Unit-IV
Part-A

1. **Define standard costing**

The CIMA, London has defined standard cost as "a predetermined cost which is calculated from management's standards of efficient operations and the relevant necessary expenditure."

2. Define costing
   Costing has been defined by the Institute of Cost and Works Accountants, England as: "The technique and process of ascertaining costs".
   Wheldon has defined the costing as: "Costing is the classifying, recording and appropriate allocation of expenditure for the determination of the costs of products or services; and for presentation of suitably arranged data for the purposes of control, and guidance of management.
3. Define variance
   The difference between an expected and actual result, such as between a budget and actual expenditure.
4. What is break even analysis ? Break even point
   Break-even analysis is a technique widely used by management accountants. ... Total variable and fixed costs are compared with sales revenue in order to determine the level of sales volume, sales value or production at which the business makes neither a profit nor a loss (the "break-even point").

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5. What is margin of safety?
   Margin of Safety In break-even analysis, the term *margin of safety* indicates the amount of sales that are above the break-even point

6. What is angle of incidence?

Angle indicates rate at which profits are being made. Large angle of incidence is an indication that profits are being made at a high rate. On the other hand, a small angle indicates a low rate of profit and suggests that variable costs from the major part of cost of production.

6. What does prime cost mean?
   Prime costs are a firm's expenses directly related to the materials and labor used in production. ... The *prime cost* calculates the direct costs of raw materials and labor, but *does* not factor in indirect expenses,
7. Write a note on CVP analysis:
   Cost-Volume-Profit Analysis (CVP) Cost-volume-profit (CVP) analysis is used to determine how changes in costs and volume affect a company's operating income and net income.

In performing this analysis, there are several assumptions made, including:

- Sales price per unit is constant.
- Variable costs per unit are constant.

- Total fixed costs are constant.
- Everything produced is sold.
- Costs are only affected because activity changes.
- If a company sells more than one product, they are sold in the same mix.

8. Define budget

According to the Institute of Cost & Management (ICMA), London, a Budget is 'a financial and / or quantitative statement, prepared and approved prior to a defined period of time, of the policy to be pursued during that period for the purpose of attaining a given objective. It may include income, expenditure and the employment of capital'.

9. What is direct cost?

A *direct cost* is a price that can be directly tied to the production of specific goods or services. A *direct cost* can be traced to the *cost* object, which can be a service, product, or department.

10. What is contract costing?

Contract costing is the tracking of *costs* associated with a specific *contract* with a customer

11. What is job costing?

Job costing is defined as a method of recording the costs of a manufacturing *job*, rather than process. With *job costing* systems, a project manager or accountant can keep track of the *cost* of each *job*, maintaining data which is often more relevant to the operations of the business.

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12. What is zero based Budget?

Zero based budgeting in management accounting involves preparing the budget from the scratch with fresh evaluation of each line item. *It* is a method of *budgeting* in which all expenses must be justified for each new period.

13. What is factory cost?
    What Selling and Administrative Cost?
14. What is key factor in cost Accounting?
15. What is marginal Costing?
16. What is a profit centre?
17. What is a cost centre?
18. Wha

Part: B

1. Explain about the types of Budget

Classification of budgets

There are three popular bases for classifying budgets. It includes,

1.Based on time

2. Based on functions

3.Based on flexibility.

Apart from these classifications, several other budgets can also be found in practice such as – performance budget, Zero Base Budget(ZBB), etc

1.On the basis of time

a.Long term budget: According to National Association of Accountants, America, a long term budget is, a systematic and formalized process for purposeful directing and controlling future operations towards a desired objective for periods extending beyond one year.

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b.Short term budget : Short term budget covers a budget period of one year or less.

c.Current budget : These budgets cover a very short period such as a month or a quarter. They are essentially short term budgets adjusted to current conditions

2.On the basis of functions

a.Functional / Subsidiary budgets: A Functional budget is a budget of income or expenditure appropriate to or the responsibility of functions, such as production, sales, purchase etc.

b. Master Budget: Each functional department prepares its own budget, and all these functional budgets are integrated into the Master budget. It is also called as summary budget. It generally includes details relating to production, sales, stock, debtors, cash position, fixed assets etc,

c. Sales budget: It gives details about volume, price and sales mix. It alsogives details about the quantity of sale, month-wise or quarter-wise, market-wise, area-wise and on whatever other basis be important to the organization. The responsibility for preparation of this budget falls onthe sales manager. While preparing this budget, he/she has to consider certain influencing factors such as – past sales figures and trend, salesmen's estimates, general trade practice, orders in hand, proposed expansion or discontinuance of products, potential market, availability of material and supply, finance etc.

