CA INTER - **COSTING**

THEORY BOOK

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INDEX TO
COST & MANAGEMENT ACCOUNTING
Important Theory Questions

Introduction to Cost & Management Accounting

Question Explain the meaning of cost, costing and cost accounting?

Answer:- Cost:- Amt of expenditure incurred in producing a product or providing a service.

Costing:- Procedure of ascertaining cost of product being manufactured or service being rendered.

Cost Accounting:- Process beginning with recording of income & expenditure and ending with preparation of periodical statements and reports for controlling costs

Question Define Cost Units and provide some examples?

Answer:-Unit of product, service or/and time in relation to which costs is expressed e.g. cost per passenger km

Question Define Cost Centres and describe its types ?

Answer:- It is dept. product or job for which cost is ascertained. Cost Centres are of two types

1. **Personal Cost Centre*:*** It consists of a person or group of persons e.g. machine operator.
2. **Impersonal Cost Centre:** It consists of a location or an equipment e.g. location of factory

Cost Centre in a manufacturing concern: 2 Types

1. ***Production Cost Centre:-*** where raw material is converted into finished product.
2. ***Service Cost Centre:*** It is a cost centre which provide service to a production cost centre.

Question Write Short note on Cost Objects?

Answer:- Cost object is anything for which a separate measurement of cost is required. Cost object may be a product (Computer, TV) a service (Transport service) a project, a customer (Metro rail project) etc.

Question State difference between Cost Control and Cost Reduction?

Cost Control	Cost Reduction
Actual cost should not exceed standard cost If it exceeds, investigation is needed.	Reducing cost further from standard cost level without impairing product quality.
Main objective - Control cost so as not to exceed the standard limits.	Main objective - Achieve real and permanent reduction in cost p.u. of goods mfd.
Standards are treated as milestone	Standards are assumed to have much extra cost.
Preventive function	Corrective function.
Emphasis on past and present.	Emphasis on present and future.

Question State difference between Financial Accounting and Cost Accounting

Sl No.	Basis	Financial Accounting	Cost Accounting
1.	Objective	To provide information about financial performance.	To provide information of ascertainment of cost for the purpose of cost control and decision making.
2.	Nature	Records all expenses as direct or indirect	Records all expenses as material, labour and OH cost.
3.	Recording of	Records Historical data.	Use of both historical costs & pre-

	Data		determined costs.
4.	Users of information	Users are shareholders, creditors, financial analysts and government and its agencies etc.	User is only internal mgt
5.	Analysis of costs and profits	Shows total profit or loss of company	Shows profit or loss of each product
6.	Time Period	Financial statements are prepared usually for a year.	Its reports and statements are prepared as and when required.

Question State difference between Cost Accounting and Management Accounting?

	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	Development	It's development is related to industrial revolution.	It develops in accordance to the need of modern business world.
6	Rules and Regulation	It follows certain principles and procedures for recording costs of different products	It does not follow any specific rules and regulations.

Question Classify Costs on the basis of Management Decision Making?

1. **Pre-determined Cost -** Cost which is computed in advance before production start on some scientific basis of all factors e.g. standard cost of material. May be std cost or estimated cost.
2. **Standard Cost -** A pre-determined cost, which is calculated from managements 'expected standard of efficient operation' e.g. e.g. cost of standard material to be consumed.
3. **Marginal Cost –** It is sum of direct material, direct labour, direct expenses and variable overhead.
4. **Estimated Cost –** A pre-determined cost which is computed in advance before the production start on some scientific basis of past actual costs adjusted with anticipated future changes.
5. **Differential Cost -** Increase or decrease in total cost (variable as well as fixed) due to change in activity level, technology, process or method of production.
6. **Imputed Costs -** Notional costs which do not involve any cash outlay. Interest on own capital.
7. **Capitalised Costs -** Costs which are initially recorded as assets & subsequently treated as exp.
8. **Product Costs –** Costs which are charged to products or services. Variable manufacturing cost under marginal costing technique and manufacturing costs (variable and fixed) under absorption costing technique are products costs.
9. **Opportunity Cost –** Cost of next best alternative. This cost refers to the value of sacrifice made or benefit of opportunity foregone in accepting an alternative course of action.
10. **Out-of-pocket Cost -** Cost which involves cash outflow e.g. wages of workers.

11. **Shut down Costs -** Costs which continue to be incurred even when a plant is temporarily shut down *e.g.* rent of building.
12. **Sunk Costs -** Historical costs incurred in the past are known as sunk costs. They play no role in decision making in the current period.
13. **Discretionary Costs –** Costs which can be avoided /reduced by managerial decisions e.g. advertising, research and development etc.
14. **Period Costs -** Costs which are not charged to the products but are charged as expenses against the revenue of the period in which they are incurred.
15. **Explicit Costs -** Costs which require immediate cash payment e.g. when materials are purchased, labour are employed. These are required to be paid instantly in cash
16. **Implicit Costs -** Costs do not involve any immediate cash payment e.g. depreciation of machine.

Question *Define Explicit costs. How is it different from implicit costs?*

Answer: Explicit costs: These costs are also known as out of pocket costs. They refer to those costs which involves immediate payment of cash. Salaries, wages, postage and telegram, interest on loan etc. are some examples of explicit costs because they involve immediate cash payment. These payments are recorded in the books of account and can be easily measured.

