INTERMEDIATE EXAMINATION

GROUP II

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

DECEMBER 2011

Paper-8 : COST AND MANAGEMENT ACCOUNTING

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

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

Answer **Question No. 1** *which is compulsory and* **any five** *questions from the rest.*

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

Column - I	Column - II
(i) Performance of Public Enterprises	(A) Measures Divisional Performance
(ii) Residual Income	(B) Purchase Order Processed
(iii) Cost Driver	(C) Future Costs affected by decision making
(iv) Point Rating	(D) Shows profitability and capacity utilisation
(v) Relevant Cost	(E) Job Evaluation

(b) State whether the following statements are True or False : [1×5]

(i) Incentive systems benefit only workers.

(ii) Service departments do not render services to each other.

(iii) Contract costing is only a variant of Job.costing.

(iv) Differential costing and Marginal costing mean the same thing.

(v) Standards are arrived at based on past performance.

(c) Fill up the blanks suitably : [1×5]

(i) In absorption costing _____ cost is added to inventory.

(ii) _____ becomes more effective in a firm with the use of standard costing.

(iii) In 'make or buy' decision, it is profitable to buy from outside only when the supplier's price is below the firm's own _____ .

(iv) A cost which does not involve any cash outflow is called _____ .

(v) _____ costing reduces the possibility of under pricing.

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

(i) XYZ Co. Ltd. is having 400 workers at the beginning of the year and 500 workers at the end of the year. During the year 20 workers were discharged and 15 workers left the company. The Labour Turnover rate under 'separation method' is:

A. 22.20%

B. 7.78%

C. 4.00%

D. 14.40%

(ii) A factory operates a standard cost system, where 2000 kgs of raw materials @ ` 12 per kg were used for a product, resulting in price variance of ` 6000 (F) and usage variance of ` 3000 (A). Then standard material cost of actual production was

A. ` 20,000

B. ` 30,000

C. ` 25,000

D. ` 27,000

(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) The annual demand of a certain product is 8000 units, ordering cost per order is ` 40, carrying cost is 10% of average inventory value and purchase cost is ` 10 per unit. The EOQ for the product is

A. 1200

B. 1000

C. 900

D. 800

(v) Sales for two consequtive months of a company are ` 3,80,000 and ` 4,20,000. The company's net profits for these months amounted to ` 24,000 and ` 40,000 respectively. There is no change in P/V ratio or fixed costs. The P/V ratio of the company is

A. $33\frac{1}{3}\%$

B. 40%

C. 25%

D. None of the above

Answer 1. (a)

(i) — D

(ii) — A

(iii) — B

(iv) — E

(v) — C

Answer 1. (b)

(i) False

(ii) False

(iii) True

(iv) False

(v) False

Answer 1. (c)

(i) Fixed

(ii) Budgetary Control

(iii) Variable Cost

(iv) Imputed Cost

(v) Absorption

Answer 1. (d)

(i) 'B' — 7.78%

Average No. of workers (400 + 500) / 2 = 450 Labour Turnover rate (Separation Method)

$$= \frac{\text{No. of separation during the year}}{\text{Average No. of Workers}} \times 100 = \frac{(20+15)}{450} \times 100 = \frac{35}{450} \times 100 = 7.78\%$$

(ii) 'D' – ` 27,000

= Material price variance + material usage variance

= 6000 (F) + 3000 (A) = 3000 (F)

Actual Material cost 2000 × 12 = ` 24000

Standard Material Cost of actual production = ` 24,000 + ` 3,000 = ` 27,000.

(iii) 'B' — ` 300 Lakhs

Marging of Safety = Profit / PV ratio.

= 30 ÷ 40 = 75 Lakhs

∴ Total Sales $\frac{75}{.25}$ = ` 200 Lakhs

(iv) 'D' — 800

$$EOQ = \sqrt{\frac{2AO}{C.i}}$$

$$= \frac{\sqrt{2 \times 8000 \times 40}}{10 \times \frac{10}{100}} = 800$$

(v) 'B' — 40%

$$PV\ Ratio = \frac{Change\ in\ Profit}{Change\ in\ sales} \times 100 = \frac{16000}{40000} \times 100 = 40\%$$

Q. 2. (a) A company prepares a budget for a production of 200000 units. Variable cost per unit is ` 15 and the fixed cost is ` 2 per unit. The company fixes its selling price to fetch a profit of 10% on cost.

(i) What is the break-even point? (both in units and in `)

(ii) What is profit volume ratio?

