average over a period under normal circumstances taking into account the reduction in capacity resulting from planned maintenance.	
Actual capacity	✓ It is the capacity actually achieved during a given period. It is presented as a percentage of installed capacity.	
Idle capacity	✓ It is that part of the capacity of a plant, machine or equipment which cannot be effectively utilised in production . It may arise due to lack of product demand, non-availability of raw material, seasonal nature of product etc.	
	Normal Idle Capacity	✓ It is the difference between Installed capacity and Normal capacity .
	Abnormal Idle Capacity	✓ It is the difference between Normal capacity and Actual capacity utilization .

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Treatment of Certain Specific Items in Costing

Fringe Benefits		
Meaning	✓ These are the additional payments or facilities provided to the workers apart from their salary and direct cost-allowances like house rent, dearness and city compensatory allowances.	
Treatment	If the amount of is considerably large	✓ It may be recovered as direct charge by means of a supplementary wage or labour rate .
	If the amount is small	✓ It may be treated as part of Production Overheads .
Expenses on Removal and Re-erection of Machines		
Reasons for incurrence	✓ Such expenses may be incurred due to factors like change in the method of production ; change in the flow of production, etc.	
Treatment	In normal circumstances	✓ These expenses are treated



OVERHEADS



		as production overheads.
	When amount of such expenses is large	✓ These may be spread over a period of time.
	If such expenses are incurred due to some abnormal factor.	✓ These may be charged to costing Profit and Loss Account.

Bad Debts

First View	✓ According to this view, bad debts are financial losses and therefore, they should not be included in the cost of a particular job or product.	
Second View	✓ According to another view it should form part of selling and distribution overheads, especially when they arise in the normal course of trading.	

Training Expenses

Inclusions	✓ Training expenses include : ❖ Salaries/ Wages to trainees or apprentices ❖ Costs incurred in running the training department ❖ Extra spoilage etc.	
Treatment	Training expenses of Factory trainees	✓ These should be treated as Production over-heads.
	Training expenses of Office & Adm. Trainees	✓ These should be treated as Administration overheads.
	Training expenses of Sales Trainees	✓ These should be treated as Selling overheads.
	Training expenses of Distribution Trainees	✓ These should be treated as Distribution overheads.
	Training expenses which are due to high labour turnover.	✓ These should be charged to Costing Profit & Loss Account.

Canteen Expenses/ Welfare Expenses

Meaning	✓ These represent the subsidy provided or expenses borne by the firm in running the canteen.	
Treatment	If the canteen is meant only for factory workers	✓ It should be regarded as a production overhead.
	If office workers or workers of selling & distribution also take advantage of the canteen facility	✓ A suitable share of the expenses should be treated as office overhead and selling & distribution overhead.

Research and Development Expenses

Research costs	✓ CIMA, London defines Research Cost as "the cost of searching for new or improved products, new applications of materials or new	
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OVERHEADS



	or improved methods.”	
Treatment	If research is conducted in the methods of production	✓ It should be treated as part of Production overheads.
	Cost of Research relating to Marketing activities	✓ It should be treated as part of Selling & Distribution overheads.
	Cost of Research relating to Particular Product	✓ It should directly be charged to that a particular product.
	Cost of Unsuccessful Research	✓ It should be charged to Costing Profit & Loss Account.
	General research expenses of a routine nature	✓ It should be charged to General Overheads. ✓ If the amount involved is substantial it may be treated as a deferred revenue expenditure.
Development Cost	✓ CIMA London, defines Developments Cost as “the cost of the process which begins with the implementation of the decision to produce a new or improved product. ”	
Treatment	Development Costs relating to a particular product	✓ It should directly be charged to that product. ✓ Such expenses are usually treated as “deferred revenue expenses,” and recovered as a cost per unit of the product when production is fully established.

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6 ACTIVITY BASED COSTING



Basics of Activity Based Costing (ABC)

Meaning	<ul style="list-style-type: none"> Activity based costing identifies the activities which cause cost to be incurred and searches for fundamental cost drivers of these activities. Once the activities and their cost drivers have been identified, this information can be used to assign overheads to cost objects (e.g. products) which have actually caused cost to be incurred.
Advantages of ABC	<ul style="list-style-type: none"> More accurate costing of products/ services. Overhead allocation is done on logical basis. Overcomes the inherent limitations of traditional absorption costing and use of blanket overhead Rates. Helps in cost control and cost reduction, as well as improved profitability. Helps to identify non-value added activities which facilitates cost reduction.
Limitations of ABC	<ul style="list-style-type: none"> Implementing an ABC system requires substantial resources, so costly to maintain. It is not helpful for small organizations. It is a complex system which needs lots of records for calculations. There is a need of trained professionals who are limited in number.

Difference between ABC & Traditional Absorption Costing

S.No.	Basis	Activity Based Costing	Traditional Absorption Costing
1.	Assignment of costs	Cost are assigned to cost objects, e.g. customers, products, services, epartments, etc.	Costs are assigned to Cost Units i.e. to products, or jobs or hours.
2.	Cost Driver	Activity-wise cost drivers are determined.	Hours is assumed to be only cost driver governing costs in all departments.
3.	Recovery Rates	Activity-wise recovery rates are determined and there is no concept of a single overhead recovery rate.	Either multiple overhead recovery rate (for each department) or a single overhead recovery rate may be determined for absorbing overheads.
4.	Aid in Cost control	Essential activities can be simplified and unnecessary	Cost Centers/ departments cannot be eliminated. Hence



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ACTIVITY BASED COSTING



	activities can be eliminated. Hence ABC aids cost control.	not suitable for cost control.
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Terminology Used in ABC

Activity	✓ Activity, here, refers to an event that incurs cost.
Cost Object	✓ It is an item for which cost measurement is required e.g. a product, job or a customer.
Cost Driver	✓ It is a factor that causes a change in the cost of an activity. There are two categories of cost driver.
Cost Pool	✓ It represents a group of various individual cost items.

Level of Activities under ABC Methodology/ Cost Hierarchy

Unit level activities	<ul style="list-style-type: none"> ✓ These are activities for which the consumption of resources can be identified with the number of units produced. ✓ It is performed each time a unit is produced.
Batch level activities	<ul style="list-style-type: none"> ✓ The costs of some activities are driven by the number of batches of units produced. ✓ It is performed each time a batch is processed.
Product level activities	✓ These are the activities which are performed to support different products in product line.
Facility Level Activities	✓ These are the activities which cannot be directly attributed to individual products, as are common and joint to all products manufactured.

