

# INTERMEDIATE EXAMINATION

## GROUP II

(SYLLABUS 2008)

### SUGGESTED ANSWERS TO QUESTIONS

December  
2012

### Paper- 8 : COST & MANAGEMENT ACCOUNTING

Time Allowed : 3 Hours

Full Marks : 100

*The figures in the margin on the right side indicate full marks.*

**Question No. 1 is compulsory and answer any five from the rest.**

1. (a) Match the statement in Column I with the appropriate statement in Column II: [1×5=5]

Column I	Column II
(i) Angle of Incidence	(A) Management by exception
(ii) JIT System	(B) Profitability Rate
(iii) Pareto Distribution	(C) Reverse cost method
(iv) Variance Analysis	(D) ABC Analysis
(v) By-Product Cost Accounting	(E) Control of Inventory

- (b) State whether the following statements are TRUE or FALSE: [1×5=5]

- (i) FIFO method of pricing issues of materials is useful during inflationary period.
- (ii) Future costs are not relevant in making management decisions.
- (iii) Sales Budget is prepared before Production Budget.
- (iv) In process costing, a meaningful distinction is made between direct and indirect materials.
- (v) Value analysis promotes innovation and creativity.

- (c) Fill in the blanks suitably: [1×5=5]

- (i) When P/V ratio is 20% and margin of safety ratio is 30%, profit is \_\_\_\_\_ % of sales.
- (ii) \_\_\_\_\_ costing is a must for meaningful inter-firm comparison.
- (iii) \_\_\_\_\_ costs are the future costs affected by decision taken.
- (iv) In activity based costing, costs are accumulated by \_\_\_\_\_.
- (v) A \_\_\_\_\_ is the notional value at which goods and services are transferred between divisions in a decentralised organization.

- (d) In the following cases, one out of four answers is correct. You are required to indicate the correct answer (= 1 mark) and give brief workings (= 1mark): [2×5=10]

- (i) If the ordering cost per order is ₹ 40, carrying cost is 10% of average inventory value, purchase cost is ₹ 10 per unit and Economic Order Quantity (EOQ) for the product is 800 units; what is the expected annual demand for the product?
- (a) 8,000 units
  - (b) 10,000 units
  - (c) 20,000 units
  - (d) None of the above
- (ii) Depreciation charged in cost accounts is ₹ 12,500 and in financial books is ₹ 11,200. What will be the financial profit/loss, when profit as per cost accounts is ₹ 5,000?
- (a) Profit ₹ 3,700
  - (b) Loss ₹ 3,700
  - (c) Profit ₹ 6,300
  - (d) Loss ₹ 6,300
- (iii) Standard time is 60 hours and guaranteed time rate is ₹ 50 per hour. Under Rowan Plan, what is the amount of wages, if job is completed in 48 hours?
- (a) ₹ 2,480
  - (b) ₹ 2,680
  - (c) ₹ 2,880
  - (d) None of the above
- (iv) A truck capable of carrying 5 tonnes of goods normally carries 80% of the load on the outward journey and 40% of the load on inward journey. The journey is 300 kms for one side. It takes two days to complete the return trip. In a year of 300 days compute the tonnes-km.
- (a) 2,70,000
  - (b) 3,00,000
  - (c) 3,30,000
  - (d) 3,50,000
- (v) Selling price of a product is ₹ 5 per unit, variable cost is ₹ 3 per unit and fixed cost is ₹ 10,000. Then B.E. point in units will be:
- (a) 10,000
  - (b) 5,000
  - (c) 7,500
  - (d) None of the above

**Answer 1.**

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

**(b) (i) False.**

Under FIFO, the cost of goods sold is based upon the cost of material bought earliest in the period,

while the cost of inventory is based upon the cost of material bought later in the year. This results in inventory being valued close to current replacement cost. During periods of inflation, the use of FIFO will result in the lowest estimate of cost of goods sold among the three approaches, and the highest net income. As a result, income tax liability is increased. So, FIFO method of pricing issues of materials is not useful during inflationary period.