Main points of difference: The following are the main points of difference between Explicit and Implicit costs.
1. Implicit costs do not involve any immediate cash payment. They are also known as imputed costs or economic costs.
2. Implicit costs are not recorded in the books of account but yet they are important for certain types of managerial decisions such as relative profitability under two alternative courses of action.

Question Distinguish between Marginal Costing and Differential Costing?

Marginal Costing It is defined as the ascertainment of marginal cost by differentiating between fixed and variable costs. It is used to ascertain effect of changes in volume on profit.
Differential Costing is a technique of costing which uses differential costs and differential revenues for ascertaining the acceptability of an alternative.
The technique is termed as incremental costing when the difference between costs is increase in costs. The technique is termed as decremental costing when the difference between costs is decrease in costs. The main points of distinction between marginal costing and differential costing are as below:

1. The technique of marginal costing requires a clear distinction between variable costs and fixed costs whereas no such distinction is made in the case of differential costing.
2. In marginal costing, contribution ratio is the main yard stick for performance evaluation and for decision making whereas under differential costing, differential costs are compared with the incremental or decremental revenue for choosing an alternative.
3. Differential cost analysis is possible in both absorption costing and marginal costing whereas marginal costing in itself is a different technique.
4. Marginal costs are incorporated in the cost accounting whereas differential costs are worked out separately.

Question Explain Profit centres and investment centres? OR Define Responsibility centre?
Responsibility Centre :- it is a unit of function of the organisation under the control of a manager who has direct responsibility for its performance. Responsibility centre are classified into following 5 categories:-
1. <u>Cost centre</u>:- it is a responsibility centre for which costs are accumulated. The main objective of cost centre is to minimise the costs of centre.

2. Revenue Centre:- it is a responsibility centre for which revenues are accumulated. The main objective of revenue centre is to maximise revenue of the centre.
3. Profit centre:- it is a responsibility centre for which both revenues and costs are accumulated. The main objective of this centre is to maximise profit of the centre.
4. Contribution Centre:- it is a responsibility centre for which both revenues and variable costs are accumulated. The main objective of this centre is to maximise contribution of the centre.
5. Investment centre:- it is a responsibility centre for which costs, revenues and investment in assets are accumulated. The main objective of this centre is to maximise return on capital employed or return on investment of the centre.

Question State the method of costing and the suggestive unit of cost for the following industries

	Industry	**Method of Costing**	**Suggestive Unit of Cost**
(a)	Transport	Operating Costing	Passenger k.m. or tonne k.m.
(b)	Power	Operating Costing	Kilo-watt (kw) hours
(c)	Hotel	Operating Costing	Room day
(d)	Hospital	Operating Costing	Patient-day
(e)	Steel	Process Costing/ Single Costing	Tonne
(f)	Coal	Single Costing	Tonne
(g)	Bicycles	Multiple Costing	Number
(h)	Bridge Construction	Contract Costing	Project/ Unit
(i)	Interior Decoration	Job Costing	Assignment
(j)	Advertising	Job Costing	Assignment
(k)	Furniture	Job Costing	Number
(l)	Brick Works	Single Costing	1000 units/ units
(m)	Oil refining mill	Process Costing	Barrel/ Tonne/ Litre
(n)	Sugar company having its own sugarcane field	Process Costing	Tonne
(o)	Toy Making	Batch Costing	Units
(p)	Cement	Single Costing	Tonne/ per bag
(q)	Radio assembling	Multiple Costing	Units
(r)	Ship Building	Contract Costing	Project/ Unit

Question State the types of cost in the following cases:

(i) Interest paid on own capital not involving any cash outflow - Type of cost - Imputed cost
(ii) Withdrawing money from bank deposit for the purpose of purchasing new machine for expansion purpose – Type of cost - Opportunity cost
(iii) Rent paid for the factory building which is temporarily closed – Type of cost - Shut down cost
(iv) Cost associated with the acquisition and conversion of material into finished product – product cost

Question Identify the methods of costing for the following:

(i) Where all costs are directly charged to a specific job. – **Job costing**
(ii) Where all costs are directly charged to a group of products. --- batch costing
(iii) Where cost is ascertained for a single product. – unit costing / single costing / output costing

(iv) Where the nature of the product is complex and method cannot be ascertain – multiple costing

Question Explain meaning of Digital Costing System and brief benefits of Digital costing system?

Answer: Like the conventional cost accounting system, Digital costing system too collects data, classify the data, account the data to get and process information to make decisions, but the difference is the method of collection, medium of storage, forms of analysis and reporting

Digital Costing System provides data to get the following information:

- (i) Cost incurred on a cost object.
- (ii) Data on time spent.
- (iii) Data on resource consumption.
- (iv) Data on current market price of final product and raw materials.
- (v) Data on lead time and availability of materials.
- (vi) Data on product demand and trend.

Benefits of Digital Costing System

- (i) **Ascertainment of cost** with certainty on a cost object (the cost object is discussed in later paragraph). This helps to analyse the activities for cost allocation and apportionment.
- (ii) Analysis of **data on time spent** on each activity to study and formulate incentive plans.
- (iii) Helps in **material requirement planning and scheduling** the material procurement. Data on resource consumption can be analysed for resource optimisation and finding the possibilities for zero wastage and Just-in Time (JIT).
- (iv) Helps to **identify and eliminate the non-value-added activities**.
- (v) Data on resource consumption is helpful in **setting the standards** and measurement of variances on real time basis.
- (vi) Data on current market prices of material and consumables helps to **estimate cost and setting standards** on Marked to Market (M2M) basis.
- (vii) Extrapolation of data on customer behaviour towards the products to **predict the market demand**. It is helpful is preparation of budgets and planning of production.
- (viii) A better analysis of cost behaviour **improves the cost benefit analysis** and equipping the management in informed decision making.