Stages in Activity Based Costing (ABC)

Step 1	✓ Studying the Activities involved
Step 2	✓ Relating the Overheads to Activities
Step 3	✓ Spreading Support Activities over Primary Activities
Step 4	✓ Determining the Activity Cost Drivers
Step 5	✓ Calculating Activity Cost Driver Rates
Step 6	✓ Assigning Costs to Cost objects

Practical Applications of Activity Based Costing

As Activity Based Management	
Meaning	✓ ABM is a discipline that focuses on the efficient and effective management of activities as the route to continuously improving



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ACTIVITY BASED COSTING



	the value received by customers. ABM utilizes cost information gathered through ABC.	
Various analysis in Activity Based Management	Cost Driver Analysis	✓ The factors that cause activities to be performed need to be identified in order to manage activity costs.
	Activity Analysis	✓ This is focused on identifying the Value added and Non-Value added activities,
	Performance Analysis	✓ It involves the identification of appropriate measures to report the performance of activity centres.
Facilitates Activity Based Budgeting		
Meaning	<ul style="list-style-type: none"> ✓ Activity based budgeting analyses the resource input or cost for each activity. ✓ It provides a framework for estimating the amount of resources required in accordance with the budgeted level of activity. 	
Key Elements	<ul style="list-style-type: none"> ✓ Type of work to be done ✓ Quantity of work to be done ✓ Cost of work to be done 	

“
Every artist was first an amateur.
Ralph Waldo Emerson
”

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7 BUDGETARY CONTROL



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Budget

Meaning	<ul style="list-style-type: none"> ✓ A budget is a financial and/ or quantitative statement, prepared and approved prior to a defined period of time, of the policy to be pursued during that period for the purpose of attaining a given objective.
Essential Characteristics of Budget	<ul style="list-style-type: none"> ✓ A budget is concerned for a definite future period. ✓ A budget is a written document. ✓ A budget is a detailed plan of all the economic activities of a business. ✓ Budget is a mean to achieve business and it is not an end in itself. ✓ Different types of budgets are prepared by industries according to business requirements. ✓ Budget is usually prepared in the light of past experience.

Budgeting

Meaning	<ul style="list-style-type: none"> ✓ Budgeting is the process of designing, implementing and operating of budget. 	
Objectives of budgeting	Planning	<ul style="list-style-type: none"> ✓ The process of budgeting begins with the establishment of specific targets of performance and is followed by executing plans to achieve such desired goals.
	Directing and Coordinating	<ul style="list-style-type: none"> ✓ Once the budget plans are in place, they can be used to direct and coordinate operations in order to achieve the stated targets.
	Controlling	<ul style="list-style-type: none"> ✓ As time passes, the actual performance of an operation can be compared against the planned targets.

Budgetary Control

Meaning	<ul style="list-style-type: none"> ✓ It is the system of management control and accounting in which all the operations are forecasted and planned in advance to the extent possible and the actual results compared with the forecasted and planned ones.
Core theme	<ul style="list-style-type: none"> ✓ Establishment of budgets ✓ Continuous comparison of actual with budgets for achievement of targets





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BUDGETARY CONTROL



- ✓ Revision of budgets after considering changed circumstances
- ✓ Placing the responsibility for failure to achieve the budget targets

Objectives

- ✓ Portraying with precision the overall aims of the business and determining targets of performance.
- ✓ Laying down the responsibilities of each of the executives and other personnel.
- ✓ Providing a basis for the comparison of actual performance with the predetermined targets and investigation of deviation.
- ✓ Ensuring optimum use of available resources to maximise profit or production.
- ✓ Co-ordinating various activities of the business.

Feedback and Feedforward Control

There are two types of budgetary control system based on timing of action:

Feedback Control	Meaning	✓ The exercise of variance identification of actual results with budgeted figures is done after the completion of the budget period.
	Suitability	✓ Where Management Information System is not so robust and where data is obtained only after the finalisation of books of account.
Feed forward Control	Meaning	✓ The budgets are set at the inception of the budgeted period and the actual results are continuously monitored and compared.
	Suitability	✓ It requires a robust MIS supported by integrated ERP system enabling an entity to get data as and when desired basis.

Budget Committee and Budget Officer

The responsibility for successfully introducing and implementing Budgetary Control System rests with the Budget Committee acting through the Budget Officer. The Budget Committee would be composed of all functional heads and a member from the Board to preside over and guide the deliberations.

The main responsibilities of the Budget Committee/ Budget Officer are as follows :

- ✓ Co-ordination
- ✓ Providing guidance
- ✓ Periodical budget reports
- ✓ Follow up
- ✓ Reports for board meeting

Advantages of Budgetary Control System

Efficiency	✓ The use of budgetary control system enables the management of a business concern to conduct its business activities in the efficient manner.
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BUDGETARY CONTROL



Control on expenditure	✓ It provides a yardstick for measuring and evaluating the performance of individuals and their departments.
Finding deviations	✓ It reveals the deviations to management, from the budgeted figures after making a comparison with actual figures.
Effective utilisation of Resources	✓ Effective utilisation of various resources like men, material, machinery & money is made possible, as the production is planned after taking them into account.
Cost Consciousness	✓ It inculcates the feeling of cost consciousness among workers.

Limitations of Budgetary Control System

Based on Estimates	✓ Budgets are based on series of estimates which are based on the conditions prevailing, at the time budget is established. It requires revision in plan if conditions change.
Time factor	✓ Budgets cannot be executed automatically. It requires proper attention and time of management.
Co-operation	✓ Staff co-operation is usually not available during budgetary control exercise. In a decentralised organization, each unit has its own different objective.
Expensive	✓ Its implementation is quite expensive. For successful implementation of the budgetary control, proper organization structure with responsibility is prerequisite.

Components of Budgetary Control System

Physical budgets	✓ These are the budgets which contain information in terms of physical units about sales, production etc. For example, quantity of sales, production etc.
Cost budgets	✓ These are the budgets which provide cost information in respect of manufacturing, selling, administration etc. For example, manufacturing costs, selling costs etc.
Profit budgets	✓ It's a budget which enables in the ascertainment of profit. For example, profit and loss budget, etc.
Financial budgets	✓ It's a budget which facilitates in ascertaining the financial position of a concern. For example, cash budgets, budgeted balance sheet etc.

Budget Manual

Meaning

- ✓ A budget manual is a collection of documents that contains key information for those involved in the planning process. It should be well written and indexed. A copy of this must be given to each departmental head for guidance.