**(ii) False.**

Future costs are relevant for making management decisions because they are subject to management control. These costs are relevant in cost control, profit projections, appraisal of capital expenditure, introduction of new products, expansion programmes and pricing etc.

**(iii) True.**

After having established Sales Budget, Production Budget is attempted to show the quantity to be produced for achieving sales targets and keeping sufficient inventories. Budgeted production is equal to projected sales plus closing inventory of finished goods minus opening stock of finished goods. Thus Production Budget is based on Sales Budget.

**(iv) False**

The objective of process costing is to find out the cost of each process by identifying the direct costs with the particular process and apportioning the indirect costs, i.e. overheads to each process on some suitable basis.

**(v) True**

One of the objectives of value analysis or function analysis is to improve value by reducing the cost function relationship of a product which is achieved by eliminating or combining as many secondary functions as possible.

- (c)** (i) 6%  
(ii) Uniform  
(iii) Relevant  
(iv) Cost Pool  
(v) Transfer Price

**(d)** (i) (a) 8,000 units

$$\text{Reason: } 800 = \sqrt{(2 \times A \times 40)} / \sqrt{10\% \text{ of } 10}$$

$$\text{Or, } A = 8,000$$

(ii) (c) Profit ₹ 6,300

$$\text{Reason: } ₹ 5,000 + (12,500 - 11,200) = ₹ 6,300$$

(iii) (c) ₹ 2,880

$$\text{Reason: } (48 \times 50) + (60 - 48) / 60 \times 48 \times 50 = ₹ 2,880$$

(iv) (a) 2,70,000

$$\text{Reason: } (4 \text{ ton} \times 300\text{km} + 2\text{ton} \times 300\text{km}) \times 300/2 = 2,70,000 \text{ tonnes-km.}$$

(v) (b) 5,000

$$\text{Reason: BEP (in units)} = \frac{\text{FC}}{\text{CONT PER UNIT}} = \frac{10,000}{2} = 5,000$$

Here, FC = Fixed cost;

CONT PER UNIT = Contribution per unit = ₹ (5 – 3) = ₹ 2.

- 2 (a) A Sales Manager of a large Retail chain has to travel extensively to visit the various sales outlets. Currently he is hiring an airconditioned car to make the trip at a cost of ₹ 20 per kilometer. The office is considering the following two alternatives:
- to buy a new small car at a cost ₹ 4.50 lakhs, which will be disposed of at a price of ₹ 1 lakh after 5 years;
  - to buy a second hand car at a cost of ₹ 4.50 lakhs, which will be disposed of at a price of ₹ 50,000 after 5 years.

The following further particulars are provided:

	For New Car	For Old Car
Repairs & Servicing per annum	₹ 15,000	₹ 25,000
Taxes and Insurance per annum	₹ 6,000	₹ 3,500
Petrol consumption per litre	15 km	12 km
Petrol/Diesel price per litre	₹ 75	₹ 48

Currently the Sales Manager has to Travel 12,000 km annually, which is likely to increase to 18,000 km annually.

You are required to work out which of the three alternative transport will be most economical if the Sales Manager travels 12,000 km and 18,000 km respectively. [3+3+2+2=10]

- (b) List out at least five types of managerial decisions for which “Differential Cost Analysis” is useful. [5]

**Answer 2.**

**(a) Comparative Cost Statement**

	New Small Car ₹	Second Hand Car ₹
Fixed cost per annum		
Depreciation (i) $\frac{(\text{₹}4.50 - \text{₹}1) \text{ Lakh}}{5 \text{ years}}$	70,000	
(ii) $\frac{(\text{₹}4.50 - \text{₹}0.50) \text{ Lakh}}{5 \text{ years}}$		80,000
Repairs & Servicing	15,000	25,000
Taxes & Insurance	6,000	3,500
	91,000	1,08,500
<b>Variable Cost</b>		
Petrol/Diesel Cost		
(i) $\frac{\text{₹}75}{15} = \text{₹}5 \text{ per Km}$		