Material Cost

Question Distinguish between Bill of material and material requisition note?
Answer:-

Bills of Material (BOM)	Material Requisition Note (MRN)
Prepared by **planning** dept.	Prepared by the production dept.
It shows description of all material required for a job along with required quantities.	It is prepared when a single or few items (NOT ALL ITEMS) of materials are required.
it can replace **MRN**.	It cannot replace **BOM**.
It can be used for the purpose of inviting **quotation.**	It can be used in calculating **historical cost** only.
It shows quantity of material to be drawn from stores.(Quantitative Control)	It shows material actually drawn from stores.

Question Distinguish between bin card and stores ledger?

Answer:- Difference between Bin Card & Stores Ledger

Bin Card	Stores Ledger
Maintained by store keeper in store.	Maintained by costing dept.
Contains only quantity of material received, issued & returned.	Contains both quantity and cost of material.
Bin cards are updated instantly with each receipt & issue.	Posting in stores ledger is done at periodic intervals
Each transaction is posted quickly.	Transactions are summarized & posted at intervals.
Inter- dept. transfer not recorded.	Inter- dept. transfer recorded.

Question Write short note on HML, VED, FSN, GOLF, SOS as a technique of inventory control?
Answer:-

1. **HML:** Inventory items are classified as high cost, medium cost & low cost items.
2. **VED:** Inventory items are classified as vital, essential and desirable items under this system.
    - Vital items are important since their unavailability will result in storage of production.
    - Essential items are required for efficient running of production process hence stock must be maintained.
    - Desirable items does not affect production immediately but help in more efficiency and less fatigue.
3. **FSN:** Inventory items are classified as fast moving, slow moving and non-moving items.
4. **GOLF:** Inventory items are classified as Government supply, ordinary supply, local and foreign supply.
5. **SOS:** Inventory items are classified as seasonal and off seasonal items.

Question Explain in detail perpetual inventory control and continuous stock verification along with their advantages?

Answer:- There are 2 inventory systems

1. **Periodic inventory system**:- it is system of calculating quantity and cost of inventory on the basis of actual physical count of all inventory items at the end of accounting period.
2. **Perpetual inventory system**:- it is a system of recording material balances after each receipt and issue of material. **(USE COMPUTER)**

Advantages of perpetual inventory:

(1) **Reconciliation** of physical stocks with book balances.
(2) Preparation of **P&L Account** (for interim period) due to prompt availability of stock figures.
(3) Identification of **stock discrepancies** & instant corrective action to avoid re-occurrence.
(4) Identification of **obsolete and slow-moving materials** to avoid these.
(5) Helpful in **Fixation of the various stock levels**.
(6) **Closure of normal work** for stock taking is not required.
(7) Helps in avoiding **over-stocking & under stocking situation**.

Periodic inventory system	Perpetual inventory system
Quantity & cost of inventory is ascertained on the basis of actual physical cou.	Quantity & cost of inventory is ascertained on the basis of records.**(USE COMPUTER)**
Closing down of work for stock taking is required.	Closing down of work for stock taking is not required.
Simple and less expensive	More expensive
Continuous stock taking is not facilitated.	Continuous stock taking is facilitated.
Quantity & Cost of inventory is directly calculated applying method of valuation of inventories like FIFO, LIFO.	Quantity & Cost of inventory is calculated as residual figure:- Closing inventory = opening inventory + purchases – Cost of material issued
Cost of material issued is calculated as a residual figure:- Cost of materials issued = opening inventory +purchases – closing stock	Cost of material issued is directly calculated by applying the method of valuation of inventories like FIFO, LIFO.

Continuous Stock Verification:-

- Physical stock verification is done for each item of material on **continuous basis**.
- It is comparison of physical stocks with stock records on **continuous basis**.

Advantages of continuous stock-taking:

1. Closure of **normal work** for stock taking is not required.
2. Identification of **stock discrepancies** & instant corrective action to avoid re-occurrence.
3. **Staff of stores** remain active because of surprise check element.
4. **Unnecessary buying** of material is reduced.
5. **Final Accounts** and interim accounts can be prepared quickly (Stock figure available)

Perpetual Inventory system	Continous Stock Taking
It is a system of recording material balances after each receipt and issue of	It is a physical verification of a number of items daily or at frequent intervals.

material.	
It emphasis on recording of book balances.	It emphasis on physical verification of recorded book balances with actual physical balances.

Question Explain use of control ratios as inventory control technique?
Answer:-

1. **Input Output Ratio:**
    - it is the ratio of **quantity of input of material to production and the standard material content of the actual output.**
    - It compares actual consumption and standard consumption of material to check material usage variance.
2. **Inventory Turnover Ratio (ITR)**:
    - High inventory turnover ratio indicates that the material is a fast moving.
    - Low turnover ratio indicates over-investment in inventories of material.

ITR = $\frac{\text{Cost of materials consumed during the period}}{\text{Average stock held during the period}}$

Where Average stock = $\frac{Opening\ stock + closing\ Stock}{2}$

Average No. of days of inventory holding = $\frac{\text{360 Days/12 } Months}{Invetory\ Turnover\ Ratio}$

Question What is material handling cost? How will you deal with it in cost accounts?
Answer:- Material handling cost: Expenses involved in handling of material (In receiving, storing & issuing)

First approach suggests

- Include material handling cost to cost of material by calculating "material handling rate" on the basis of cost of material issued or on the basis of weight of material issued.

