Paper – 8: Cost & Management Accounting

Time Allowed: 3 Hours **Full Marks: 100**

Question No 1 is Compulsory. Answers any five Questions from the rest.
Working Notes should form part of the answer.

Question.1

(a) Match the statement in Column I with appropriate statement in Column II [1x5]

Column I	Column II
(i) Differential cost analysis	(A) ABC analysis
(ii) JIT System	(B) Cost Control
(iii) Standard Costing	(C) Considers cost by behavior
(iv) Flexible budget	(D) Decision Making
(v) Pareto distribution	(E) Inventory Management

(b) State whether the following statements are TRUE or FALSE: [1x5]

(i) The stock turnover ratio indicates the slow moving stocks.
(ii) The flux rate method of labour turnover considers employees replaced.
(iii) An automobile service unit uses batch costing.
(iv) The marginal costing method conforms with the accounting standards
(v) An increase in variable cost reduces contribution

(c) Fill in the blanks: [1x5]

(i) The cost of abnormal waste should be excluded from the total cost and charged to …….

(ii) Under ABC System, the aggregate of closely related tasks is called ……

(iii) In ……contract with escalation clause, the contractor can claim for increase in prices of inputs to the agreed extent.

(iv) …… arises when the actual process loss is less than the normal predetermined process loss.

(v) In accounting of joint products under market value method, joint costs will be apportioned to the products in the ratio of …… of the respective individual products.

(d) In the following cases, one out of four answers is correct. You are required to indicate the correct answer (= 1 mark) and give workings (=1 mark): [2x5=10]

(i) In a manufacturing company, the production passes through four processes – A, B, C & D sequentially and the output of each process is the input of the subsequent process. The following is the loss of the four processes :

A - 12%
B - 14%
C - 16%

D - 15%

The output in process D is 6,754.44 kg., the input of process A is

(A) 12,500 kgs.
(B) 11,400 kgs.
(C) 10,475 kgs.
(D) 12,800 kgs.

(ii) Budgeted sales for the next year is 5,00,000 units. Desired ending finished goods inventory is 1,50,000 units and equivalent units in ending W-I-P inventory is 60,000 units. The opening finished goods inventory for the next year is 80,000 units, with 50,000 equivalent units in beginning W-I-P inventory. How many equivalent units should be produced

(A) 5,80,000
(B) 5,50,000
(C) 5,00,000
(D) 5,75,000

(iii) A Company maintains a margin of safety of 25% on its current sales and earns a profit of ₹ 30 lakhs per annum. If the Company has a p/v ratio of 40%, its current sales amount to

(A) ₹ 200 lakhs
(B) ₹ 300 lakhs
(C) ₹ 325 lakhs
(D) None of the above

(iv) A company is currently operating at 80% capacity level. The production under normal capacity level is 1,50,000 units. The variable cost per unit is ₹ 14 and the total fixed costs are ₹ 8,00,000. If the company wants to earn a profit of ₹ 4,00,000, then the price of the product per unit should be……..

(A) ₹ 37.50
(B) ₹ 38.25
(C) ₹ 24.00
(D) ₹ 36.00

(v) Normal rate per hour for worker A in a factory is ₹ 5.40. Standard time per unit for the worker is one unit. Normal piece rate per unit for the worker is

(A) ₹ 0.90
(B) ₹ 0.09
(C) ₹ 0.11
(D) None of the above

Answer:

(a)

(i) -(D)
(ii) -(E)
(iii) -(B)
(iv) -(C)
(v) -(A)

(b)

(i) True
(ii) False

(iii) False
(iv) False
(v) True

(c)

(i) Costing profit and loss account.
(ii) Activity.
(iii) Fixed price.
(iv) Abnormal gain.
(v) Sale price.

(d)

(i) (A) 12,500 Kgs.

The input in process A = 6,754.44 / (0.88 x 0.86 x 0.84 x 0.85)
= 12,500 kgs.

(ii) (A) 5,80,000

Using production related budgets, units to produce equals budgeted sales + desired ending finished goods inventory + desired equivalent units in ending W-I-P inventory – beginning finished goods inventory – equivalent units in beginning W-I-P inventory. Therefore, in this case, units to produce is equal to 5,00,000 + 1,50,000 + 60,000 – 80,000 – 50,000 = 5,80,000.