(ii)	$\frac{₹ 48}{12} = ₹4 \text{ per Km}$		
For 12000 km		60,000	48,000
For 18,000 km		90,000	72,000
Total cost (i)	for 12,000 km	1,51,000	1,56,500
(ii)	for 18,000 km	1,81,000	1,80,500

For Hired Car (i) for 12,000 km                      2,40,000

(ii) for 18,000 km                                      3,60,000

Hired car is costlier in both cases

For 18,000 km – Second hand car is cheaper

For 12,000 km – New small Car cheaper

(b) Managerial decision of the following type for which differential cost analysis is useful are:

- i. Accept or reject an offer at lower than existing price.
- ii. Submission of a tender.
- iii. Reduce or maintain price.
- iv. Retain or replace a machine.
- v. Processing a product further or not.
- vi. Lease or buy.
- vii. Optimizing investment plan out of several plans.
- viii. Export sales vs. local sales.
- ix. Shut down or continue.

3. (a) XYZ Ltd. manufactures a particular product for which it has the existing capacity to produce 10,000 numbers each month. Currently it produces and sell 7,500 numbers per month at a price of ₹ 150 each.

The following cost information are provided for the month just concluded for 7500 numbers:

	₹
Direct Material	2,25,000
Direct Labour	3,00,000
Variable Costs –set ups, material handling, quality control (150 batches of 50 nos. each x ₹ 500 per batch)	75,000
	6,00,000
Fixed manufacturing costs	2,75,000
Fixed marketing costs	1,25,000
	10,00,000

The company has received a special one-time order for 2,500 numbers of the product at a special price of ₹ 100 each. The company can manufacture the additional quantity of 2,500 numbers in 25 batches of 100 nos. each. You are required to evaluate whether it will be worthwhile for XYZ. Ltd. to accept the

special offer to sell additional 2,500 numbers.

If the capacity of the plant was restricted to 9,000 numbers, will it be advisable to accept the special one-time order for 2,500 number given that the special order must be executed either in full or rejected totally? [4+3+2+1=10]

(b) Discuss the advantages of standard costing system. [5]

**Answer 3.**

**(a) Working Note**

	Current Contribution Margin for 7,500 Nos. ₹	Revised Contribution Margin at 9,000 capacity for 6,500 Nos. (2,500 Special offer + 6,500 = 9,000 nos.) ₹
Sales Revenue @ ₹150/- each	11,25,000	9,75,000
Variable costs :		
Direct material @ ₹30	2,25,000	1,95,000
Direct labour @ ₹40	3,00,000	2,60,000
Setup, Handling, Quality		
150 x ₹ 500	75,000	
130 x ₹ 500		65,000
	6,00,000	5,20,000
Contribution Margin	5,25,000	4,55,000

(i) Acceptance of special order (when capacity is 10000)

Additional Revenue	₹ 2,50,000
(2,500 nos x ₹ 100 each)	
Variable Cost – Material @ ₹ 30	75,000
- Labour @ ₹ 40	1,00,000
- Set up etc 25 x ₹ 500	12,500
	<u>₹ 1,87,500</u>
Additional Contribution	₹ 62,500

As there is additional contribution the company may accept the order

(ii) Acceptance of special order (when capacity is restricted to 9,000)

Gain in contribution margin because of order	₹ 62,500
Loss of contribution margin for reduction in Sale by 1,000 units (₹ 5,25,000 – ₹ 4,55,000)	70,000
Loss	<u>7,500</u>

The special order should not be accepted.

(b) The various advantages of standard costing system are as under:-

- (i) It acts as an yardstick to measure operating performance by comparing the variances and also

assists in controlling cost by taking corrective steps.