Contents





7 BUDGETARY CONTROL



- ✓ A statement regarding the objectives of the organisation and how they can be achieved through budgetary control;
- ✓ A statement about the functions and responsibilities of each executive, both regarding preparation and execution of budgets;
- ✓ Procedures to be followed for obtaining the necessary approval of budgets.
- ✓ A form of organisation chart to show who are responsible for the preparation of each functional budget and the way in which the budgets are interrelated.
- ✓ A timetable for the preparation of each budget.
- ✓ Reports, statements, forms and other record to be maintained;
- ✓ The reporting of the remedial action;
- ✓ Information concerning key assumptions to be made by managers in their budgets.

Lightbulb Different Types of Budgets

Classification on the basis of Capacity or Flexibility	
Fixed Budget/ Static Budget	
Meaning	✓ Once the budget has been determined, it is not changed, even if the activity changes.
Features	<ul style="list-style-type: none"> ✓ It is prepared for one fixed level of activity. ✓ Expenses are not classified into fixed, variable and semi - variable.
Suitability	<ul style="list-style-type: none"> ✓ When the nature of business is not seasonal. ✓ The demand of the product is certain and stable. ✓ There is a trend of price stability.
Flexible Budget	
Meaning	✓ In a flexible budgetary control system, a series of budgets are prepared one for each of a number of alternative production levels or volumes.
Features	<ul style="list-style-type: none"> ✓ It is prepared for different levels of activity. ✓ It changes with the change in the level of activity. ✓ Expenses are classified into fixed, variable and semi - variable. Semi - variable expenses are further segregated into fixed and variable expenses.
Suitability	<ul style="list-style-type: none"> ✓ There are seasonal fluctuations in sales and/ or production. ✓ Industries which are engaged in make-to-order business like ship building. ✓ An industry which is influenced by changes in fashion.
Classification on the basis of Function	
Sales Budget	✓ It represents the physical quantities and values of total sales to be achieved during the budget period. Sales Budget is based on

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BUDGETARY CONTROL



	sales forecast.
Production Budget	✓ It is a forecast of the production for the budget period of an organisation. The purpose of this budget is to represent the units of finished products to be produced, which further facilitates the preparation of Raw Material Consumption & Purchase budget.
Consumption Budget	✓ This is a budget which shows the consumption of material to produce the finished product which has been computed as per production budget.
Purchase Budget	✓ It represents the physical quantities of material to be purchased and cost of total materials during the budget period.
Personnel (or Labour Cost) Budget	✓ Labour Cost Budget represents the hours and cost of total labour force required during the budget period. It is generally based on Production budget.
Factory Overhead Budget	✓ It represents the amount of total factory overheads to be incurred during the budget period i.e. indirect materials, indirect labour and indirect expenses.
Production Cost Budget	✓ It represents the amount of total production cost to be incurred during the budget period i.e. aggregate of direct material cost, direct labour cost, direct expenses and factory overheads.
Cost of Goods Sold Budget	✓ The cost of goods sold budget represents the total cost of goods to be sold during the budget period.
Administrative Expenses Budget	✓ Administrative Cost Budget represents the amount of total office & administrative expenses to be incurred during the budget period.
Selling and Distribution Cost Budget	<ul style="list-style-type: none"> ✓ It represents the amount of total selling & distribution cost to be incurred during the budget period. ✓ Selling costs are defined as the cost of seeking, to create and stimulate demand and of securing orders. These are incurred to maintain and increase the level of sales. ✓ Distribution cost begins with making the packet product available for dispatch and ends with making the re-conditioned return empty package, if any, available for re - use.
Research and Development Expense Budget	<ul style="list-style-type: none"> ✓ R & D Cost Budget represents the amount of total research & development costs to be incurred during the budget period. ✓ Research and development expenses should be controlled carefully and hence a limit on the spending is placed, i.e., the amount to be spent is carefully determined or allocated.
Cash Budget	✓ Cash Budget represents the amount of estimated cash inflows,

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BUDGETARY CONTROL



	estimated cash outflows and deficit or surplus over a given budget period.
Master Budget	
✓ The master budget is a summary budget which incorporates all functional budgets in a capsule form and shows Budgeted Income Statement for the budget period and Budgeted Balance Sheet as at the end of the budget period.	
Classification on the basis of Period or Time	
Long - term Budgets	<ul style="list-style-type: none"> ✓ The budgets which are prepared for longer period are called long-term budgets. ✓ The Budgets are prepared to depict long term planning of the business. ✓ The period of long term Budgets varies between three to ten years.
Short - term Budgets	<ul style="list-style-type: none"> ✓ These are prepared for period less than that of long-term budget. ✓ These budgets are generally for 1 or 2 years.
Current Budget	✓ A budget which is established for use over a short period of time and is related to the current conditions is called current budget.

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Lightbulb Difference between Fixed Budget & Flexible Budget

No.	Basis	Fixed Budget	Flexible Budget
1.	Flexibility	It is inflexible and does not change with the actual volume of output achieved.	It is flexible and changes according to the level of activity.
2.	Conditions	It assumes that conditions would remain static .	It is prepared according to changing conditions.
3.	Classification of Costs	Costs are not classified according to their variability i.e., fixed, variable and semi variable.	Costs are classified according to their variability i.e., fixed, variable and semi variable.
4.	No. of budgets	Only one budget at a fixed level of activity is prepared.	Under it, series of budgets are prepared at different level of activity.



Zero-Based Budgeting (ZBB)

Meaning

✓ Zero-based Budgeting (ZBB) is defined as a method of budgeting which requires each cost element to be specifically justified, though the activities to which the budget relates are not being undertaken for the first time. The cost of each activity has to be justified and without justification, the budget allowance is zero.

Advantages of Zero-based Budgeting OR

- ✓ It provides a systematic approach for the evaluation of different activities and rank them in order of preference for the allocation of scarce resources.
- ✓ It ensures that the various functions undertaken by the organization are critical for the achievement of its objectives and are being performed in the best possible way.
- ✓ It provides an opportunity to the management to allocate resources for various activities only after having a thorough cost-benefit-analysis.
- ✓ The areas of wasteful expenditure can be easily identified and eliminated.

Difference between Traditional Budgeting and Zero Based budgeting

No.	Basis	Traditional Budgeting	Zero Based budgeting
1.	Approach	Traditional budgeting is accounting oriented. Main stress happens to be on previous level of expenditure.	Zero-based budgeting makes a decision oriented approach. It is very rational in nature and requires all programmes, old and new, to compete for scarce resources.
2.	Focus	In traditional budgeting, first reference is made to past level of spending and then demand for inflation and new programmes.	In zero-based budgeting, management focuses only on decision packages, which enjoy priority to others.
3.	Inflating budgets	In tradition budgeting, some managers deliberately inflate their budget request so that after the cuts they still get what they want.	In zero-based budgeting, a rationale analysis of budget proposals is attempted.
4.	Responsibility	In traditional budgeting, it is for top management to decide why a particular amount should be spent on a particular decision unit.	In Zero-based budgeting, this responsibility is shifted from top management to the manager of decision unit.