(iii) (B) ₹ 300 lakhs

Margin of safety=Profit/p/v ratio=30/.40= ₹ 75 lakhs
Or, 0.25 of sales= ₹ 75 lakhs
Hence, sales=75 /0.25= ₹ 300 lakhs

(iv) (C) ₹ 24.00

Total fixed cost	-	₹ 8,00,000
Expected profit	-	₹ 4,00,000
Variable cost at 80% level (80% x 1,50,000 units x ₹ 14)	-	₹ 16,80,000
Total price	-	₹ 28,80,000

Per unit price at 80% level = (₹ 28,80,000 / 1,20,000 units) = ₹ 24.00.

(v) (B) ₹ 0.09

Rate per hour=₹ 5.40 per hour
Rate per minute=₹ 5.40/60
=₹ 0.09 per minute

Question.2

(a) The finishing shop of a company employs 50 direct workers Each worker is paid ₹ 300 as wages per week of 40 hours When necessary, overtime is worked up to a maximum of 15 hours per week per worker at time rate plus one-half as premium. The current output on an average is 6 units per man hour which may be regarded as standard output. If bonus scheme is introduced, it is expected that the output will increase to 8 units per man hour.

The company is considering introduction of either Halsey Scheme or Rowan Scheme of Wage Incentive system. The budgeted weekly output is 15,000 units. The selling price is ₹ 8 per unit and the direct Material Cost is ₹ 5 per unit. The variable overheads amount to ₹ 0.40 per direct labour hour and the fixed overhead is ₹ 6,000 per week. Prepare a Statement to show the effect on the Company's weekly Profit of the proposal to introduce (a) Halsey Scheme, and (b) Rowan Scheme [5+5=10]

Answer:

Working notes:

1. Total available hours per week 2,000
   (50 workers × 40 hours)
2. Total standard hours required to produce 15,000 units 2,500
   (15,000 units/6 units per hour)
3. Total labour hours required 1,875
   Introduction of bonus scheme to produce 15,000 units
   (15,000 units / 8 units per man hour)
4. Time saved in hours for incentive system 625
   (2,500 hours – 1,875 hours)
5. Overtime worked 500
   i. (2,500 – 2,000)
6. Wage rate per hour (₹) 7.50
   (₹ 300/40 hours)
7. Bonus:

(a) Halsey Scheme $= \frac{1}{2}$ × Time saved × Wage rate per hour

$= \frac{1}{2}$ x 625 hours x ₹ 7.5 = ₹ 2,344

(b) Rowan Scheme $= \frac{\text{Time saved}}{\text{Time allowed}}$ × Time taken × Wage rate per hour

$= \frac{625 \text{ hrs}}{2{,}500 \text{ hrs}} \times 1875 \text{ hrs} \times ₹7.50$

= ₹ 3,516

Statement showing the effect on the Company's Weekly Present profit by the introduction of Halsey & Rowan schemes

	Present ₹	Halsey ₹	Rowan ₹
Sales revenue: (A) (15,000 units × ₹ 8)	1,20,000	1,20,000	1,20,000
Direct material cost (15,000 units × ₹ 5)	75,000	75,000	75,000
Direct wages (Refer to working notes 2 & 3)	18,750 (2,500 hrs × ₹ 7.5)	14,063 (1,875 hrs × ₹ 7.5)	14,063 (1,875 h₹ ×₹ 7.5)
Overtime premium	2,500 (500 h₹ × ₹ 5)	-	-
Bonus (Refer to working notes 7 (a) & (b))	-	2,344	3,516
Variable overheads	1,000 (2,500 h₹ × 0.40 P)	750 (1,875 h₹ × 0.40 P)	750 (1,875 h₹ × 0.40 P)

Fixed overheads	6,000	6,000	6,000
Total cost: (B)	1,03,250	98,157	99,330
Profit: {(A)- (B)}	16,750	21,843	20,670

From the above, it can be shown that the profit increased by ₹ (21,843 – 16,750) = ₹ 5,093 in Halsey scheme and by ₹ (20,670 – 16,750) = ₹ 3,920 in case of Rowan scheme.