- (ii) Prices can be fixed based on standard costs provided there is no wide variation.
- (iii) When standard costing is in operation, estimation of product cost for tendering purpose becomes easy.
- (iv) It aids business planning, budgeting and managerial decision making.
- (v) Standard costing like product pricing can also be used for inventory valuation, estimation of profit.
- (vi) Standard costing helps in achieving standardization of products, operations and processes.
- (vii) Standard Costing facilitates the formulation of production policies for various products by providing predetermined costs of each element of cost on the basis of engineering specifications.
- (viii) It through variance analysis provides a ready means of interpretation of information for the management for the purpose of control and decision making. Ready reporting enhances the value of reports.
- (ix) It facilitates the use of management by Exception principle since the management need to concentrate only on the areas and problems which require its attention through study of variance analysis.
- (x) It facilitates co-ordination between different functions such as purchasing, production, selling, accounting together while fixing standards.

4. (a) Discuss the treatment of overtime wages in Cost Accounts. [5]

(b) New Construction Ltd. is engaged in a contract during the year. Following information is available at the year end.

Particulars	Amount Contract (₹)
Contract price	6,00,000
Material delivered direct to site	1,20,000
Material issued from stores	40,000
Materials returned to stores	4,000
Materials at site at the end of year	22,000
Direct labour payments	1,40,000
Direct expenses	60,000
Architect's fees	2,500
Establishment charges	24,500
Plant installed at cost	80,000
Value of plant at the end of year	65,000
Accrued wages at the end of year	10,000
Accrued expenses at the end of year	6,000
Cost of contract not certified by architect	23,000
Value of contract certified by architect	4,20,000
Cash received from contractor	3,78,000

During the period, materials amounting to ₹ 9,000 have been transferred to another contract to another place.

You are required to show the Contract A/c and Contractee A/c.

[7+3=10]

**Answer 4.**

- (a) The following are the accounting treatment of overtime premium in Cost Accounts:
- If overtime is resorted to at the desire of the customer, then the overtime premium may be charged to the job directly.
  - If overtime is required to cope with general production programme or for meeting urgent orders, the overtime premium should be treated as overhead cost of particular department which works overtime.
  - If overtime worked for account of abnormal conditions should be charged to Costing Profit & Loss Account.
  - If overtime is worked in a department to the fault of another department, the overtime premium should be charged to that other department.
  - If overtime is required regularly as a policy due to the labour shortage, then it should be treated as part of costs and hence charged to job at an inflated wage rate.
  - If overtime is required to increase the output to meet the additional market demand, then it should be treated as production overhead.

(b) Contract Account

Dr.		Cr.	
Particulars	Amount ₹	Particulars	Amount ₹
To Direct Materials delivered to site	1,20,000	By Material Returned to store	4,000
To, Materials issued from store	40,000	By Material transferred to another Contract	9,000
To, Wages paid	1,40,000	By Stock of Material (closing)	22,000
To, Direct Expense	60,000	By, Work certified by architect	4,20,000
To, Depreciation of plant (80,000 - 65,000)	15,000	By, Work not certified by architect	23,000
To, Architect's Fees	2,500		
To, Establishment charges	24,500		
To, Wages accrued	10,000		
To, Direct Expenses accrued	6,000		
To, Notional Profit c/d	60,000		
<b>TOTAL</b>	<b>4,78,000</b>		<b>4,78,000</b>
To, Profit/Loss A/c	36,000	By, Notional Profit b/d	60,000
To, Transfer to Reserve	24,000		
<b>Total</b>	<b>60,000</b>		<b>60,000</b>

$$\text{Degree of completion of contract} = \frac{\text{Work Certified}}{\text{Contract Price}} \times 100 = \frac{4,20,000}{6,00,000} \times 100 = 70\%$$

**Amount of profit to be taken to Profit/Loss A/c**

$\frac{2}{3} \times \text{Notional Profit} \times \text{Cash Received} / \text{work certified}$

$$= \frac{2}{3} \times 60,000 \times 3,78,000 / 4,20,000 = ₹ 36,000$$

As the Contract is 70% Completed  $\frac{2}{3}$  of notional profit is taken into consideration.