d.Production budget: It includes details about the types, quantity and cost of goods and services produced in the organization. The responsibility of preparing this budget falls on the departmental Works managers. **e.Production cost budget:** It is divided into material cost budget, labour cost budget and overhead cost budget, because cost of production includes material, labour and overheads.

f.Materials budget: It includes details about the kinds and quantity of material required, price paid for it, cost of transportation and storage, etc Labor budget: It includes details about the types and number of workers, the number of hours required, the wage rates and other allowances, the welfare and other facilities provided and cost thereof etc.

g.Overheads budget: It gives details of items of factory overhead expenses, their quantity and cost.

h.Research and Development budget: Every organization of some size, particularly, of a manufacturing or technical type, has a Research and Development Department. Expenses incurred by it are parts of operating cot, until efforts lead to some findings that can be used for improvement of quality of product technology improvement, and/or for producing something new, at which stage all expenses incurred are capitalised. **i.Capital expenditure budget:** This budget shows the estimated expenditure on fixed assets such as land and buildings, plant and machinery, etc. It is a long term budget. This budget is prepared to plan for replacement of old machines, increased demand of products, expansion of activities, etc.

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j.Cash budget: A Cash budget deals with cash, including its equivalent, like bank balance and bills receivable. It shows the inflows of cash and outflows of cash during a particular period of time. It can be prepared for a year, but for better control and management of cash, it is normally prepared on monthly basis. It takes into account only cash transactions.

3.On the basis of flexibility

a.Fixed budget: A Fixed budget is designed to remain unchanged irrespective of the volume of output or turnover attained. The budget remains fixed over a given period and does not change with the change in the volume of production or level of activity attained.

b.Flexible budget: It is also known as variable budget. A Flexible is designed to change along with the changes in the output or turnover. It changes according to the levels of activity.

2.Describe in detail the steps involved in budgetary control1.

3.Essentials of successful budgetary control1.

4. Explain the application of marginal cost analysis for managerial decision making.

5.Explain in detail about the features, Advantages and Disadvantages of Marginal Costing

Features of Marginal Costing

The main features of marginal costing are as follows:

1.Cost Classification

The marginal costing technique makes a sharp distinction between variable costs and fixed costs. It is the variable cost on the basis of which production and sales policies are designed by a firm following the marginal costing technique.

2.Stock/Inventory

Valuation Under marginal costing, inventory/stock for profit measurement is valued at marginal cost. It is in sharp contrast to the total unit cost under absorption costing method.

3.Marginal Contribution

Marginal costing technique makes use of marginal contribution for marking various decisions. Marginal contribution is the difference between sales and marginal cost. It forms the basis for judging the profitability of different products or departments.

2.Explain in detail about the Advantages and Disadvantages of Marginal Costing

Advantages of Marginal Costing

1.By not charging fixed overhead to cost of production, the effect of varying charges per unit is avoided.

2.It prevents the illogical carry forward in stock valuation of some proportion of current year's fixed overhead.

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3The effects of alternative sales or production policies can be more readily available and assessed, and decisions taken would yield the maximum return to business.

4.It eliminates large balances left in overhead control accounts which indicate the difficulty of ascertaining an accurate overhead recovery rate.

5.Practical cost control is greatly facilitated. By avoiding arbitrary allocation of fixed overhead, efforts can be concentrated on maintaining a uniform and consistent marginal cost.

6.It is useful to various levels of management.

7.It helps in short-term profit planning by breakeven and profitability analysis, both in terms of quantity and graphs.

8.Comparative profitability and performance between two or more products and divisions can easily be assessed and brought to the notice of management for decision making.

Disadvantages of marginal costing

1.The separation of costs into fixed and variable is difficult and sometimes gives misleading results.

2.Normal costing systems also apply overhead under normal operating volume and this shows that no advantage is gained by marginal costing.

3.Under marginal costing, stocks and work in progress are understated. The exclusion of fixed costs from inventories affect profit and true and fair view of financial affairs of an organization may not be clearly transparent.

4. Marginal cost data becomes unrealistic in case of highly fluctuating levels of production, e.g., in case of seasonal factories.