(b) What are the advantages of integrated accounting? [5]

Answer:

Advantages of Integrated Accounting:

Integrated Accounting is the name given to a system of accounting whereby cost and financial accounts are kept in the same set of books. Such a system will have to afford full information required for Costing as well as for Financial Accounts. In other words, information and data should be recorded in such a way so as to enable the firm to ascertain the cost (together with the necessary analysis) of each product, job, process, operation or any other identifiable activity. For instance, purchases are analysed by nature of material and its end-use. Purchase Account is eliminated and direct postings are made to Stores Control Account, Work-in-Progress Account, or Overhead Account. Payroll is straightway analysed into direct labour and overheads. It also ensures the ascertainment of marginal cost, variances, abnormal losses and gains. In fact all information that management requires from a system of Costing for doing its work properly is made available. The integrated accounts give full information in such a manner so that the profit and loss account and the balance sheet can be prepared according to the requirements of law and the management maintains full control over the liabilities and assets of its business.

The main advantages of Integrated Accounting are as follows:

(i) Since there is one set of accounts, thus there is one figure of profit. Hence the question of reconciliation of costing profit and financial profit does not arise.

(ii) There is no duplication of recording of entries and efforts to maintain separate set of books.

(iii) Costing data are available from books of original entry and hence no delay is caused in obtaining information.

(iv) The operation of the system is facilitated with the use of mechanized accounting.

(v) Centralization of accounting function results in economy.

Question.3

(a) A company runs a hotel. For this purpose, it has hired a building at a rent of ₹ 12,000 per month along with 5% of total taking. It has three types of suites for its customers, viz., Normal, Executive and Luxury.

Following information is given:

Type of suite	Number	Occupancy percentage
Normal	**90**	**100%**
Executive	**60**	**80%**
Luxury	**25**	**60%**

The rent of Executive suite is to be fixed at twice of the Normal suite and that of Luxury suite as 2.5 times of the Executive suite.

The other expenses for the year 2013 are as follows:

	₹
Staff salaries	**11,40,000**

Room attendants' wages	**3,60,000**
Lighting, heating and power	**1,72,000**
Repairs and renovation	**98,800**
Laundry charges	**64,400**
Interior decoration	**59,200**
Sundries	**1,22,400**

Provide profit @ 25% on total taking and assume 365 days in a year.
You are required to calculate the rent to be charged for each type of suite. **[10]**

Answer:

(i)

Nature of suite	Total equivalent single room suites Occupancy	Equivalent Normal suites
Normal suites	90 × 365 × 100% = 32,850	32,850 × 1 = 32,850
Executive suites	60 × 365 × 80% = 17,520	17,520 × 2 = 35,040
Luxury suites	25 × 365 × 60% = 5,475	5,475 × 5 = 27,375
		Total 95,265

(ii) Statement of total cost:

	₹
Staff salaries	11,40,000
Room attendants' wages	3,60,000
Lighting, heating and power	1,72,000
Repairs and renovation	98,800
Laundry charges	64,400
Interior decoration	59,200
Sundries	1,22,400
	20,16,800
Building rent 12,000 × 12 + 5% on total taking	1,44,000
	+ 5% on takings
Total cost	21,60,800 + 5% on total takings

Profit is 25% of total takings
∴ Total takings = ₹ 21,60,800 + 30% of total takings
Let x be rent for Normal suite
Then 95,265 x = 21,60,800 + 30% of (95,265 x)
or 95,265 x = 21,60,800 + 28,580 x
or 66,685 x = 21,60,800
or x = 32.40

(iii) Rent to be charged for Normal suite = ₹ 32.40
Rent for Executive suites ₹ 32.40 × 2 = ₹ 64.80
Rent for Luxury suites ₹ 32.40 × 5 = ₹ 162.00

(b) What do you understand by Batch Costing? In which industries it is applied? **[2+3]**

Answer:

Batch Costing: It is a form of job costing. In this, the cost of a group of products is ascertained. The unit of cost is a batch or a group of identical products instead of a

single job, order or contract. Separate cost sheets are maintained for each batch of products by assigning a batch number. The cost per unit is ascertained by dividing the total cost of a batch by the number of items produced in that batch.