(iii) If it reduces its selling price by 5%, how does the revised selling price affect the break-even point and the profit volume ratio?

(iv) If a profit increase of 10% is desired more than the budget, what should be the sales at the reduced price? [3+2+3+2]

(b) State briefly the effect on profitability under marginal costing and absorption costing. [5]

Answer 2. (a)

Budgeted Cost Price Structure

	Per Unit `
Variable Cost	15.00
Fixed Cost	2.00
Total Cost	17.00
Profit (10% of cost)	1.70
Sale Price	18.70

Total Fixed Cost Rs. 2 × 200000 = ` 4,00,000

Contribution per unit ` 18.70 – 15.00 = ` 3.70

Total profit = Total Contribution – Total Fixed cost

= (3.70 × 2,00,000) – 4,00,000

= ` 3,40,000.

(i) Break Even Point (in unit) $= \frac{Total\ Fixed\ Cost}{Contribution\ Per\ Unit}$

$= \frac{4,00,000}{3.70}$ = 1,08,108 (approximately)

Break Even Point (in Rupees) = 1,08,108 × selling price per unit (` 18.70)
= ` 20,21,622

(ii) P/V Ratio : $\frac{3.70 \times 100}{18.70} = 19.79\%$

(iii) If the selling price is reduced by 5%, the revised selling price will be ` 17.765 [18.70 – (5% of 18.70)]

Under the revised selling price :

Break Even (in unit) = $\frac{4,00,000}{(17.765 - 15)}$
= 144665 Units

Break Even price (in `) = 144665 × Selling price/unit (` 17.765)
= 2569982

P/V Rated = $\frac{17.765 - 15}{17.765} \times 100 = 15.56\%$

(iv) Desired profit
= Budgeted profit + 10% of the Budgeted profit
= 3,40,000 + 10% of 3,40,000
= Rs. 3,74,000

Sales to achieve the desired profit (at the reduced selling price)

= $\frac{\text{Fixed Cost} + \text{desired Profit}}{\text{P/V Ratio}}$

= $\frac{4,00,000 + 3,74,000}{15.56\%}$

= ` 49,74,293

Answer 2. (b)

Effect of profitability under marginal costing & absorption costing :

(a) When unit of production and sales unit are equal, profit under marginal costing will be same as profit under the absorption cosing.

(b) When unit production is more than sales, profit under absorption costing will be greater then the profit under marginal costing.

(c) When unit of production is less than sales, profit under absorption costing will be lower than the profit under marginal costing.

Q. 3. (a) The following facts are extracted from the books of Alpha Radio Manufacturing Company for the year 2010.

(i) It produces two types of radio-Type A and Type B and sells these in two markets-Kolkata and Siliguri.

(ii) The budgeted and actual sales for the year 2010 are as follows:

		Kolkata	Siliguri
Type A —	Budgeted	1000 units at ` 200 each	800 units at ` 200 each
	Actual	900 units at ` 200 each	750 units at ` 200 each
Type B —	Budgeted	800 units at ` 300 each	600 units at ` 300 each
	Actual	1000 units at ` 300 each	750 units at ` 300 each

Analysis of variance discloses that Type A is overpriced and Type B is underpriced. If the price of A Type radio set is reduced by 10% and price of B Type radio set is increased by 20% and if a modem and extensive advertisement campaign is introduced, then the following volume of sales could be made in the next year as expected by the Marketing Manager.

Expected increase/decrease over the current budget		Kolkata Market	Siliguri Market
Product A:	Due to change in pricing policy	+20%	+15%
	Due to introduction of modern advertisement campaign	+5%	+3%
Product B:	Due to change in pricing policy	+10%	(–)2%
	Due to introduction of modem advertisement campaign	.+5%	+5%

On the basis of above you are required to prepare sales budget for the year 2011. [10]

(b) State the difference between Forecast and Budget. [5]

Answer 3. (a)

		Budget for 2010			Actual for 2010			Budget for 2011		
Product Type	Market Area	Unit	Price per unit (`)	Value (`)	Unit	Price Unit (`)	Value	Unit	Price per unit (`)	Value (`)
A	Kolkata	1000	200	2,00,000	900	200	1,80,000	1250	180	2,25,000
	Siliguri	800	200	1,60,000	750	200	1,50,000	944	180	1,69,920
	Total	1800		3,60,000	1650		3,30,000	2194		3,94,920
B	Kolkata	800	300	2,40,000	1000	300	3,00,00	920	360	3,31,200
	Siliguri	600	300	1,80,000	750	300	2,25,000	618	360	2,22480
	Total	1400		4,20,000	1750		5,25,000	1538		5,53,680