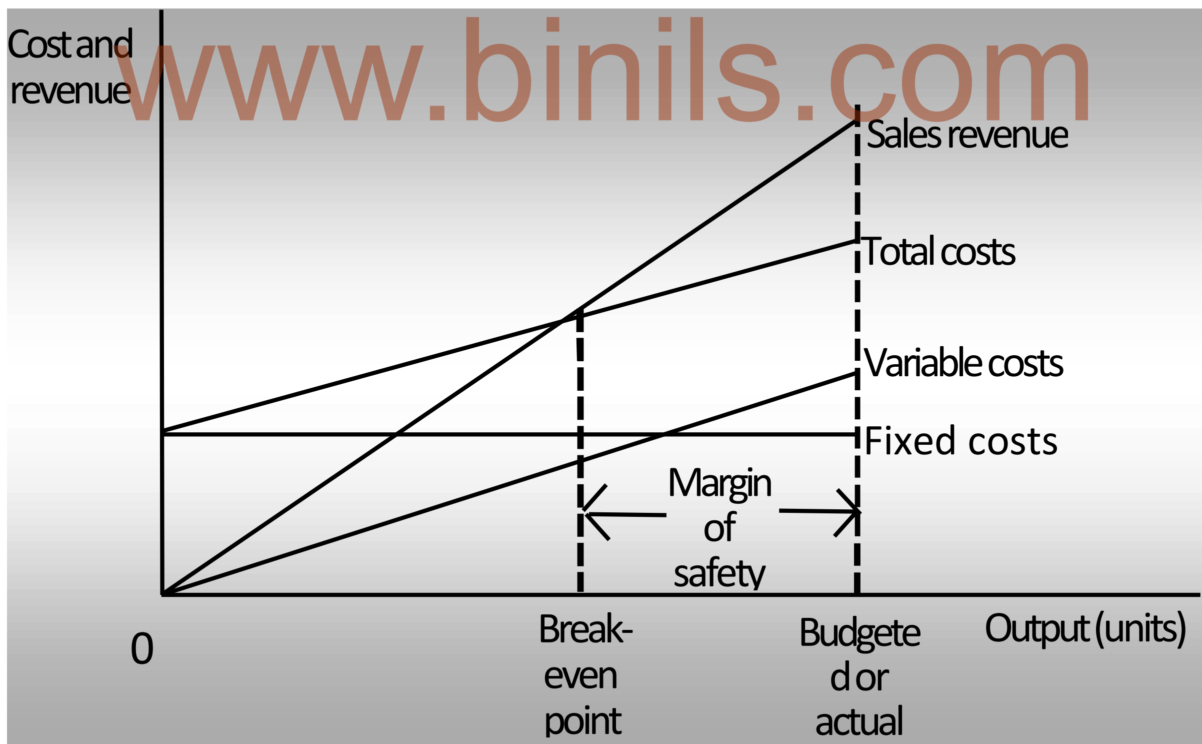
5.Application of fixed overhead depends on estimates and not on the actual and as such there may be under or over absorption of the same.

6. A system which ignores fixed costs is less effective since a major portion of fixed cost is not taken care of under marginal costing.

7.In practice, sales price, fixed cost and variable cost per unit may vary. Thus, the assumptions underlying the theory of marginal costing sometimes becomes unrealistic.

6.Draw Break-even charts and explain the assumptions

Indicates graphically profit and losses at different levels of sales volume achieved.



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- Where sales revenue is greater than total cost it means that profits are being generated.
- Where sales revenue is less than total cost it means that losses are being incurred.

- Where sales revenue equals total costs (intersection of the sales revenue line and total costs line) it means that no profit or loss is occurring. This is the break-even point.

- Variable costs vary directly with output, as more output is produced then more variable costs are incurred.

- Fixed costs do not vary with output and are constant for a range of output produced. They are incurred even when there is no output at the beginning of production. This is because they are costs that must be incurred to support manufacture such as machinery or a warehouse.

- The total costs line is a representation of the combined variable and fixed costs. This is why at nil output it has a cost which represents fixed costs, and then as output increases the total cost line varies with it and in parallel with the variable cost line.

- The margin of safety is the extra amount of sales that is expected to be generated when the budget or actual sales is compared to the break even level of sales.