Batch costing is employed by companies manufacturing in batches. It is used by readymade garment factories for ascertaining the cost of each batch of cloths made by them. Pharmaceutical or drug industries, electronic component manufacturing units, radio manufacturing units too use this method of costing for ascertaining the cost of their product.

Question.4

(a) What is the difference between Contribution and Profit? [4]

Answer:

Difference between Contribution and Profit

Contribution	Profit
1. It includes fixed cost and profit.	1. It does not include fixed cost.
2. Marginal Costing technique uses the concept of contribution.	2. Profit is the accounting concept to determine profit or loss of a business concern.
3. At break-even point, contribution equals to Fixed cost.	3. Only the sales in excess or break-even points results in profit.
4. Contribution concept is used in managerial decision making.	4. Profit is computed to determine the profitability of product and the concern.

(b) ABC Ltd. has to spent ₹ 75,000 on a research project and it expects that when completed in a further year the results of that research can be sold for ₹ 1,00,000. In trying to decide whether to proceed, the business identifies the additional expenses necessary to complete the research:

Materials: ₹ 30,000. This materials (Already in store and paid for is very toxic and will have to be disposed of in sealed containers at a cost of ₹ 2,500).

Labour: ₹ 20,000. The research project uses highly skilled labour taken from the production department of the company. If they were working on normal production, the company could earn ₹25,000 additional contribution to profit in the next year after paying the skilled labour.

Research staff: ₹ 30,000. The research unit will close down after the project has been completed and voluntary retirement pay has already been agreed at ₹ 12,500.

General overheads: ₹ 20,000. The research unit is apportioned a share of the total fixed costs of the business.

The Management Accountant of the Company has presented the following analysis recommended against continuation, since the analysis that the company would lose ₹ 25,000 more by continuing the project that by abandoning now.

The Managing Director seeks your opinion as the group Management Accountant about the analysis presented by the Management Accountant.

	Abandon now	Complete the project
Sales	**-**	**₹ 1,00,000**
Costs to date	**₹75,000**	**₹ 75,000**

Additional costs :			
Material		**30,000**	
Labour		**20,000**	
Research staff		**30,000**	
Overheads		**20,000**	
Loss in contribution		**25,000**	**2,00,000**
Net loss	**75,000**		**1,00,000**

[11]

Answer.

The analysis presented by the Management Accountant does not speak about his expertise in presenting decision-making data. He has not considered the sunk cost, relevant and irrelevant cost and opportunity cost concepts. The conclusions drawn by the Management Accountant are incorrect due to the following reasons:

(i) The company has already spent ₹ 75,000 on a research project. The company cannot retrieve the amount already spent, if the discontinues the project. It is sunk cost, and irrelevant for decision making.

(ii) The materials worth ₹ 30,000 purchased in the past is still lying in store and it has no substitute use. Thus ₹ 30,000 is again a sunk cost and the same cannot be considered for decision analysis. The amount of ₹ 2,500 spent on disposing it off will have to be taken into consideration.

(iii) If the research project is abandoned, labour cost of ₹ 20,000 is not relevant as the same will be used by production department. If the research project is continued, it is necessary to consider the contribution foregone (opportunity cost of ₹ 25,000) plus ₹ 20,000 labour cost to be paid by research department.

(iv) Salaries of research staff will be saved if the research project is abandoned. This is relevant to this decision. The voluntary retirement pay has already been agreed and it forms part of sunk cost and, therefore, it is irrelevant to this decision analysis.

(v) Apportionment of general overheads to research project is irrelevant as it is a fixed overhead. This cost will continue to be incurred by the production department irrespective of whether the research project is continued or not. The correct analysis is given below :

Statement showing relevant cost of continuing or discontinuing the research project:

	Abandon the project	**Complete the project**
Sale proceeds from research	-	₹ 1,00,000
Relevant costs:		
Disposal cost of material	` 2,500	-
Labour (₹ 25,000 + ₹ 20,000)	-	45,000
Research staff cost	-	30,000
Total cost	2,500	75,000
Profit/ (Loss)	(2,500)	25,000

If the project is abandoned, the company's loss will be ₹ 2,500. However, if the research project is completed, the company will earn a profit of ₹ 25,000. Therefore, company should continue the project.