Contractee Account

Particulars	Amount ₹	Particulars	Amount ₹
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To value of Work Certified	4,20,000	By Cash Received	3,78,000
		By Balance c/d	42,000
	4,20,000		4,20,000

5. (a) The share of production and the cost-based fair price computed separately for a common product for each of the four companies in the same industry are as follows:

	Company			
	A	B	C	D
Share of Production (%)	40	25	20	15
Costs:				
Direct materials (₹/Unit)	75	90	85	95
Direct Labour (₹/Unit)	50	60	70	80
Depreciation (₹/Unit)	150	100	80	50
Other Overheads (₹/Unit)	150	150	140	120
Total (₹/Unit)	425	400	375	345
Fair Price (₹/Unit)	740	615	550	460
Capital employed per Unit:				
(i) Net Fixed Assets (₹/Unit)	1,500	1,000	800	500
(ii) Working Capital (₹/Unit)	70	75	75	75
Total (₹/Unit)	1,570	1,075	875	575

Required: What should be the uniform price that should be fixed for the common product? [10]

- (b) Distinguish between Indifference Point and Break-Even Point with regard to their (i) Formula, (ii) Definition, and (iii) Purpose. [2+2+1=5]

**Answer 5.**

- (a) Let us assume total production in the industry is 100 units.

Total cost computation (₹)	Return on Capital (₹)	Sales Value (₹)
A) 425 x 40 = 17,000	315 x 40 = 12,600	29,600
B) 400 x 25 = 10,000	215 x 25 = 5,375	15,375
C) 375 x 20 = 7,500	175 x 20 = 3,500	11,000
D) 345 x 15 = 5,175	115 x 15 = 1,725	6,900
<b>39,675</b>	<b>23,200</b>	<b>62,875</b>

Return = (Fair price – Cost)

So, for A = (740 – 425) = ₹ 315, B = ₹ 215, C = ₹ 175 & D = ₹ 115.

These returns are equivalent to 20% on capital.

**Return on Capital employed computation:**

$$A: \frac{(\text{Fair Price} - \text{Cost}) \text{ per unit}}{\text{Total Fixed Cost per unit}} = \frac{740 - 425}{1570} = \frac{315}{1570} = 0.2006 \quad \text{i.e., 20.06\%}$$

$$\begin{aligned}
 \text{B :} & \quad = \frac{615 - 400}{1075} = \frac{215}{1075} = 0.20 & \quad \text{i.e., 20.00\%} \\
 \text{C :} & \quad = \frac{550 - 375}{875} = \frac{175}{875} = 0.20 & \quad \text{i.e., 20.00\%} \\
 \text{D :} & \quad = \frac{460 - 345}{575} = \frac{115}{575} = 0.20 & \quad \text{i.e., 20.00\%}
 \end{aligned}$$

∴ Uniform price for the common product for each of the four companies in industry  
 $= \frac{₹ 62,875}{100} = ₹ 628.75$

(b) (i) **With Regard to Formula:**

$$\text{Indifference point} = \frac{\text{Difference in Fixed Cost}}{\text{Difference in P/V Ratio}}$$

$$\text{Break - even Point} = \frac{\text{Fixed Cost}}{\text{P/V Ratio}}$$

(ii) **With regard to definition:**

Indifference point is the level of sales at which Total Costs and profits of two points are equal.

Break-even Point is the level of sales at which total sales revenue is equal to total costs and there is neither profit nor loss to the firm. At BEP, total contribution equals fixed cost.

(iii) **Purpose:**

Indifference point is used to choose between two alternative options of achieving the same objective – Break-even point is used for profit planning.

6. (a) XYZ Co. Ltd. has two divisions A and B. A sells half of its output on the open market and transfers the rest to Division B. Costs and revenue during 2011 are:

	A (₹)	B (₹)	Total (₹)
Sales	18,000	50,000	68,000
Cost of production in the division	26,000	22,000	<u>48,000</u>
Profit during the period			<u>20,000</u>

There are no opening or closing stocks.