Second approach suggests

- Include material handling cost to manufacturing overhead and charge to products on the basis of direct labour hours or machine hours.

Employee Cost & Direct Expenses

Question What are the effects of labour turnover and its associated cost. Suggest remedial steps to minimise labour turnover?

Answer:- Effects of Labour Turnover :-

1. Flow of **production** gets disturbed.
2. **Efficiency** of new & unexperienced workers remains low initially.
3. **Productivity** of new but experienced workers also low in the beginning
4. Increased **training cost**
5. New workers cause increased **wastage of materials**.
6. Increased **recruitment cost**.

Costs associated with LT :-

1. **Preventive costs (PC):** These cost incurred to maintain low LTR e.g. cost of medical services, welfare & pension schemes. High preventive costs helps low LTR.
2. **Replacement costs (RC):** These cost incurred due to high LTR. If employee leave org after acquiring training & experience of good word, then again training cost, recruitment cost incurred to employ other. High Replacement cost incurred if high LTR.

Hence Co. should maintain balance between PC & RC to keep low LTR.

Steps to Minimise Labour Turnover

1. **Exit interview:** To know reasons of resignation.
2. **Job analysis and evaluation:** Carry job analysis & evaluation for each job & then recruit suitable employee.
3. **Scientific system of recruitment, placement and promotion:** defined parameters to recruit new.
4. **Healthy working atmosphere:-** Education & training to workers, settle worker's grievances**.**
5. **Use of committee:** Make committee comprising of management persons & workers to handling workers grievances.

Question Distinguish between Job Evaluation and Merit Rating?

Answer:- Job Evaluation:- Evaluation (rating) of various jobs as per responsibility & skills required for them. (To determine basic wage & salary for a job).

Merit Rating:- Rating (relative worth) of each worker as per performance of each employee.

Job Evaluation	Merit Rating
Evaluation (rating) of various jobs as per responsibility & skills required for them	Rating (relative worth) of each worker as per performance of each employee
It rate job.	It rate job-holder.
To determine basic wage & salary for a job	To determine fair wages for each worker

Question Define Direct Expenses along with examples?

Answer: Expenses other than direct material cost and direct employee cost, which are incurred to manufacture a product or for provision of service and can be directly traced in an economically feasible manner to a cost object. The following costs are examples for direct expenses:

(i) Royalty paid/ payable for production or provision of service;
(ii) Hire charges paid for hiring specific equipment;
(iii) Cost for product/ service specific design or drawing;
(iv) Cost of product/ service specific software;
(v) Other expenses which are directly related with the production of goods or provision of service.

Overheads – Absorption Costing Method

Question Explain departmentalisation of overhead along with its advantages ?

Answer:- Departmentalisation :- Process of allocation & apportionment of overheads to various departments.
All Dept. divided into production Depts & service Depts. Prod. Dept involved in production process while service dept provides services to all production depts. & other service depts.. Departmentalisation of overhead refers to apportionment of overhead between production & service department & then re-apportionment of all service department overheads to production departments.

Advantages of Departmentalisation:

1. **Better Estimation of Expenses***:* Hence better cost control & reduction.
2. **Better Control***:* By comparing actual overhead with budgeted overhead.
3. **Ascertainment of Cost for each department***:* Greater accuracy in ascertaining cost of each job/product.
4. **Valuation of WIP:-** Calculation of correct cost of WIP since WIP is charged with the overheads of only those departments through which it has passed & not the overheads of entire organisation.

Activity Based Costing

Question What are the limitations of **Activity Based Costing?**

LIMITATIONS OF ABC

Activity based costing help managers in decision making. However activity based costing has certain limitations or disadvantages which as are under:

1. Implementing an ABC system requires substantial resources, which is costly to maintain.
2. Activity Based Costing is a complex system which need lot of record for calculations.
3. In small organisation mangers are accustomed to use traditional costing systems to run their operations and traditional costing systems are often used in performance evaluations.
4. Activity based costing data can be easily misinterpreted and must be used with care when used in decision making. Managers must identify which costs are really relevant for the decisions at hand.
5. Reports generated by this systems do not conform to generally accepted accounting principles (GAAP). Consequently, an organization involved in activity based costing should have two cost systems - one for internal use and one for preparing external reports.

Question What is usefulness/Suitability of Activity Based Costing?

Answer: ABC is particularly needed by organisations for product costing in the following situations:

1. **High amount of overhead**: When production overheads are high and form significant costs, ABC is more useful than traditional costing system.
2. **Wide range of products**: ABC is most suitable, when, there is diversity in the product range or there are multiple products.
3. **Presence of non-volume related activities**: When non-volume related activities e.g. material handling, inspection set-up, are present significantly and traditional system cannot be applied, ABC is a superior and better option. ABC will identify non-value-adding activities in the production process that might be a suitable focus for attention or elimination.
4. **Stiff competition**: When the organisation is facing stiff competition and there is an urgent requirement to compute cost accurately and to fix the selling price according to the market situation, ABC is very useful. ABC can also facilitate in reducing cost by identifying non-value-adding activities in the production process that might be a suitable focus for attention or elimination.

Question Explain Activity Based Management?