Question.5

(a) In a factory three products A, B and C are produced from a single process. Each product can be sold at the end of each process or can be further processed

independently to produce separate products, which are marketed under different names X, Y, Z respectively.
Details for a period are given below:

Product	Initial Output (Units)	Sales Price (₹)	Further processing cost (₹)	Rejection rate
A	5,000	24 per unit	14 per unit	-
B	8,000	10 per unit	6 per unit	-
C	10,000	30 per unit	16 per unit	-
X		44 per unit	-	5%
Y		18 per unit	-	10%
Z		48 per unit	-	8%

Initial total process cost 4 lakhs.
Further processing costs are incurred at the commencement of the second stage of operations.
You are required to
(i) Calculate the apportionment of total cost of products A,B and C using sales value,
(ii) State whether further process should be undertaken for each product or not.
[2+3=5]

Answer:

Apportionment of Joint Costs on the Basis of Sales Value

Particulars	A	B	C
Sales value	(5,000x24)=1,20,000	(8,000x10)=80,000	(10,000x30)=3,00,000
Joint costs in the Ratio of sales value i.e. 6:4:15	96,000	64,000	2,40,000
Joint cost per unit	19.20	8	24

Income statement

Particulars	A	B	C	X	Y	Z
Sales price per unit	24	10	30	44	18	48
Less: Joint cost per unit	19.20	8	24	19.20	8	24
	4.80	2	6			
Less: further cost per unit	-	-	-	14	6	16
Profit per unit	4.80	2	6	10.80	4	8

Since, the profit per unit is higher in X, Y, Z so, the products A, B, C shall be further processes into X, Y, Z.

(b) List the essential of Inter Firm Comparison. [5]

Answer:

1. Centre for Inter Firm Comparison is a centre which is essentially for the collection and analysis of data received from member units.
The function of such a centre are:
(a) Collection of data and information from the participating firms.
(b) Dissemination of results to the firms
(c) Conducting research and development activities for the benefit of the members
(d) Organizing training programmes
(e) Publishing trade magazines

2. Grant of membership-Firms of different sizes should be given membership to participate in the functions of the centre entrusted with the task of carrying out inter firm comparison.
3. Nature of information- The information generally collected for inter firm comparison is:
   (a) Information regarding cost and cost structures.
   (b) Liquidity of the organization.
   (c) Stock of raw material, wastage of materials, etc.
   (d) Labour efficiency and labour utilization
   (e) Methods of production and technical aspects.
   (f) Machine utilization and machine efficiency.
   (g) Capital employed and return on capital.
   (h) Reserve and appropriation of profit.
   (i) Creditors and debtor
   (j) Raw material consumption.
4. Method of collection and presentation of information
   (a) Information is collected at fixed intervals, usually at the end, in a prescribed form.
   (b) Replies to the questionnaire sent to each member provide useful information.
   (c) The information is generally in the form of ratios and not in absolute figures.
   (d) The information thus collected is stored and presented in a report form.
   (e) Such reports are not made available to non-member

(c) DEF Ltd is tendering for a six months contract which would require the use of specialized machine. The Machine was purchased 4 years ago for ₹ 90000 whose net book value as on date is ₹ 35000. The Company was about to sell the Machine for ₹ 40000 but if it is used in the given contract, it may be sold after 6 months for ₹ 25000. The variable operating cost of the machine for 6 months would be ₹ 45000. Identify the relevant cost of using the machine on contract. (Ignore interest costs.) [2]

Answer:

Relevant Cost of operating the Machine on contract for six months:

Variable operating costs	₹45000
Reduction in realizable Value during use(₹ 40000-₹ 25000)	₹15000
Total relevant cost	**₹60000**

Note: The original cost of ₹ 90000 and Net Book Value are irrelevant Sunk Costs.

(d) Fixed Costs are irrelevant in decision making. List out the exceptions. [3]

Answer:

In the following circumstances, Fixed Costs become relevant in decision making:

(i) Fixed Costs are specifically incurred for any Contract;
(ii) When Fixed costs are incremental in nature;
(iii) When fixed portion of semi variable costs increases due to change in level of activity consequent to acceptance of a contract;
(iv) When Fixed Costs are avoidable or discretionary;
(v) When Fixed cost are such that one cost is incurred in lieu of the another.