Working Note : (1) Calculation of Budgeted sales for 2011

	Type A	**Type B**
(a) **Market :** Kolkata		
Budgeted Sale for 2010	1000	800
For expected change in pricing policy	200	80
For introduction of modern advertisement campaign	50	40
Budgeted sale for 2011	1250	920

	Type A	Type B
(b) **Market :** Siliguri		
Budgeted Sale for 2010	800	600
Add : Expected increase/decrease		
For change in pricing policy	120	(–) 12
For introduction of modern advertisement campaign	24	30
	944	618

(2) Calculation of selling price for 2011

	Type A Price per unit	Type B Price per unit
Price in 2010	200	300
Add increase/decrease	(–) 20	(+) 60
Budgeted selling price	180	360

Answer 3. (b)

Forecast VS Budget

Forecast	Budget
1. It is merely an estimate which is likely to happen. It is a statement of profitable event which are likely to happen under anticipated condition during a specified period of time.	A budget is a detailed plan of operation for some specific period.
2. It being statements of future events, do not connote any sense of control.	It is on the other hand a tool of control since it represents action which can be shaped according to will so that it can be suited to the condition which may or may not happen.

Q. 4. (a) Distinguish between "Incentives to indirect workers" and "Indirect incentives to direct workers". [5]

(b) Both direct and indirect employees of a department in a factory are entitled to production bonus in accordance with a Group Incentive Scheme, the outlines of which are as follows:

(i) For any production in excess of standard rate fixed at 10,000 tonnes per month of 25 days, a general incentive of ` 10 per tonne is paid in aggregate. The total amount payable to each separate group is determined on the basis of an assumed percentage of such excess production being contributed by it, namely @70% by direct labour, @10% by inspection staff, @12% by maintenance staff and @ 8% by supervisory staff.

(ii) Moreover, if the excess production is more than 20% above the standard, direct labour also get a special bonus @ ` 7 per tonne for all production in excess of 120% of standard.

(iii) Inspection staff are penalised @ ` 20 per tonne for rejection by customers in excess of 1% of production (Actual).

(iv) Maintenance staff are penalised @ ` 20 per hour of breakdown.From the following particulars for a month, workout the production bonus by each group :

A. Production 13,000 tonnes (Actual)

B. Rejection by customers—200 tonnes

C. Machine breakdown—50 hours [4+2+2+2]

Answer 4. (a)

Main condition of incentive system is that the actual output or time taken in relation to standard set is determinable. In case of indirect works, their performance cannot be directly measurable. Still it is essential to provide for incentive to them. The following are such incentive to indirect workers —

(i) Bonus to foremen and supervisors.

(ii) Bonus to repairs and maintenance staff.

(iii) Bonus to stores staff

The following are the indirect incentives to direct workers.

(i) Profit sharing

(ii) Co-partnership

(iii) Education for employees and their children

(iv) Health and safety

(v) General Welfare, recreation facilities

(vi) Subsidized meals.

Answer 4. (b)

No. of working days p.m. = 25

Standard production = 10,000 tonnes.

Actual production = 13,000 tonnes.

Excess production = 3,000 tonnes.

20% of standard production = 2,000 tonnes.

Excess production above 20% = 1000 tonnes

Statement showing Bonus earned by each.

Category	General Incentive			Special Incentive		Penalty	Bonus
	%	Tonnes	Amount	Tonnes	`	`	`
Direct Labour	70	2,100	21,000	1000	7,000		28000
Inspection Staff	10	300	3000			1,400	1,600
Maintenance Staff	12	360	3600			1000	2,600
Supervisory Staff	8	240	2400				2400
Total	100	3000	30000	1000	7000	2400	34,600

Workings :

Penalty for rejection :

Rejections	=	200 tones
Rejections allowed 1% of 13,000	=	130 tones
Penalised	=	70 tones
70 × ` 20	=	` 1400
Break down 50 hours × ` 20	=	` 1000

Q. 5. (a) Budgets are classified according to Time. State how they are classified. [5]

(b) XYZ Ltd. manufactures four products A, B, C and D. Whose data are given below :

	A	B	C	D
Direct Materials (`)	3,000	6,000	9,000	18,000
Direct Labour (`)	1,500	3,000	4,500	9,000
Direct Labour Hours	50	100	150	300
Machine Hours	30	15	10	5

You are required to prepare a statement showing the allocation of factory overheads (which amounted to ` 1,08,000) using the basis of allocation as under :

(i) Direct Material Cost

(ii) Direct Labour Cost

(iii) Direct Labour Hours

(iv) Machine Hours

Out of these four bases of allocation, which you prefer and why? [2+2+2+2+2]

Answer 5. (a)

Budget are divided in the following categories according to time :

(i) **Short term Budgets** - Any budget that is prepared for a period upto one year generally is known as Short Term Budget. Functional budgets are normally prepared for a period of one year.