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BUDGETARY CONTROL



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Performance Budgeting (PB)

Meaning of Performance Budgeting

- ✓ Performance budgeting requires fixing of the responsibility of each executive in organisation and the continuous appraisal of his performance. It is, therefore, considered to be synonymous with responsibility accounting.

Essential requirements to adopt PB

- For an enterprise that wants to adopt PB, it is thus imperative that:
- ✓ the objectives of the enterprise are spelt out in concrete terms,
 - ✓ the objectives are then translated into specific functions, programmes, activities and tasks for different levels of management,
 - ✓ realistic performance indicators should be evolved and expressed in quantifiable physical units,
 - ✓ a style of management based upon decentralised responsibility structure should be adopted, and
 - ✓ an accounting and reporting system should be developed to facilitate monitoring, analysis and review of actual performance in relation to budgets.

■ He who has never learned to obey cannot be a good commander.
Aristotle ■



JOB & BATCH COSTING



Job Costing - Basics

Meaning	✓ Job Costing is that form of specific order costing under which each job is treated as a cost unit and costs are accumulated and ascertained separately for each job.
Basic Features	<ul style="list-style-type: none"> ✓ Each job is unique. ✓ Each job is executed as per customer's specifications. ✓ Each job is treated as a cost unit. ✓ All costs are accumulated and ascertained for each job. ✓ A separate Job Cost Sheet or Job Card is used for each job.

Batch Costing

Meaning	✓ Batch Costing is that form of specific order costing under which each batch is treated as a cost unit and costs are accumulated and ascertained separately for each batch.
Basic Features	<ul style="list-style-type: none"> ✓ Each batch is treated as a cost unit. ✓ Each batch consists of a number of like units. ✓ All costs are accumulated and ascertained for each batch. ✓ A separate Batch Cost Sheet is used for each batch. ✓ The cost per unit is ascertained by dividing the total cost of a batch by the number of items produced in that batch.

Economic Batch Quantity or Optimum Batch Quantity

Meaning	✓ It refers to the optimum quantity batch which should be produced at a point of time so that the Set up & Processing Costs and Carrying Costs are together optimized.		
Factors	<ul style="list-style-type: none"> ✓ Annual Demand of Product ✓ Setting up & Processing Costs ✓ Carrying Costs 		
Relationship between batch size and setting up costs & carrying costs	✓ There is an inverse relationship between batch size and setting up & processing costs whereas there is positive relationship between batch size and carrying cost.		
		Setting up & Processing Costs	Carrying Costs
	Larger the batch size	Lower the setup costs because of few batches	Higher the carrying costs because of high average inventory
Smaller the batch size	Higher the setup costs because of more batches	Lower the carrying costs because of low average inventory	





PROCESS COSTING



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Process Costing

Meaning	✓ Process Costing is a method of costing used in industries where the material has to pass through two or more processes for being converted into a final product.
Basic Features	<ul style="list-style-type: none"> ✓ The production is continuous. ✓ The processes are standardised. ✓ The output of one process becomes the input of another process. ✓ The output of the last process is transferred to Finished Stock Account. ✓ Costs are collected process-wise. ✓ Cost per unit is calculated at the end of period by dividing the total process cost by the normal output produced.

Treatment of Normal Loss, Abnormal Loss, Abnormal Gain

Normal Loss	
Meaning	✓ It is defined as the loss of material which is inherent in the nature of work.
Nature	✓ It is unavoidable because of nature of the material or the process.
Example	✓ Loss due to evaporation.
Computation	Units ✓ Input × Expected Percentage of Normal Loss
	Amount ✓ Normal Loss Units × Normal Loss Scrap Rate per unit
Treatment	<ul style="list-style-type: none"> ✓ The cost of normal loss is treated as part of the cost of production. ✓ Cost of normal loss is absorbed by good units produced by inflating the cost per unit.
Abnormal Loss	
Meaning	✓ It is defined as the loss in excess of the pre-determined loss (Normal process loss).
Estimation	✓ Such a loss cannot obviously be estimated in advance.
Nature	✓ It can be avoided by taking suitable measures.
Example	✓ Loss due to the carelessness of workers, etc.
Computation	Units ✓ Expected Output (i.e. Input - Normal Loss) - Actual Output
	Amount ✓ Abnormal Loss Units × Cost per unit of Process
Treatment	<ul style="list-style-type: none"> ✓ The cost of abnormal loss is not treated as part of the cost of production. ✓ It is charged to Costing Profit and loss Account.



PROCESS COSTING

Abnormal Gain/ Abnormal Effectives	
Meaning	✓ Abnormal Gain arises when actual output is more than the expected output or when actual losses are less than the expected normal losses.
Estimation	✓ Such a gain cannot obviously be estimated in advance.
Computation	Units ✓ Actual output - Expected output (i.e. Input - Normal Loss)
	Amount ✓ Abnormal Gain Units × Cost per unit of Process
Accounting Treatment	✓ Cost of abnormal gains is not treated as recovery of cost of production. ✓ It is credited to Costing Profit and Loss Account .

Inter Process Profits

Meaning	✓ In some process industries, the output of one process is transferred to the next process not at cost but at market value or cost plus a percentage of profit. The difference between cost and the transfer price is known as inter-process profits.
Advantages	✓ It reveals the profitability of each process individually . ✓ It assists in decision-making such as to purchase a partly processed material rather than to process work internally or to sell a partly processed product or to process it further.
Disadvantages	✓ The use of inter-process profits involves complication . ✓ Closing stocks of WIP and finished goods include unrealized profits .

Operation Costing

Meaning	✓ In those industries where a process consists of distinct operations , the method of costing applied or used is called operation costing. It is also known as Hybrid product costing system.
Focus	✓ It is concerned with the determination of the cost of each operation rather than the process.

Focus on being productive instead of busy.