Question.6

(a) Write short note on 'Cost centre' and 'Cost unit'. [5]

Answer:

CIMA defines Cost Centre as "a production or service, function, activity or item of equipment whose costs may be attributed to cost units. A cost centre is the smallest organisational sub-unit for which separate cost allocation is attempted". A cost centre is

an individual activity or group of similar activities for which costs are accumulated. For example in production departments, a machine or group of machines within a department or a work group is considered as cost centre. Any part of an enterprise to which costs can be charged is called as 'cost centre'.
A cost centre can be:
(i) Geographical i.e. an area such as production department, stores, sales area.
(ii) An item of equipment e.g. a lathe, forklift, truck or delivery vehicle.
(iii) A person e.g. a sales person.

CIMA defines Cost Unit as "a quantitative unit of product or service in relation to which costs are ascertained". A 'cost unit' is a unit of product or unit of service to which costs are ascertained by means of allocation, apportionment and absorption. It is a unit of quantity of product, service or time or a combination of these in relation to which costs are expressed or ascertained. For example, specific job, contract, unit of product like fabrication job, road construction contract, an automobile truck, a table, 1000 bricks etc. The cost units which pass through the cost centre, the direct and indirect costs of the cost centre are charged to the units of production by means of an absorption rate. The unit of output in relation to which cost incurred by a cost centre is expressed is called 'cost unit'. Cost units can be developed for all kinds of organizations, whether manufacturing, commercial or public utility services.

(b) The cost sheet of a company based on a budget volume of sales of 4,00,000 units per quarter is as under :

	(₹ Per unit)
Direct materials	**6.00**
Direct wages	**3.00**
Factory overheads (50% fixed)	**8.00**
S/ Adm. Overheads (1/3 variable)	**4.50**
Selling price	**24.00**

When the budget was discussed it was felt that the company would be able to achieve only a volume of 3,00,000 units of production and sales per quarter. The company therefore decided that an aggressive sales promotion campaign should be launched to achieve the following improved operations:

Proposal I:
- **Sell 5,00,000 units per quarter by spending ₹ 2,50,000 on advertising.**
- **The factory fixed costs will increase by ₹ 4,00,000 per quarter.**

Proposal II :
Sell 6,00,000 units per quarter subject to the following conditions :
- **An overall price reduction of ₹ 2 per unit is allowed on all sales.**
- **Variable selling and administration costs will increase by 6%.**
- **Direct material costs will be reduced by 1.5% due to purchase price discounts.**
- **The fixed factory costs will increase by ₹ 2,50,000 more.**

You are required to prepare a Flexible Budget at 3,00,000, 5,00,000 and 6,00,000 units of output per quarter and calculate the profit at each of the above levels of output.

[10]

Answer:

Flexible budget for the quarter ended…… **₹**

Units produced and sold	**3,00,000**	**5,00,000**	**6,00,000**
Sales revenue (3,00,000 x ₹ 24); (5,00,000 x ₹ 24); (6,00,000 x ₹ 22)	72,00,000	1,20,00,000	1,32,00,000

(a)			
Variable costs :			
Direct materials (3,00,000 x ₹ 6); (5,00,000 x ₹ 6); (6,00,000 x₹ 5.91)	18,00,000	30,00,000	35,46,000
Direct labour (@ ₹ 3 per unit)	9,00,000	15,00,000	18,00,000
Factory overheads (@ ₹ 4 per unit)	12,00,000	20,00,000	24,00,000
Selling and Administration overheads (3,00,000 x ₹ 1.5); (5,00,000 x ₹1.5); (6,00,000 x ₹ 1.59)	4,50,000	7,50,0000	9,54,000
Total variable costs (b)	43,50,000	72,50,000	87,00,000
Contribution (c) = (a) – (b)	28,50,000	47,50,000	45,00,000
Fixed costs :			
Factory overhead	16,00,000	16,00,000	16,00,000
Selling and administration overheads	12,00,000	12,00,000	12,00,000
Increase in fixed factory costs	-	4,00,000	6,50,000
Advertisement costs	-	2,50,000	-
Total fixed costs (d)	28,00,000	34,50,000	34,50,000
Profit (c) – (d)	50,000	13,00,000	10,50,000