You are required to find out the profit of each division and profit of the company using transfer prices:

- (i) at cost
- (ii) at cost plus 20%
- (iii) at cost plus 20% but there is over spending in Division A by ₹ 4,000. [4+3+3=10]

(b) Job Order Costing method is a Specific Order Costing method.- Explain. [5]

**Answer 6.**

(a) Here  $\frac{1}{2} \times ₹ 26,000 = ₹ 13,000$  (at cost) will be the transfer sale of Division A and transfer cost of

Division B.

(i) Transfer sale at cost:

	Division A ₹		Division B ₹	Total ₹
Outside Sale →	18,000		50,000	68,000
Transfer sale (at cost)	13,000			
	31,000			
Transfer Cost	-----	13,000		
Own Cost	26,000	22,000		48,000
Total Cost	26,000		35,000	
Profit	<b>5,000</b>		<b>15,000</b>	<b>20,000</b>

The transfer sales of A ₹ 13,000 and transfer cost of B ₹ 13,000 cancel each other. The transfer price just spreads the profit of ₹ 20,000 between A and B.

(ii) At actual cost plus a margin of 20%

	Division A ₹		Division B ₹	Total ₹
Outside Sale	18,000		50,000	68,000
Transfer sale (at cost 20%)	15,600		---	---
	33,600		50,000	68,000
Transfer Cost	-----	15,600	---	---
Own Cost	26,000	22,000		48,000
Total Cost	26,000		37,600	
	<b>7,600</b>		<b>12,400</b>	<b>20,000</b>

The effect of this transfer is that profit of Division A has increased by ₹ 2,600 and that of Division B has been decreased by ₹ 2,600.

(iii) At actual cost plus 20% over spending in Division A by ₹ 4,000

	Division A ₹	Division B ₹	Total ₹
Outside Sale	18,000	50,000	68,000
Transfer sale (1.2 x 15,000)	18,000		
	36,000	50,000	68,000
Transfer Cost	18,000		
Own Cost 30,000	22,000		52,000
Total Cost	30,000	40,000	
	<b>6,000</b>	<b>10,000</b>	<b>16,000</b>

The actual cost of DIV A is ₹ 30,000 transfer price of

- I. Division A =  $\frac{1}{2} \times ₹ 30,000 = ₹ (15,000 + 3,000) = ₹ 18,000$
- II. Over spending in Division A reduces the profit by ₹ 4,000 (₹ 1,600 in Division A and ₹ 2,400 in Division B)

(b) Job order costing is defined as the form of specific order costing which applies where work is undertaken on the basis of customer's specific requirement and each order is of comparatively short duration. The work is usually carried out within a factory and moves through processes and operations as a continuously identifiable unit. The term may be applied to work.

The main features of job costing method can be summarized as follows:-

- i. Product is not meant for a mass market.
- ii. Production is undertaken after obtaining customers order.
- iii. Each order is different and suited to the requirement of the customer.
- iv. Job can be identified at each stage of production from start to finish.
- v. Production cycle is usually short but a large order may extend beyond one year.
- vi. Cost information is collected by job order.

7. (a) A Primary School has a total of 150 students consisting of 5 sections with 30 students per section. The school plans for outing around the city during the weekend. A private transport operator has come forward to hire the buses for taking the students. Each bus will have a maximum capacity of 50 (excluding 2 seats reserved for teachers accompanying the students). The school will employ two teachers for each bus, paying them an allowances of ₹ 100 per teacher. The operator will hire out the required number of buses. The following are the other cost estimates:

Breakfast ₹ 10 per student

Lunch ₹ 20 per student

Tea ₹ 6 per student

Entrance fee at zoo ₹ 4 per student

Rent per bus ₹ 1,300

Special permit fees ₹ 100 per bus

Block entrance fees at planetarium ₹ 500

Prizes to students for games ₹ 500

No costs are incurred in respect of accompanying teachers (except allowance of ₹ 100 per teacher).