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JOINT & BY PRODUCT



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Basics about Joint Products

Meaning	✓ Joint products represent two or more products of almost equal importance which are produced in natural proportions simultaneously from the same material in the same process.	
Examples	✓ In Oil-refining industry, Gasoline, petrol, diesel, paraffin wax, coal tar, kerosene etc. are joint products.	
Meaning of Split off Point	✓ Split off point or Separation point refers to that stage in the manufacturing process at which the products get separated and become separately identifiable.	
Costs of Joint Products	Joint Costs	✓ Joint costs refer to the total costs incurred up to the split off point when the products get separated.
	Subsequent Costs	✓ Subsequent costs refer to the total costs incurred after the split off point on further processing of products.
Primary Issue	✓ Since Joint costs cannot directly be allocated to individual products produced, there arises a problem of apportionment of joint costs amongst various products produced.	

Methods of Apportioning Joint Costs over Joint Products

Physical Unit Method	✓ Joint costs are apportioned on the basis of physical volume of the joint products at the split off point. This method is suitable where the physical units of joint products are same.	
Average Unit Cost Method	✓ Joint costs are apportioned on the basis of Average Cost Per Unit which is obtained by dividing total joint costs by total number of units of joints products produced.	
Survey Method/ Point Value Method	✓ Joint costs are apportioned on the basis of point values/ percentages assigned to the products according to their relative importance.	
Contribution Margin Method	Variable portion of total joint cost	✓ It is apportioned on the basis of units produced.
	Fixed portion of total joint cost	✓ It is apportioned in the ratio of Contribution Margin.
Market Value at Separation Point	✓ Joint costs are apportioned in the ratio of market value of the joint products at the separation point. ✓ Units Produced of each Joint Product × Selling Price per unit at Separation Point.	



JOINT & BY PRODUCT



Method	
Market Value after Further Processing Method	<ul style="list-style-type: none"> ✓ Joint costs are apportioned in the ratio of market value of the joint products after further processing. ✓ Units Produced of Each Joint Product × Selling Price per unit after further processing
Net Realizable Value Method	<ul style="list-style-type: none"> ✓ Joint costs are apportioned in the ratio of Net Realizable Values of the joint products at the separation point. ✓ Sales Value after Further Processing - Further Processing Costs
Reverse Cost Method	<ul style="list-style-type: none"> ✓ This method is preferred when the profit of each joint product is given. ✓ A Cost sheet is prepared in reverse manner by deducting profit and all the traceable costs from sales of each joint product. ✓ The resultant amount is share of each joint product in the joint cost.

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Co-Products

Meaning	<ul style="list-style-type: none"> ✓ Co-products may be defined as two or more products which are contemporary but do not emerge necessarily from the same material in the same process.
Example	<ul style="list-style-type: none"> ✓ Wheat and grain produced in two separate farms with separate processing of cultivation are the co-products

By-Products

Meaning	<ul style="list-style-type: none"> ✓ By-products are products of relatively small value which emerges incidentally in the course of manufacturing the main product. ✓ These are secondary or subsidiary products.
Features	<ul style="list-style-type: none"> ✓ By-products are of relatively small value. ✓ These emerge incidentally in the course of manufacturing the main product.
Examples	<ul style="list-style-type: none"> ✓ Molasses are By-product in the manufacture of sugar. ✓ Husk is By-product in the manufacture of Rice.

अगर एक हारा हुआ इंसान हारने के बाद भी मुस्कुरा दें.. तो जितने वाला भी जीत की खुशी खो देता है।





III

STANDARD COSTING



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Standard Costing

Standard Cost	✓ Standard Cost is the pre-determined operating cost calculated from Management's standards of efficient operation and the relevant necessary expenditure.
Standard Costing	✓ Standard costing is a method of costing which measures the performance of an activity by comparing actual cost with standard cost, analyse the variances (deviations) and reporting of variances for investigation and appropriate action.

Advantages of Standard Costing

Measuring Performance	✓ It serves as a basis for measuring operating performance and cost control. It is possible by setting standards, proper classification and determination of variances.
Cost Estimation	✓ Standard costing facilitates the estimation of the cost of new products with greater accuracy.
Inventory Valuation	✓ Standard costs are used for inventory valuation.
Clear definition of target	✓ It provides objectives and targets to be achieved by each level of management and defines the responsibilities of departmental managers.
Controls wastages	✓ The maximum use of working capital, plant facilities and current assets is assured because wastage of materials and loss due to idle time are closely controlled.

Criticism of Standard Costing

Variation in price	✓ One of the chief problem faced in the operation of the standard costing system is the precise estimation of likely prices or rate to be paid.
Changing standard of technology	✓ In case of industries that have frequent technological changes affecting the conditions of production, standard costing may not be suitable.
Mix of products	✓ Standard costing presupposes a pre-determined combination of products both in variety and quantity. The mixture of materials used to manufacture the products may vary in the long run.
Costly	✓ It may require high order of skill and competency. Small concerns, therefore, feel difficulty in the operation of such system.

Setting up of Standard Cost

Physical Standards	✓ Physical standards refer to expression of standards in units or hours.
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STANDARD COSTING



Price or Rate Standards	✓ These standards refer to expression of standards in price or rate.
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Types of Standards

Ideal Standards

✓ These represent the **level of performance attainable** when prices for material and labour are **most favourable**, when the highest output is achieved with the best equipment and layout and when the maximum efficiency in utilisation of resources results in maximum output with minimum cost. It is merely a **theoretical standard** which is **unrealistic and unattainable**.

Normal Standards

✓ Normal Standard is a standard which is **based on average performance** in the past. It is **attainable under normal conditions**.

Basic or Bogey Standards

✓ Basic standard is a standard which is **established for some base year and remain in use for a long period of time**. Since basic standards do not represent what should be attained in the present period, current standards should also be prepared if basic standards are used.

Current Standards

✓ Current Standard is a standard which is **established for a limited period** and is related to current conditions. These standards reflect the management's anticipation of what actual costs will be for the current period.

Types of Variance

Controllable and Un-controllable variances

Controllable variances	✓ Controllable variances are those which can be controlled under the normal operating conditions if a responsibility centre takes preventive measures and acts prudently.
Uncontrollable variances	✓ Uncontrollable variances are those which occur due to conditions which are beyond the control of a responsibility centre and cannot be controlled even though all preventive measures are in place .