Question.7

(a) Gain More Ltd. Showed a net loss of ₹ 6,30,000 as per the Financial Accounts for the year ended 31st March, 2013. The Cost Accounts however disclosed of ₹ 5,00,000 loss for the same period. On Security of two accounts the following are available:

	₹
Factory overheads under-recovered	**70,000**
Administration overheads over-recovered	**30,000**
Depreciation charged to financial accounts	**1,50,000**
Depreciation charged in cost accounts	**1,20,000**
Interest on investment not included in cost accounts	**30,000**
Income tax provided in financial accounts	**1,00,000**
Stores adjustments (credit in financial accounts)	**10,000**

You are required to prepare Memorandum Reconciliation Account for the year ended 31st March, 2013. [4]

Answer:

Gain More Ltd.
Memorandum Reconciliation Account
for the year ended 31st March, 2013

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Loss as per Financial Accounts	6,30,000	By Factory overhead under recovered	70,000
To Administrative Overhead over-recovered	30,000	By Depreciation under charged in Cost Accounts	30,000
To Interest on investment not included in cost Accounts	30,000	By Provision for income tax not taken in Cost Accounts	1,00,000
To Store adjustments credit in financial accounts	10,000	By Balance c/d (net loss as per Cost Accounts)	5,00,000
	7,00,000		7,00,000

(b) From the following details, prepare Store Ledger under Simple Average Method of pricing the issues.

January 2013
1st: Received 500 units @₹20 per unit
10th: Received 300 units @₹24 per unit
15th: Issued 700 units
20th: Received 400 units @₹28 per unit
25th: Issue 300 units
27th: Received 500 units @₹22 per unit
31st: Issued 300 units. **[4]**

Answer:

Store Ledger

Date	Particulars	Receipts			Issue			Balance	
January		Qty.	Rate	Amount	Qty.	Rate	Amount	Qty.	Amount
1st	Receipts	500	20	10,000				500	10,000
10th	Receipts	300	24	7,200				800	17,200
15th	Issue				700	22*	15,400	100	1,800
20th	Receipts	400	28	11,200				500	13,000
25th	Issue				300	26#	7,800	200	5,200
27th	Receipts	500	22	11,000				700	16,200
31st	Issue				300	25^	7,500	400	8,700

* The rate of issue is computed by taking the simple average of the rates of ₹ 20 and ₹ 24, i.e. ₹ 22

#The rate is computed by taking the simple average of the rates of ₹ 24 and ₹ 28 i.e. ₹ 26. The earlier rate of ₹ 20 is not taken into consideration as the material quantity has been issued and is not there in the stock on 15th January.

^The rate is computed by taking the simple average of the rate of ₹ 28 and ₹ 22, i.e. ₹ 25.

(c) Difference between Cost Accounting and Financial Accounting. **[7]**

Answer:

Financial Accounting	Cost Accounting
1. It aims at finding out results of accounting year in the form of Profit and Loss Account and Balance Sheet.	It aims at computing cost of production/ service in a scientific manner and then cost control and cost reduction.
2. It is more attached with reporting the results and position of business to persons and authorities other than management like government, creditors, inventors, owners etc.	It is an internal reporting system for an organization's own management for decision making.
3. Financial Accounting data is historical in nature.	It not only deals with historical data but is also futuristic in approach.
4. In Financial Accounting, the major emphasis is in cost classification based on type of transactions, e.g. salaries, repairs, insurance, stores etc.	In Cost Accounting, classification is basically on the basis of functions, activities, products, process and on internal planning and control and information needs of the organization.
5. In Financial Accounting, only those transactions are recorded which can be expressed in monetary terms.	Cost Accounting used both monetary as well as quantitative information.
6. It aims at presenting 'true and fair' view of the profit and loss position as well as financial position.	It aims at computing 'true and fair' view of the cost of production/ services offered by the firm.

7. Financial Accounts are subject to statutory audit to verify whether they disclose a true and fair view of the profit and loss as well as financial position.	Cost Accounts are subject cost audit which verifies whether the cost accounts disclose true and fair view of the cost of production of the company.