You are required to prepare a statement showing total cost and also average cost per student for the levels of 30, 60, 90, 120 and 150 students. [3+3+3+1=10]

(b) Explain what is meant by Cost Apportionment and Cost Absorption. [5]

**Answer 7.**

**(a) Statement showing cost per Student at Various Level**

(Amount in ₹)					
1) Particulars variable Cost	30 Students	60 Students	90 Students	120 Students	150 Students
Breakfast (₹10 per student)	300	600	900	1,200	1,500

Lunch (₹ 20 per student)	600	1,200	1,800	2,400	3,000
Tea (₹ 6 per student)	180	360	540	720	900
Entrance Fee (₹ 4 per student)	120	240	360	480	600
<b>Total</b>	<b>1,200</b>	<b>2,400</b>	<b>3,600</b>	<b>4,800</b>	<b>6,000</b>

(Amount in ₹)

2) Semi-variable Cost	30 Students	60 Students	90 Students	120 Students	150 Students
Rent of bus	1,300	2,600	2,600	3,900	3,900
Permit fees	100	200	200	300	300
Allowance to teachers	200	400	400	600	600
<b>Total</b>	<b>1,600</b>	<b>3,200</b>	<b>3,200</b>	<b>4,800</b>	<b>4,800</b>

(Amount in ₹)

3) Fixed Cost	30 Students	60 Students	90 Students	120 Students	150 Students
Block entrance fees at planetarium	500	500	500	500	500
Prizes to student for games	500	500	500	500	500
<b>Total</b>	<b>1,000</b>	<b>1,000</b>	<b>1,000</b>	<b>1,000</b>	<b>1,000</b>
4) Total Cost (1+2+3)	3,800	6,600	7,800	10,600	11,800
Average Cost Per Student	126.67	110.00	86.67	88.33	78.67

Average cost per student is minimum at 150 student level, i.e. ₹ 78.67

- (b) Cost Apportionment is the process of charging cost in an equitable proportion to the various cost centers or departments. This describes the allotment of proportions of overhead to cost center, it is carried out in respect of those items of cost which cannot be allocated to any specific cost centre. For example, salary of general manager cannot be allocated wholly to the production departments as he attends in general to all departments. Therefore, some logical basis is selected for the appointment of such types of cost over various cost centers departments.

Cost Absorption is the process of absorbing all overhead expenses allocated to or apportioned over particular cost centre by the units produced. For example, the manufacturing cost of lathe centre is absorbed by a rate per lathe hour. The purpose behind the absorption is that expenses should be absorbed in the cost of the output of the given period. For overhead absorption some suitable basis has to be adopted. The formula used for deciding the rate is as follows :

Overhead Absorption Rate = Overhead Expenses/ Units of the base selected

8. Write short notes on (any three) of the following: [5x3=15]
- Benefits of Budgeting;
  - Difference between marginal costing and absorption costing;
  - Features of process costing;
  - Advantages of job costing;
  - Difference between merit rating and job evaluation.

**Answer 8.**

(a) **Benefits of Budgeting:**

- Budgeting facilitates planning of various activities and ensures that the working of the organization is

systematic and smooth.

- (ii) Budgeting helps planning and controlling income and expenditure so as to achieve higher profitability and also act as a guide for various management decisions.
- (iii) Budgeting is a coordinated exercise and hence combines the ideas of different levels of management in preparation of the same.
- (iv) It is an effective means for planning and thus ensures sufficient availability of working capital and other resources.
- (v) As resources are directed to the most productive use, budgeting helps in reducing the wastages and losses.
- (vi) It is extremely necessary to evaluate the actual performance with predetermined parameters. Budgeting ensures that there are well-defined parameters and thus the performance is evaluated against these parameters.
- (vii) Budget cannot be prepared in isolation and therefore co-ordination among various departments is facilitated automatically.
- (viii) It helps management in planning, co-ordination and control. It also helps to check and evaluate the performance of each department.