Favourable and Adverse Variances

Favourable variances	<ul style="list-style-type: none"> ✓ Favourable variances are those which are profitable for the company. These are denoted by capital 'F'. ✓ While computing cost variances, favourable variance means actual cost is less than standard cost. ✓ While computing sales variances, favourable variance means
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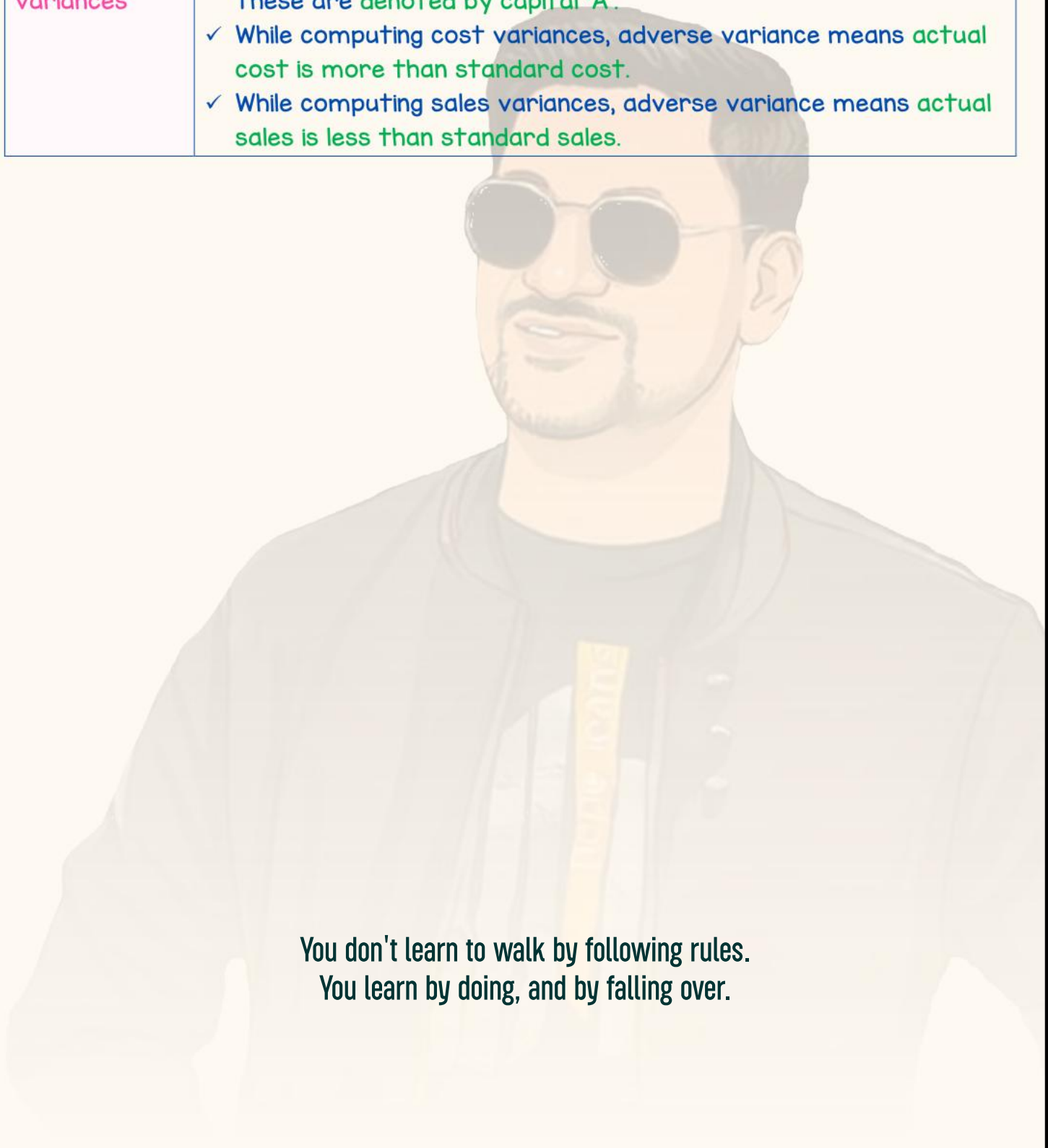


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STANDARD COSTING



	actual sales is more than standard sales.
Adverse variances	<ul style="list-style-type: none"> ✓ Adverse variances are those which causes loss to the company. These are denoted by capital 'A'. ✓ While computing cost variances, adverse variance means actual cost is more than standard cost. ✓ While computing sales variances, adverse variance means actual sales is less than standard sales.



You don't learn to walk by following rules.
You learn by doing, and by falling over.

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MARGINAL COSTING



Marginal Costing

Meaning	✓ Marginal costing is the practice of charging all marginal costs to operations, processes or products and writing off all fixed costs against the profits in the period in which they arise.
Basic Features	<ul style="list-style-type: none"> ✓ All costs are classified on variability basis as fixed costs and variable costs. ✓ Only variable costs are treated as product costs and hence are charged to operations, processes or products. ✓ All fixed costs are treated as period costs and hence are written off against profits in the period in which they arise.

Insights into Marginal Costing

Advantages of Marginal Costing	
Simplified Pricing Policy	✓ Since marginal cost per unit is constant from period to period within a short span of time, firm decisions on pricing policy can be taken.
Proper recovery of Overheads	<ul style="list-style-type: none"> ✓ In absorption costing, overheads are recovered on the basis of pre-determined rates. ✓ This creates the problem of treatment of such under or over-recovery of overheads. Marginal costing avoids such under or over recovery of overheads by charging full cost of fixed overheads.
Shows Realistic Profit	✓ The stock of finished goods and work-in-progress are carried on marginal cost basis and the fixed expenses are written off to profit and loss account as period cost. This shows the true profit of the period.
Break Even Analysis	✓ Marginal costing helps in preparation of break-even analysis which shows the effect of increasing or decreasing production activity on the profitability of the company.
More control over expenditure	✓ Segregation of expenses as fixed and variable helps the management to exercise control over expenditure.
Helps in Decision Making	✓ Marginal costing helps the management in taking a number of business decisions like make or buy, discontinuance of a particular product, etc.
Limitations of Marginal Costing	
Difficulty in classifying cost	✓ It is difficult to classify exactly the expenses into fixed and variable category. Most of the expenses are neither totally variable nor wholly fixed.



MARGINAL COSTING



Dependence on key factors	✓ Contribution of a product itself is not a guide for optimum profitability unless it is linked with the key factor.
Unpredictable nature of Cost	<ul style="list-style-type: none"> ✓ Fixed cost may change in totality from one period to another. ✓ The variable costs may not remain constant per unit of output.
Apportionment of Fixed Costs	✓ In case of multiple products, separate break-even points are to be calculated. This poses a problem of apportionment of fixed costs to each product.
Understating of WIP	✓ Under marginal costing, stocks and work in progress are understated.