Question.8 Write Short notes on: any three **[3x5=15]**

(a) Role of costs in pricing
(b) Opportunity cost
(c) Departmental overhead rate
(d) Cost Volume Profit Analysis
(e) Budget Mannual

Answer:

(a) Role of Costs in Pricing:

Cost data constitute the fundamental element in the price setting process. Higher costs including promotional expenses involved in connection with advertising or personal selling as well as taxation may necessitate an upward adjustment of price. If costs go up, price rise can be quite justified. However, their relevance to the pricing decision must neither be under estimated nor exaggerated. No company should charge prices below full costs unless such a policy appears necessary or expedient in the short period. Costs are just one of the several factors to be considered in a pricing decision and for pricing purposes; costs are best regarded as floor below which a company will not normally price its products. Costs determine the profit consequences of the various pricing alternatives. Cost calculations may also help in determining whether the product whose price is determined by its demand is to be included in the product line or not.

Though in the long run, all costs have to be covered for managerial decisions. In the short run direct costs are more relevant. In a single product firm, all costs are direct costs with respect to the product. In multi product firm, for pricing decisions, relevant costs are those costs that are directly traceable to an individual product. In addition, it must contribute to the common costs and to the realization of profit.

(b) Opportunity Cost:

Opportunity cost is the value of a benefit sacrificed in favour of an alternative course of action. It is the maximum amount that could be obtained at any given point of time if a resource was sold or put to the most valuable alternative use that would be practicable. Opportunity cost of good or service is measured in terms of revenue which could have been earned by employing that good or service in some other alternative uses. Opportunity cost can be defined as the revenue foregone by not making the best alternative use.

Opportunity costs represent income foregone by rejecting alternatives. They are, therefore not incorporated into formal accounting systems because they do not incorporate cash receipts or outflows. Opportunity costs are, however, very relevant when examining alternative proposals or projects. When deciding whether or not to allocate capital to a project it is highly desirable to consider if the money could produce a better or worse return if invested elsewhere.

One foregoes the potential benefits of Alternative A if one applied one's resources to Alternative B, and these foregone benefits constitute the opportunity cost of Alternative B.

(c) Departmental overhead rate:

To arrive at the department overhead rates it is necessary to have complete account of overhead expenses. These overhead expenses are either completely assigned to the production and service departments or are apportioned by using suitable basis. This process of distributing overhead expenses between the production and service departments is known as primary distribution.

As the service departments in an organization are meant for rendering service to other Production departments, their expenses are apportioned to the users viz. production departments. This process of apportioning service department expenses to the production departments by using suitable basis is known as secondary distribution.

Thus by using primary and secondary distribution processes, the total overhead expenses are apportioned to the concerned production departments. These total overhead expenses of each production department may be absorbed by using a suitable method of overhead absorption. For example the total overheads of each department may be divided by labour hour, machine hours etc., to arrive at departmental overhead recovery rate.

(d) Cost Volume Profit Analysis:

(i) In order to forecast profit accurately, it is necessary to find out the relationship between cost and profit. It aims at maturing variation in cost with volume. Profit planning considers the project level of output, optimum product combination, estimated revenue, total cost of production and thus based on cost volume profit analysis.

(ii) CVP analysis is used in setting up flexible budget

(iii) CVP analysis helps management in the evaluation of performances for control purpose.

(iv) CVP analysis is helpful in formulating pricing policies

(v) It helps to ascertain the amount of overhead costs that could be charged to product cost at different level of production

(vi) It helps in making short term tactical decisions like shift workings, acceptance of special orders etc.

(e) Budget Mannual:

A Budget Mannual is a document which sets out the responsibilities of the persons engaged in the process of budgetary control. The budget manual thus is a schedule documents or booklet, which contains different forms to be used, procedures to be followed, budgeting organization details, and set of instructions to be followed in the budgeting system. It also list out details of responsibilities of different persons and the managers involved in the process. A typical Budget manual contains the following:-

(i) Objectives and managerial policies of the business concern.

(ii) Internal lines of authorities and responsibilities.

(iii) Functions of budget committee including the role of budget officer