(ii) **Medium Term Budget :** Budget prepared for a period of 1-3 years is Medium Term Budget. Budget like manpower planning are prepared for Medium Term.

(iii) **Long Term Budget :** Any Budget exceeding 3 years is known as Long Term Budgets. Master Budget is normally prepared for Long Term. In the modern days due to uncertainty, very few budgets are prepared for Long Term.

Answer 5. (b)

Workings : Calculation of overhead rate using different basis —

(i) Direct Material Cost :

$$\text{Rate} = \frac{\text{Total Factory O/H}}{\text{Total Material Cost}} = \frac{` 1,08,000}{36,000} = ` 3 \text{ per } ` \text{ Material Cost}$$

(ii) Direct Labour Cost :

$$\text{Rate} = \frac{\text{Total Factory O/H}}{\text{Total Labour Cost}} = \frac{₹\ 1,08,000}{18,000} = ₹\ 6 \text{ per } ₹ \text{ Labour Cost}$$

(iii) Direct Labour Hours = $\frac{₹\ 1,08,000}{600}$ = ₹ 180 per hour

(iv) Machine Hour = $\frac{₹\ 1,08,000}{60}$ = ₹ 1,800 per M/C. hour

Statement showing allocation of overheads

Basis	Rate ₹	A ₹	B ₹	C ₹	D ₹	Total ₹
Direct Material Cost	3	9,000	18,000	27,000	54,000	1,08,000
Direct Labour Cost	6	9,000	18,000	27,000	54,000	1,08,000
Direct Labour Hour	180	9,000	18,000	27,000	54,000	1,08,000
Machine Hour	1,800	54,000	27,000	18,000	9,000	1,08,000

Out of these basis of allocation, Machine Hour Rate is most preferable. Overheads are to be allocated on the basis of time taken by each product in the shop, i.e. on the basis of machine hours required by each product.

Q. 6. (a) Following are the particulars given by the owner of a hotel. You, as a Cost & Management Accountant, are requested to advise him that what rent should he charge from his customers per day so that he is able to earn 25% on cost other than interest:

(i) Staff salaries ₹ 80,000 per annum.

(ii) Room attendants salary ₹ 2 per day. The salary is paid on daily basis and services of room attendant are needed only when the room is occupied. There is one room attendant for one room.

(iii) Lighting, heating and power. The normal lighting expenses for a room if it is occupied for the whole month is ₹ 50. Power is used only in winter and normal charge per month if occupied for a room is ₹ 20.

(iv) Repairs to Building— ₹ 10,000 per annum

(v) Linen, etc.— ₹ 4,800 per annum

(vi) Sundries— ₹ 6,600 per annum

(vii) Interior decoration, etc.— 10,000 per annum

(viii) Cost of Building at ₹ 4,00,000 and its depreciation rate is 5%

(ix) Other equipment at ₹ 1,00,000 and its depreciation rate is 10%

(x) Interest @ 5% may be charged on its investment in the buildings and equipment.

(xi) There are 100 rooms in the Hotel and 80% of the rooms are normally occupied in summer and 30 rooms are busy in winter.

[You may assume that period of summer and winter is six months each. Normal days in a month may be assumed to be 30.] [10]

(b) Explain the concept of 'Joint Costs' in joint products and by products. [5]

Answer 6. (a)

Room Rent fixation of Hotel :