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Cost-Volume-Profit Analysis

Meaning	✓ It is a managerial tool showing the relationship between various ingredients of profit planning viz., cost, selling price and volume of activity.
Assumptions	<ul style="list-style-type: none"> ✓ Changes in the levels of revenues and costs arise only because of changes in the number of products (or service) units produced and sold. ✓ Total cost can be separated into two components; Fixed and variable. ✓ Graphically, the behaviour of total revenues and total cost are linear in relation to output level within a relevant range. ✓ Selling price, variable cost per unit and total fixed costs are known and constant.
Impact of various changes on profit	<ul style="list-style-type: none"> ✓ An understanding of CVP analysis is extremely useful to management in budgeting and profit planning. It helps in measuring the impact of the following on the net profit : <ul style="list-style-type: none"> ❖ Changes in selling prices ❖ Changes in volume of sales ❖ Changes in variable cost ❖ Changes in fixed cost

Important Terms

Marginal Cost	✓ Marginal Cost is the amount at any given volume of output by which aggregate costs are changed if volume of output is increased or decreased by one unit.
Contribution	✓ Contribution is basically that portion of sales which remains after recovering variable costs and is available towards fixed costs and profits.



MARGINAL COSTING



	<ul style="list-style-type: none"> ✓ The contribution may or may not be equal to profit depending upon the amount of fixed costs.
Profit Volume Ratio	<ul style="list-style-type: none"> ✓ P/V Ratio is the ratio of Contribution to Sales and is usually expressed as a percentage. ✓ PV Ratio is considered to be the basic indicator of the profitability of the business. ✓ The higher the PV Ratio, the better it is for a business.

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Concept of Break Even

Break Even Point

- ✓ Break Even Point refers to that volume of operation at which total sales revenue is just equal to total cost (i.e. Fixed Cost and Variable Cost).
- ✓ It is the point at which there is neither profit nor loss.
- ✓ It is the point at which contribution is just equal to fixed costs.
- ✓ Before reaching B.E.P., the firm incurs losses and after reaching B.E.P. the firm earns profits.

Cash Break Even Point

- ✓ When break-even point is calculated only with those fixed costs which are payable in cash, such a break-even point is known as cash break-even point.

Break-Even Chart

Meaning	<ul style="list-style-type: none"> ✓ Break Even Chart is a graphical representation of the Break Even Analysis (or Cost, Volume - Profit Relationship).
Angle of Incidence	<ul style="list-style-type: none"> ✓ This angle is formed by the intersection of sales line and total cost line at the break- even point. ✓ This angle shows the rate at which profits are being earned once the break-even point has been reached. The wider the angle, the greater is the rate of earning profits.

Margin of Safety

- ✓ Margin of Safety (MoS) is the excess of total sales over the Break even sales.
- ✓ Upto BEP, the Contribution earned by the firm is sufficient only to recover Fixed Costs. However, beyond the BEP, the Contribution is called Profit.
- ✓ The size of Margin of Safety shows the strength of the business.



Reconciliation of Cost and Financial Accounts

✓ When the cost and financial accounts are kept separately, it is imperative that those should be reconciled, otherwise the cost accounts would not be reliable.

Reasons for Disagreement of Profits as per Financial Accounts and Cost Accounts

Items appearing only in financial accounts	<p>✓ The following items of income and expenditure are normally included in financial accounts and not in cost accounts.</p> <p>Purely financial expenses</p> <ul style="list-style-type: none"> ✓ Interest on loans or bank mortgages. ✓ Expenses relating to the issue and transfer of share and debentures like stamps duty expenses, discount on share and debentures etc. ✓ Other capital losses i.e., loss by fire not covered by insurance etc. ✓ Losses on the sales of fixed assets and investments ✓ Goodwill written off ✓ Preliminary expenses written off ✓ Income tax ✓ Donations ✓ Subscriptions ✓ Fines and penalties <p>Purely Financial Income</p> <ul style="list-style-type: none"> ✓ Interest received on bank deposits, loans and investments ✓ Dividends received ✓ Interest received ✓ Profits on the sale of fixed assets and investments ✓ Share Transfer fees <p>Appropriation</p> <ul style="list-style-type: none"> ✓ Dividends paid ✓ Transfer to reserves ✓ Dividend Equalization Fund, Sinking Fund etc.
Items appearing only in cost accounts (notional expenses)	<p>✓ These are :</p> <ul style="list-style-type: none"> ❖ Charges in lieu of rent where premises are owned ❖ Interest on capital at notional figure though not incurred ❖ Salary for the proprietor at notional figure though not incurred ❖ Notional Depreciation on the assets fully depreciated for which book value is nil.
Under or over - absorption	<p>✓ In cost accounts, overheads are charged to production at pre-determined rates whereas in financial accounts actual amount of overhead is charged, the different treatment gives rise to under</p>