Answer: Basically when an entity practically uses Activity based costing as a tool to manage its cost then it is termed as Activity Based Management. **The use of ABC as a costing tool to manage costs at activity level is known as Activity Based Management (ABM).**

Question How Activity Based management is useful in the organisations?

Answer: Activity Based Management can be used in the following ways

1) **Cost Reduction**: Help in reducing cost so as to produce in least cost per unit and defeat the competitor with lease pricing policy.
2) **Business Process Re-engineering**: it means making a substantial change in operation of entity to have a drastic improvement e.g. making production machine oriented in spite of earlier labour oriented will help in high quality production
3) **Benchmarking**: It means comparing cost of an activity within its organisation and along with data of competitors so as to improve over cost e.g. comparing cost per unit with another similar organisation.

4) **Performance Measurement**: ABM helps to decide different performance parameters to improve

Area	**Measure**
Quality of purchased component	**Zero defects**
Quality of output	**% yield**
Customer awareness	**Orders; number of complaints**

Cost Sheet

Question Define unit costing, cost sheet?
Answer:-
Unit costing is a form of process costing under which costs are accumulated and analysed under various elements of costs and the cost per unit is ascertained by dividing the total cost by the number of units produced. E.g.Cement industries and Brick-making.
A Cost Sheet is a statement showing various components of total cost of output of a particular product or service produced during a particular period. It may be prepared on actual basis or estimated basis.

Integrated & Non-Integrated Accounts

Question DISTINCTION BETWEEN NON-INTEGRAL SYSTEM AND INTEGRAL SYSTEM?

Basis of Distinction	Non-integral System	Integral System
No. of Sets of Books are maintained	2 separate sets of books - one to record cost trans. & other to record financial trans.	1 set of book - to record both the cost & financial transactions.
Cost Ledger maintained	Yes Maintained	No Maintained
Figure of Profit/ Loss	2 figures of profit/ loss – one as per cost books & other as per financial books.	1 figure of profit/loss because only one set of books is maintained.
Need for Reconciliation	There is need for reconciliation of cost accounts and financial accounts because there are two different figures of profit/loss as there are two sets of books.	There is no need for reconciliation because there is only one figure of profit/loss as there is only one set of books.
Economical	Expensive (Duplication of recording transactions in 2 sets of books)	Economical (Avoids duplication of recording the transactions)

Reconciliation of Cost & Financial Accounts

Question What is the need for reconciliation of Cost and Financial Accounts? State the possible reasons for difference between profits shown by cost accounts and financial accounts?

Answer:- In Non – Integral System where separate sets of books are maintained for costing and financial transactions, the profit shown by one set of books may not agree with that of the other set of books. Hence, the need for reconciliation of profit arises:

1. To identify the reasons for the difference between results of Cost & Financial Accounts.
2. To check the arithmetical accuracy and reliability of both the sets of books.

The various reasons for the difference are given below:-

1. Under or Over absorbed of Overheads:- The overheads absorbed at a pre-determined rate in cost accounts may be different from the actual overheads recorded in financial accounts. The effect of over / under absorption of overheads on profits is shown below:

Particulars	Effect on Profits on Cost Accounts	Effect on Profits on Financial Accounts
1. Over absorption of OH in Cost Accounts	Less Profits	More Profits
2. Under absorption of OH in Cost Accounts	More Profits	Less Profits

2. Different Bases for Valuation of Stocks:- In financial accounts, Stock of Finished Goods is valued at cost *or* market price whichever is lower but in cost accounts, it is valued at cost. The effect of over/under valuation of stock on profits is shown below:

Particulars	Effect on Profits on Cost Accounts	Effect on Profits on Financial Accounts
1. Over valuation of Opening Stock in Cost A/c	Less Profits	More Profits
2. Under valuation of Closing Stock in Cost A/c	Less Profits	More Profits
3. Under valuation of Opening Stock in Cost A/c	More Profits	Less Profits
4. Over valuation of Closing Stock in Cost A/c	More Profits	Less Profits

3. Different Methods of Depreciation:- In financial accounts, (SLM) or (WDV) method may be used but in cost accounts Machine Hour Rate Method is used.

4. Items Included Only in Financial Accounts (Not in cost Accounts)
    1) Incomes e.g. Profit on sale of Fixed Assets.
    2) Expenditures e.g. Loss on sale of Investments, Preliminary expenses W/off
    3) Appropriations e.g. Dividend Distribution Tax, Income Tax
5. Items Included Only in Cost Accounts (Notional Expenses):- (Not in financial accounts) e.g. notional Interest on Capital, Notional Rent on premises owned

Job & Batch Costing

Question Distinguish between job costing and process costing?

Job Costing	Process Costing
Production is special order based	Production is continuous.
Each job is different	Each product is homogenous & standardised.
Cost centre is job.	Cost centre is process.
Cost are ascertained for each job separately.	Cost are ascertained for each process separately.
Job costs are calculated when job is complete.	Process costs are calculated at end of each process.
May or may not be WIP.	Always be WIP.
Usually no transfers from one job to another.	Output of one process is transferred to next process as input.

Process Costing

Question Explain Operation costing? OR "Operation costing is defined as refinement of Process costing." Explain it?

Answer:- Operation Costing: Method under which cost are ascertained for each **operation** involved in manufacturing of goods. It is refinement of process costing. At the end of each operation, the unit operation cost is computed by dividing total operation cost by total output.

Joint Product & By Product

Question Distinguish between Joint products and By-products?