Calculation of Room Rent per day

	Particulars	`	`
(i)	Staff Salaries		80,000
(ii)	Room attendants Salaries :		
	Summer : $2 \times 100 \times \frac{80}{100} \times 30 \times 6$	28,800	
	Winter : $2 \times 100 \times \frac{30}{100} \times 30 \times 6$	10,800	39,600
(iii)	Lighting/Heating/Power :		
	Summer : $50 \times 6 \times 100 \times \frac{80}{100}$	24,000	
	Winter light : $50 \times 6 \times 100 \times \frac{30}{100}$	9,000	
	Power : $20 \times 6 \times 100 \times \frac{30}{100}$	3,600	36,600
(iv)	Repairs to Buildings		10,000
(v)	Linen, etc.		4,800
(vi)	Sundries		6,600
(vii)	Interior decoration, etc.		10,000
(viii)	Depreciation : Buildings @ 5% of ` 4,00,000	20,000	
	Other Equipments 10% of ` 1,00,000	10,000	30,000
(ix)	Interest on Investment = 5,00,000 × 5%		25,000
	Total cost including interest		2,42,600
	Add : 25% Profit on Cost other than 'Interest'.		
	Or, $(2,42,600 - 25,000) \times \frac{25}{100}$ =		54,400
	Total revenue required		2,97,000
	∴ Room Rent per day = 2,97,000 / 19,800		15 Per day

Workings :

'Room days' Computation :

No. of Rooms × % occupied × Days in a month × No. of month

Summer : $100 \times \frac{80}{100} \times 30 \times 6$ = 14,400 Days

Winter : $100 \times \frac{30}{100} \times 30 \times 6$ = 5,400 Days

Total Room Days = 19,800 Days

Answer 6. (b)

Joint Costs :

Joint cost is the pre-separation cost of commonly used input factors for the production of multiple products. That is, all costs incurred before or upto the split-off point are termed as joint costs of pre-separation costs and the apportionment of these costs is the main objective of joint product accounting. Costs incurred after split-off point are post - separation costs and can be easily identified with the products.

Here, split-off point is a point up to which, input factors are commonly used for production of multiple products, which can be either joint-products or by products, after this point, joint products and/or by products gain individual identity.

Q. 7. (a) M/s. Jupiter & Co. Ltd. manufactures a product in its factory which presently utilises 60% of its capacity. The cost details including selling price are given below:

	`
Sales 6000 units	5,40,000
Direct Materials	96,000
Direct Labour	1,20,000
Direct Expenses	20,000
Factory Overheads	2,00,000
Administration Overheads	21,000
Selling and Distribution Overheads	25,000

Out of fixed overheads, 12.5% and 20% of selling and distribution overheads variable with production and sales. Administration overheads are wholly fixed.

Now, it is revealed that existing product could not achieve budgeted level for two consecutive years, the management decides to introduce a new product with marginal investment but largely using present plant and machinery.

The cost data of the new product is given below :

	`
Direct Materials	16 per unit
Direct Labour	15 per unit
Direct Expenses	2 per unit
Variable Factory Overheads	2 per unit
Variable Selling & Distribution Overheads	1.5 per unit

Marketing Manager of the company is expecting to sell 2000 units of new product at a price of ` 60 per unit.

The fixed factory overheads are expected to increase by 10% and fixed selling and distribution expense will go up by ` 13,500 annually. Administration overheads will remain unchanged.

You are advised to give your opinion. Should the new product be introduced? [3+3+3+1]

(b) Distinguish between Job costing and Process costing. [5]

Answer 7. (a)

Analysis of over heads :

Particulars	Total	Fixed	Variable
	`	`	`
Factory Over head (Note 1)	2,00,000	1,75,000	25,000
Administration Over Head	21,000	21,000	-
Selling & Distribution Over Head	25,000	20,000	5,000
Total	2,46,000	2,16,000	30,000
Incremental Factory Fixed over head (10% of 1,75,000)		17,500	
Selling & distribution over head		13,500	
		31,000	

Note-1 : Out of the total factory overhead 12.5% is assumed as variable cost.

Statement of Profits : Existing & New Products

Particulars	Existing Product	New Product	Total Amount
Sales Quantity (Units)	6000	2000	8000
	`	`	`
Sales Value	5,40,000	1,20,000	6,60,000
Less : Direct Materials	96,000	32,000	-
Direct Labour	1,20,000	30,000	-
Direct Expenses	20,000	4,000	-
Other Variable Overheads	30,000	7,000	-
Total variable cost	2,66,000	73,000	3,39,000
Contribution	2,74,000	47,000	3,21,000
Less Fixed over head	2,16,000	31,000	
Profit	58,000	16,000	74,000

The profit of the firm is expected to increase by ` 16,000 if the product is introduced. So, the company should introduce the new product.