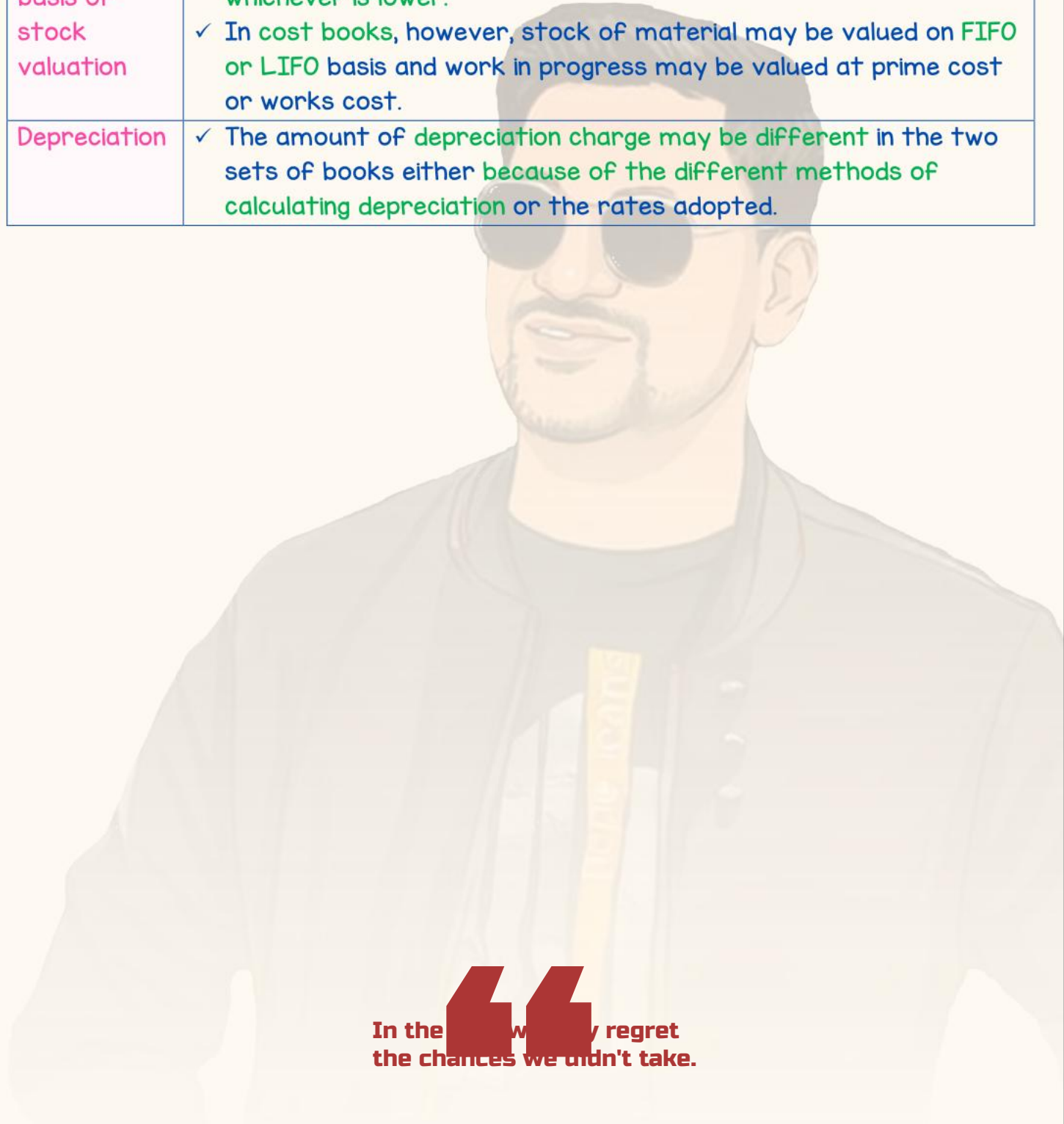




13 RECONCILIATION OF COST & FINANCIAL ACCOUNTS



of overhead	or over absorption, causing a difference in profits.
Different basis of stock valuation	<ul style="list-style-type: none"> ✓ In financial books, stocks are valued at cost or market price, whichever is lower. ✓ In cost books, however, stock of material may be valued on FIFO or LIFO basis and work in progress may be valued at prime cost or works cost.
Depreciation	✓ The amount of depreciation charge may be different in the two sets of books either because of the different methods of calculating depreciation or the rates adopted.



“ In the end, we only regret the chances we didn't take. ”

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Types of Cost Accounting System

Non-Integrated Accounting System

- ✓ Non-integral system is a system of accounting under which two separate sets of account books are maintained; one to record cost transactions and the other to record financial transactions.
- ✓ It is also known as Inter-locking system or Cost Ledger Accounting system.

Integral Accounting System	
Meaning	✓ It's a system of accounting where both costing and financial transactions are recorded in the same set of books.
Advantages	✓ The question of reconciling costing profit and financial profit does not arise, as there is only one figure of profit.
	✓ Due to use of one set of books, there is significant saving in efforts made.
	✓ No delay is caused in obtaining information provided in books of original entry.
	✓ It is economical also as it is based on the concept of 'Centralization of Accounting Function'.
Essential Pre-Requisites for Integral/Integrated System	✓ The management must decide about the extent of integration of the two sets of books. Some concerns find it useful to integrate upto the stage of prime cost or factory cost while others prefer full integration of the entire accounting records.
	✓ A suitable coding system must be made available so as to serve the accounting purposes of financial and cost accounts.
	✓ Perfect coordination should exist between the staff responsible for the financial and cost aspects of the accounts and an efficient processing of accounting documents should be ensured.

Do not follow where the path may lead.
Go instead where there is no path and leave a trail.
Harold R. McAlindon



Basics of Operating Costing

Operating Costing	
Meaning	✓ Operating Costing is a method of ascertaining costs of providing or operating a service. This method of costing is applied by those undertakings which provide services rather than production of commodities.

Applications	✓ This costing method is usually made use of by transport companies, electricity supply companies, canteens, hospitals, theatres, schools etc.
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Application of Service Costing

Internal	✓ The service costing is required for in-house services provided by a service cost centre to other responsibility centres as support services. Examples of support services are Canteen and hospital for staff, IT department services used by other departments etc.
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External	✓ When services are offered to outside customers as a profit centre as an output. Examples of services provided are goods or passenger transport service provided by a transporter, hospitality services provided by a hotel etc.
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Cost Unit in Operating Costing

Simple Unit	✓ A cost unit is said to be simple cost unit when only one cost unit is used. ✓ In case of transport, cost unit is per kilometer.
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Composite unit	✓ When two units are merged into one it is called Composite units. ✓ In case of goods transport, composite cost unit is tonne kilometer.
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Service Costing Units

Service Industry	Unit of Cost (Examples)
Transport Services	Passenger- km., (In public transportation) Quintal- km., or Tonne- km. (In goods carriage)
Electricity Supply service	Kilowatt- hour (kWh)
Hospital	Patient per day, room per day or per bed, per operation etc.
Hotels	Guest Days or Room Days
Bank or Financial Institutions	Per transaction, per services (e.g. per application, per project etc.)
IT & ITES	Cost per project, per module etc.
Insurance	Per policy, Per claim, Per TPA etc.





Costing of IT & ITES

It includes the provision for following

- ✓ Hardware and software costs involved
- ✓ Travel and training costs
- ✓ Effort costs like salaries of the software engineers or programmers

Costing of Toll Roads

Cost Involved	
Capital Costs	<ul style="list-style-type: none"> ✓ The capital cost consists of cost incurred during the construction period. The total cost includes the cost of construction of road and other structures and consultancy charges. In addition to this cost, it also includes the cost of construction of tollbooths.
Operating and Maintenance Costs	<ul style="list-style-type: none"> ✓ Routine maintenance cost would be incurred once the toll road is operational. Routine maintenance involves Patching of potholes, sealing of cracks etc. ✓ Annual operating cost includes the cost of operating tollbooths, administrative expenses, emergency services, communications and security services etc. ✓ Maintenance cost includes the cost of annual maintenance (routine) and periodic maintenance.

Build-Operate-Transfer (BOT) Approach

- ✓ In recent years, a growing trend emerged among Governments in many countries to **solicit investments for public projects from the private sector under BOT scheme**. BOT is an option for the Government to outsource public projects to the private sector.
- ✓ With BOT, the **private sector designs, finances, constructs and operate the facility and eventually, after specified concession period, the ownership is transferred to the Government**. Therefore, BOT can be seen as a developing technique for infrastructure projects by making them amenable to private sector participation.

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