JP	BP
Almost equal value.	Relatively small value.
Produced simultaneously.	Emerge incidentally in manufacturing main product.

Question Discuss briefly methods of apportionment of joint-cost into joint-products ?

Answer:- Methods of Apportioning joint costs over Joint Products

Method	Joint Costs are apportioned on the basis of ----
Physical unit method	Physical volume of JPs at spilt off point (Not suitable when cost has no relation to physical volume of JPs)
Average unit cost	average cost per unit (AC p.u.= $\frac{\text{Total joint Costs}}{\text{Total number of units of joint products}}$) Not Suitable when physical units of JPs are different e.g. one in kg. & other in litre.
Contribution Margin	Segregate Joint cost in fixed & variable. variable portion apportioned on basis of physical volume of products & fixed portion apportioned on basis of contribution margin ratio. Contribution margin = Sales value – Variable costs Contribution margin ratio = $\frac{Contribution\ of\ an\ individual\ product}{Total\ contribution\ of\ all\ products}$ x100
Market Value at time of Separation point method	Market value of JPs at the separation point. Suitable when • All JPs **not** subject to further processing **OR** further processing costs incurred disproportionately
Market Value after further Processing method	Market value of the JPs after further processing. Suitable when • All JPs subject to further processing **OR** further processing costs incurred disproportionately
Net Realisable Value Method	NRV of the JPs at separation point. NRV = Sales value after further processing – further processing costs Suitable when • All JPs subject to further processing **OR** further processing costs incurred disproportionately

Service Costing

Question Difference between service costing and product costing?
Answer: Service Costing vs Product Costing
Service costing differs from product costing (such as job or process costing) in the following ways due to some basic and peculiar nature.

(i) **Tangibility**: Unlike products, services are intangible and cannot be stored, hence, there is no inventory for the services.
(ii) **Cost units**: Use of Composite cost units for cost measurement and to express the volume of outputs
(iii) **Material VS Employee cost**: Unlike a product manufacturing, employee (labour) cost constitutes a major cost element than material cost.
(iv) **Traceability of costs**: Indirect costs like administration overheads are generally have a significant proportion in total cost of a service as unlike manufacturing sector, service sector heavily depends on support services and traceability of costs to a service may not economically feasible.

Question Explain Service Cost unit & Key Performance Indicator (KPI)?
Answer: To compute the Service cost, it is necessary to understand the unit for which the cost is to be computed. All the costs incurred during a period are collected and analyzed and then expressed in terms of a cost per unit of Service.

Service industry	Unit of cost (examples)
Transport Services	Passenger- km., (In public transportation) & Tonne- km. (In goods carriage)
Hospital	Patient per day, room per day or per bed
Canteen	Per item, per meal
Cinema	Per ticket
Hotels	Room Days
Educational Institutes	Per course, per student, per batch, per lecture etc.
Insurance	Per policy

<u>Key Performance Indicator (KPI)</u>

Key Performance Indicators (KPIs) are the quantitative and qualitative factors which are commonly used to assess the performance of an organization which are important to achieve its goal. Like calculation of cost for a cost unit, calculation of cost or revenue per KPI helps to the performance against industry standards.

Industry	KPI	Meaning
Transportation	Number of Shipments	This logistics metric monitors the number of orders that are shipped out of the warehouse
	Truck Turnaround Rate (Truck Turning)	The time from when a delivery truck enters the warehouse to collect or deliver products to when it exits the facility
	Lead Time (Order Cycle Time)	The amount of time in between order placement by customer and receipt of order
	On-Time and In-Full (OTIF)	The number of orders delivered according to the schedule and quantity specified.
Hotel Industry	Cost per Occupied Room (CPOR)	The average cost per occupied room
	Occupancy Rate	The ratio of rented or used rooms to the total amount of available rooms

	Revenue per available room (RevPAR)	The average revenue per available room days
Hospitals/ Health care Industry	Bed Occupancy Rate	The proportion of hospital beds in use at any one time
	Staff-To-Patient Ratio	The number of staff resources present to attend to the patients in a hospital over a certain period of time
	Average Treatment Charge	The average amount that a facility charges a patient for a treatment
IT & ITES sector	Gross Burn Rate	The rate at which the company uses up its available cash to cover operating expenses
	Customer Acquisition Cost (CAC)	The amount it takes to attract new Customers
	Customer Lifetime Value (CLV)	The typical net profit a company generates over the entire life cycle of a single customer
	Monthly Recurring Revenue (MRR)	The amount earned each month through subscription renewals, new sales, upsells, and fluctuations on a monthly basis
	Churn Rate	The percentage of customers that cancel their recurring subscriptions over a given time period
	Cost Per Feature	How much a specific feature costs your business, based on usage and cloud costs
Telecom	Average return per user (ARPU)	How much money a company is making for each person using its service
	Subscriber acquisition cost (SAC)	Costs involved with gaining new subscribers
	Network Operating Cost	Expenditure incurred on continual upkeep to telecom's network
	Gross Revenue Retention (GRR)	How well a company is retaining its customers based on factors such as sales price increases, organic customer growth, and more
Education Sector	Instructional Costs	The cost of part-time and full-time faculty members
	Tuition Costs	Costs accrued by students on a semester or annual basis
	Student-to-Faculty Ratio	The number of students per faculty member, on a campus-wide basis or by department
Insurance Sector	Average Cost Per Claim	The average cost of each claim made
	Components of Claim Costs (CCC)	Costs which are associated with a claim like legal fees, time to settle, administration costs, and report delays.
	Cost Per Quote	The costs that the company incurs in order to get a quote in front of a potential client
	Administrative Costs Per Policy	The cost of the policy administration to number of policies outstanding
	Average Policy Size	The total amount of premium collected by the number of policies issued for a given time period

Question Define Build-Operate-Transfer Approach?