Answer 7. (b)

The main points of difference between job costing and process costing are as follows :

Job Costing	Process Costing
1. Each job is carried out against specific orders.	Process costing has continuous flow.
2. Each job may be different.	Each product is homogenous and standardised.
3. The cost centre is a job.	The cost centre is a process.
4. Costs are collected and ascertained for each job separately.	Costs are collected and ascertained for each process separately.
5. Costs are calculated only on completion of job.	Process costs are calculated at the end of each period.
6. There may or may not be any work in progress.	There is always some WIP because of continuous nature of production.
7. Higher degree of control is required because of heterogenous nature of jobs.	Lower degree of control is required because of homogenous and standardised jobs.
8. There is usually no tranfers between jobs.	The output of one process is transferred to next as input.

Q. 8. Write short notes on *any three* of the following : [5×3]

(a) Limitations of market-based transfer pricing;

(b) Inter-Locking Accounts;

(c) Cost-plus Contract;

(d) Principal Budget Factor;

(e) Perpetual Inventory System.

Answer 8. (a)

Limitations of Market based Transfer Pricing :

1. There may be resistance from the buying division. They may question buying from the selling division if in any way they have to pay the market price.
2. Market prices may be fluctuating; and hence there may be difficulties in fixation of these prices.
3. Market price is rather a vague term as such prices may be ex-factory price, wholesale price, retail price, etc.
4. Market prices may not be available for intermediate products, as these products may not have any market.
5. The method may be difficult to operate if the intermediate product is for captive consumption.

Answer 8. (b)

Inter-locking Accounts :

Cost and Financial Accounts are said to be interlocked, when independent set of books are maintained for each of them. These accounts are interlocked through control accounts maintained in the two sets of books. Cost Ledger Control Account is maintained in the financial books and a General Ledger Adjustment Account is maintained in costing books. In this manner, connection between the two sets of books is maintained. In costing books, all entries relating to fixed assets, cash, etc. are posted in General Ledger Adjustment Account. In case it is desired to integrate the two trial balances into one, the Cost Ledger Control Account and General Ledger Adjustment Account can be omitted because they are maintained on 'Contra' principle. The 'integration' as above aims at maintenance of only one set of books in which the transactions are recorded; thereby reconciliation is eliminated. However, due to some difficulties like implementation problem of 'integration', sometimes 'interlocking' of accounts is preferred. For example, a separate cost of accounting department because of its importance, 'interlocking' accounting system may have to be operated.

Answer 8. (c)

Cost plus Contract :

In this type of contracts the contractor is usually entitled to a stipulated amount of profit in addition to actual cost of the service. The amount of profit to be added to the actual cost of contract may be in the form of fixed amount on a percentage on actual cost.

This type of contract is generally entered into for executing special type of work which is not usually undertaken by the contractor. Examples of this type of contracts are construction work during war, production of newly designed ship, etc. This type of contract is advantageous both to the contractor and the contractee. Contractor generally receives a reasonable profit. He is protected from any loss or unusual risk. Contractee can ensure a fair price of the contract because the contractee is entitled to verify the books of contractor.

Answer 8. (d)

Principal Budget Factor :

A Principal Budget Factor, also known as key factor is that factor the extent of whose influence must first be assessed in order to prepare the functional budgets. Normally sales is the PBF but other factors like skilled labour, production, purchase, raw materials may also be PBF. For example, a company has production capacity to produce 30,000 tonnes p.a. but the sales forecast tells that the market can absorb only 20,000 units, there is no point in producing 30,000 units. Thus sales is the PBF in this case. The PBF puts restrictions on the other functions and hence it must be considered carefully in advance.

A typical list of some of the PBF is given below -

(i) **Sales** - consumer demand,

(ii) **Materials** - Availabilities of supply, restrictions on import.

(iii) **Labour** - Shortage of labour.

(iv) **Plant** - Lack of capital, bottlenecks in key processes.

(v) **Managemen**t - Shortage of efficient executives, lack of knowhow, faulty design, pricing policy etc.

Answer 8. (e)

Perpetual Inventory System :

Perpetual Inventory System means continuous stock taking. CIMA defines Perpetual Inventory System as 'the recording as they occur of receipts, issues and resulting balances of individual items of stock in either quantity or quantity and value'.

Under this system a continuous record of receipt and issue of materials is maintained by the stores dept & the information about the stock of materials is always available. Entries in the Bin card and stores ledger are made after every receipt and issue and the balance is reconciled on regular basis with the physical stock. The main advantage of this system is that it avoids disruptions in the production caused by periodic stock taking. It's a very reliable check on the stocks.