(b) Difference between Marginal Costing and Absorption Costing :

Marginal Costing	Absorption Costing
i) This is a technique of costing, which advocates that only variable costs should be taken into consideration while working out the total cost of production.	i) Here costs are classified as Direct and Indirect. Direct costs are identifiable with a particular product and hence are charged directly. Indirectly costs are first identified, apportioned to the cost Centers and then finally absorbed in the product units on some suitable basis.
ii) The year-end inventory is valued at variable cost only.	ii) The year-end inventory is valued at total cost.
iii) Fixed overheads are not absorbed in the product units and hence there is no question of under/over absorption.	iii) The Fixed overhead absorption may create some problems like under/over absorption.
iv) Fixed costs are not taken into consideration while valuing the inventory and hence there is no distortion of profits.	iv) Due to inventory valuation, which is done at the full cost, the cost relating to the current period are carried forward to the subsequent period. This will distort the cost of production.
v) Only variable costs are charged to the cost of production and therefore the selling price is also based on any variable costs. This will result in fixation of selling price below the total costs. There is a possibility of starting a price war in such situations, which will be harmful to all the companies in the industry.	v) The total cost of production is charged to the product without distinguishing between the fixed and variable components. The selling price is thus fixed on the basis of total costs.

(c) **Features of Process Costing:**

Process Costing is one of the methods of Costing, which is used in those industries where the production is in continuous process, i.e., the output of one process becomes the input of the subsequent process and so on. The objective of Process Costing is to find out the cost of each process by identifying the direct costs with the particulars process and apportioning the indirect cost on some suitable basis. In this process, all the units coming out as finished products are uniform with each other in all respects. The individual units lose their identity.

Process Costing is applicable where standardized goods are produced. Industries in which Process Costing is used are Chemical works, textile, food and Canning factories etc.

The features of process costing are as follows :

- (i) The production is in continuous flow and is uniform. All units coming out as finished products are uniform with each other in all respects.
- (ii) The unit cost is obtained by dividing the total costs for a particular period by the total output. This is the average cost of the product units.
- (iii) The product is manufactured in a continuous flow and hence individual units lose their identity.
- (iv) Cost per process is ascertained and cost of each process is transferred to the subsequent process until the finished product emerges.
- (v) Sometimes each process may be treated as profit centre and so while transferring the costs from one process to another, a percentage of profit is added in the cost of that process. This is known as inter process profit and needs to be accounted for in the process cost accounts.

(d) **Advantage of Job Costing:**

Job Costing is used when single units are produced. The aim of Job Costing is to determine the cost of a specific job. Jobs are undertaken according to customer's specifications. The most common use of Job Costing is by small factories in the Engineering Industry, Printing, Machine-tool manufacturing, foundries, repair shops, garages and several such other industries where jobs are undertaken according to the requirements of customers. Job Costing is also suitable for cost plus contracts.

Accurate information is available regarding the cost of job completed and the profits generated from the same. In this system, Proper records are maintained regarding the material, labour and overheads so that a costing system is build up. Useful cost data is generated from the point of view of management for proper control and analysis. In Conclusion, it can be said that Job Costing is an extremely useful method for computation of the cost of a job. The limitation of time consuming can be removed by computerization and this can also reduce the complexity of the record keeping.

(e) **Difference between Merit Rating and Job Evaluation**

- (i) Job Evaluation is the assessment of the relative worth of jobs within a business enterprise whereas Merit Rating is the assessment of the employers with respect of a job.
- (ii) Job Evaluation helps in establishing a rational wage and salary structure. On the other hand. Merit Rating helps in fixing fair wages for each worker in terms of his competence and performance.
- (iii) Job Evaluation brings uniformity in wages and salaries while Merit Rating aims at providing a fair rate of pay for different workers on the basis of their performance.