Answer:

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.

The fundamental principle in determining user levy is, 'if the price for a transport facility is set at a level that reflects the benefit, each user gains from improvements in the facility, it will result in traffic flow levels that equate social costs with user benefits.'

Standard Costing

Question Define the process of standard costing?
Answer:
The process of standard cost is as below:
1) **Setting of Standards:** The first step is to set standards which are to be achieved, the process of standard setting is explained below.
2) **Ascertainment of actual costs:** Actual cost for each component of cost is ascertained. Actual costs are ascertained from books of account, material invoices, wage sheet, charge slip etc.
3) **Comparison of actual cost with standard cost:** Actual costs are compared with the standards costs and variances are determined.
4) **Investigate the reasons for variances:** Variances arises are investigated for further action. Based on this, performance is evaluated and appropriate actions are taken.
5) **Disposition of variances:** Variances arise are disposed-off by transferring it the relevant accounts (costing profit and loss account) as per the accounting method (plan) adopted.

Question Describe the types of variances?
1. Controllable Variance = Variance is CV if it can be controlled by depts. of company e.g. Excess use of material is fault of production dept but if this is due to defective material then it is fault of inspection dept.
2. Uncontrollable variance = Variance is UV if it cannot be controlled by depts. of company e.g. increase in market price of material, increase in wage rate in market.
3. Favorable & Adverse variance = When actual cost is less than std cost then difference is known as 'favourable' variance but when actual cost is more than standard cost, difference is known as 'unfavourable', 'adverse' variance. Favourable variance is indicated by (F) & adverse variance by (A).

Question Distinction between Standard costing and Budgetary Control?

Standard Cost	Budgetary Control
Controlled by comparing actual cost with standard cost of actual output.	Controlled by comparing actual figures with budgeted figures of sales, production, capital assets etc.
Narrow scope since it covers only production costs.	Wide scope since it covers all business operations, sales, capital & expenses.
Mainly concerned with calculation & control of each element of cost.	Mainly concerned with overall profitability & financial position of business.
Projection of cost accounts only.	Projections of financial accounts & cost accounts.
It involves detailed variance analysis item by item in respect of each element of cost.	It involves budgeting and control of total expenses and revenues based on estimates.

Marginal Costing

Question Difference between marginal and absorption costing ?

SI No.	Marginal Costing	Absorption Costing
1.Fixed Cost	FC treated as period cost. Profitability of different products is judged by their P/V ratio.	FC treated as product cost. Profitability of different products is derived after reducing share in FC.
2. Variable cost	Only VC is considered for costing product & for inventory valuation.	Both FC & CS considered for costing product & inventory valuation.
3.cost data	Cost data is presented to highlight the contribution of each product.	Cost data is presented to highlight the profit of each product.
4.cost per unit	Cost per unit of production remains same irrespective of production level since it is values at variable cost.	Cost per unit of production reduces as the level of production increases since FC per unit reduces with level of production increases.

Question Explain steps of application of CVP analysis in Decision Making?

Answer:

Step-1: Identification of Problem: Every organisation has its own objectives, and goals are set to achieve these objectives. To reach at the goal, actions are to be taken. For example, if an organisation wants to be a cost leader in the industry it operates in, it has to achieve 3Es in its all activities. 3Es means economy in inputs, efficiency in process and operations and effectiveness in output.

Step- 2: Identification of Options: After identification of problem(s), the next step is identification of options to achieve the goal (to answer the problem). All possible options need to be explored

(a) Purchase of inputs from specialised market- Local vs Import

(b) Make the input in its own factory- Make or Buy

(c) Bulk purchase to avail discount offer- How much to purchase

(d) Make in-house- Make vs Outsource

Step- 3: Evaluation of the Options: After identification of options, each option is to be evaluated against the objective criteria. An entity with objective of making profit may evaluate options on the basis of financial measures like impact of profit or loss, market share, overall impact on profitability, return on investment etc. Non-financial factors like customer satisfaction, impact on existing market/ customer, ethics of decision are also evaluated.

This step is a very important and may be grouped into two tasks

(i) Identification of Cost and Benefits of each option

(ii) Estimation of amount of each option

Step-4: Selection of option: After evaluation of the options, the best option is selected and implemented.

Budgets & Budgetary Control

Question What is zero base budgeting? What are the advantages of zero base budgeting?
Answer:- ZBB means making of budgets without any reference to past budgets & actual figures. Features:-

1. Critically evaluate each budget item whether old or new.
2. Concentration on "**why**" needs to spend (not simply on "**how much**" to spend)
3. Effective utilisation of limited resources like cash & corporate target is superior to individual dept. target.

Advantages

1. Allocation of limited resources in order of priority.
2. Budgets on cost – benefit analysis. No arbitrary cuts or increases in budget items.
3. Link budget to corporate target.
4. Identify and eliminate areas of wasteful expenditure.
5. Implementation of Management by Objectives

Stages in Zero-based Budgeting:

(i) **Identification and description of Decision packages:** Decision packages are the programmes or activities for which decision is required to be taken. The programmes or activities are described for technical specifications, financial impact in the form of cost benefit analysis and other issues like environmental, regulatory, social etc.

(ii) **Evaluation of Decision packages:** Once Decision packages are identified and described, it is evaluated against factors like synchronisation with organisational objectives, availability of funds, regulatory requirement etc.

(iii) **Ranking (Prioritisation) of the Decision packages:** After evaluation of the decision packages, it is ranked on the basis priority of the activities. Because of this prioritization feature **ZBB is also known as Priority-based Budgeting**.

(iv) **Allocation of resources:** After ranking of the decision packages, resources are allocated for decision packages. Budgets are prepared like it is done first time without taking reference to previous budgets.

DISTINCTION BETWEEN TRADITIONAL BUDGETING AND ZERO BASE BUDGETING

Traditional Budgeting / Conventional Budgeting	Zero Base Budgeting
Accounting Oriented. Main stress on previous expenditure level	**Decision Oriented (N**ot consider previous level of expenditure)
Main stress is on **how much** will be spend.	Main stress is on **why** needs to spend.
D**oes not promote** Operating Efficiency.	**Promotes** Operating Efficiency.
It **does not** identify activities involving wasteful exp.	I**dentifies** activities involving wasteful exp.
It **does not** fix any priority.	It **fixes** the priorities.

Question Discuss Fixed and Flexible budget. Briefly state the circumstances in which there arises need for preparation of flexible budget. Distinction between fixed and flexible budgets?
Answer:-
Fixed Budget:- It is a budget designed to remain unchanged irrespective of the level of activity actually obtained.
Flexible budget:- It is a budget which by recognising the difference between fixed, semi – variable and variable costs is designed to change In relation to the level of activity obtained.

The need for preparation of flexible budgets arises in the following circumstances:-

1. In case of industries where there are seasonal fluctuations in sales / production e.g soft drinks industry.

2. In case of company which keeps on doing new changes in design of its products e.g. mobile company.
3. In case of industries engaged in **made-to-order** business like ship building.
4. In case of an industry which is influenced by changes in fashion.
5. In the case of labour intensive industry.

DISTINCTION BETWEEN FIXED BUDGET AND FLEXIBLE BUDGET

FIXED / rigid / inflexible BUDGET	FLEXIBLE BUDGET
Not change with actual volume of activity.	Changes on the basis of activity level to be achieved.
It operates on one level of activity & assumes no change in the prevailing conditions.	It operates on various activity levels.
Since all costs like – fixed, variable and semi - variable are related to only one level of activity, variance analysis does not give useful information.	Here analysis of variance provides useful information as each cost is analysed according to its behaviour.
Comparison of actual performance with budgeted targets will be meaningless specially when there is a difference between the two activity levels.	It provides a meaningful basis of comparison of the actual performance with the budgeted targets.

Question Define Feedback and Feed-Forward Control?

Answer: Feedback control is a reactive process. It means taking corrective action after the error has taken place. However in some situations, it is possible to measure the error before the error has taken place. The possible effect of error is thereby reduced by measuring it & generating a control signals that counteracts it. This way of controlling the errors is called feed-forward control.

Under feed-forward control, control actions are taken based on forecast results. If forecast about results is bad, control action is taken in advance even before actual results happens.

Feedback control is also called “Post action control” and Feed-forward control is also called “Preventive control”

Example – Hospital use “thermostat” to maintain temperature of “Baby ICU”.

Under feedback control system, “Thermostat” will measure temperature in ICU. When the temperature falls below a minimum set temperature then thermostat will itself activates the furnace to warm the ICU back.

Under feed forward control system, “thermostat” might measure external and internal temperature. it will focus on weather conditions that affect temperature such as open windows etc. if the thermostat senses that it is cold outside and someone opens the window then it will pro-actively turn on the furnace to maintain temperature in ICU.

Question Define performance budgeting?

Answer:

Performance budgeting (PB) involves evaluation of the performance of an organisation in the context of both specific as well as overall objectives of the organisation. This requires complete clarity about both the short-term as well as Long term organisational objectives. The responsibility of the various levels of management should be predetermined in terms of results expected from them and the authority vested in them. In other words, 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.

Performance Budgeting provide a meaningful relationship between estimated inputs and expected outputs as an integral part of the budgeting system. **A performance budget is one which presents the purposes and objectives for which funds are required,** the costs of the programmes proposed for achieving those objectives, and quantitative data measuring the accomplishments and work performed under each programme. Thus, PB is a technique of presenting budgets for costs and revenues in terms of functions. Programmes and activities are correlating the physical and financial aspect of the individual items comprising the budget.

Traditional Budgeting vs. Performance Budgeting

- The traditional budgeting gives more emphasis on the financial aspect than the physical aspects or performance. PB aims at establishing a relationship between the inputs and the outputs.
- Traditional budgets are generally prepared with the main basis towards the objects or items of expenditure i.e., it highlights the items of expenditure, namely, salaries, stores and materials, rates, rents and taxes and so on. In the PB emphasis is more on the functions of the organisation, the programmes to discharge this function and the activities which will be involved in undertaking these programmes.

Steps in Performance Budgeting

According to the Administrative Reforms Commission (ARC, the following steps are the basic ones in PB:

- Establishing a meaningful functional programme and activity classification of government operations.
- Bring the system of accounting and financial management in accordance with this classification.
- Evolving suitable norms, yardsticks, work units of performance and units costs, wherever possible under each programme and activity for their reporting and evaluation.