7.Explain in detail about the types of variance with formulae

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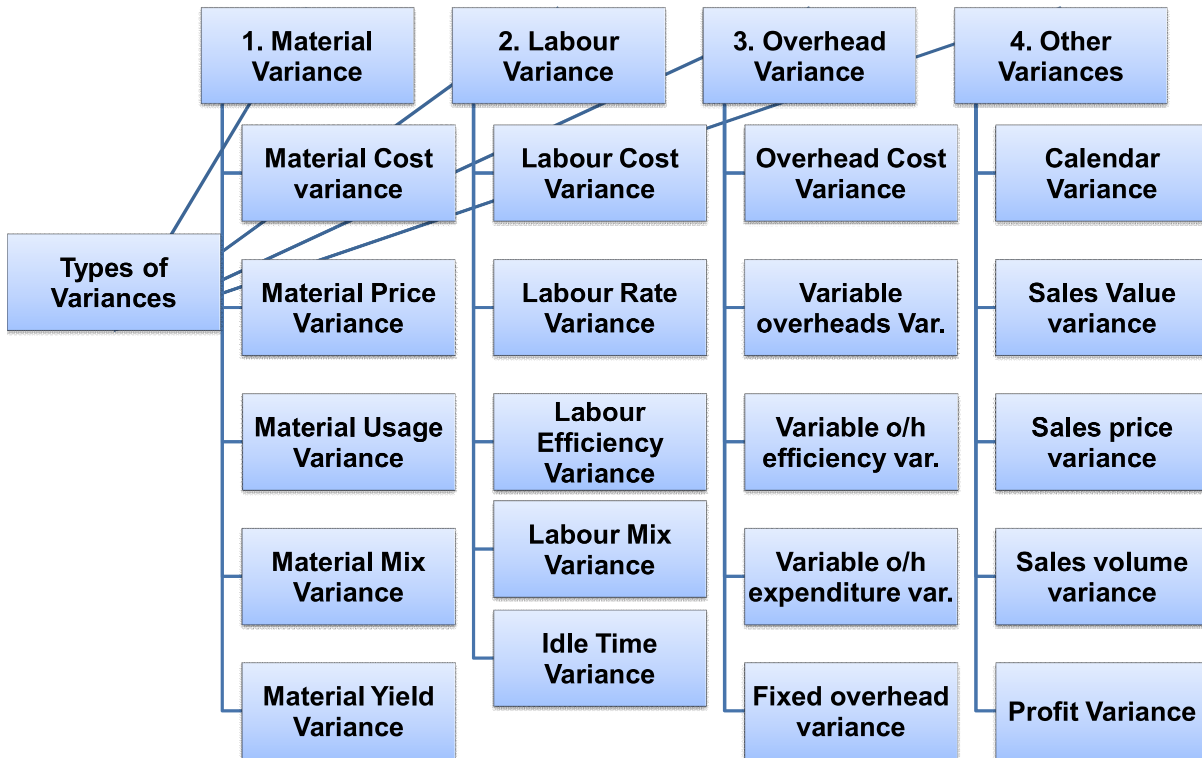
Types of variance includes the following



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I Material Variance

- ***Material Cost Variance = (SQ x SP) – (AQ x AP)***
- ***Material Price Variance = (SP – AP) x AQ***
- ***Material Usage Variance = (SQ – AQ) x SP***
- ***Material mix variance = SP X (RSQ-AQ) or***
- *Standard cost of actual quantity of the standard mixture – Standard cost of actual quantity of the actual mixture)*

SQ = Standard quantity for the actual output
SP = Standard price per unit of material
AQ = Actual quantity
AP = Actual price per unit of material

Rev. St. Qty = St. Qty of 1 Mat. x Actual Total / Standard Total

II Labour Variance

Labour Cost Variance = (SH x SR) – (AH x AR)
Labour Usage /Efficie. Var = (SH-AH) x SR

Labour Rate Variance = (SR-AR) x AH
Idle time Variance = SR x Idle time

Sales Variances
Sales Price Variance = (AP-BP) x AQ
Sales Volume variance = (AQ-BQ) x BC
Sales Value (Margin) Variance = (BQ X BC) – (AQ X AC)
Sales Mix Variance = BC X (RevisedBQ-AQ)
Revised BQ = Total actual quantity x B Ratio

III Overhead Variance

Variable Over head Variance = (SV o/h for actual prodn. – Actual variable o/h)
Variable Expenditure Variance = (AH x BR) – Actual Cost
Variable Overhead Efficiency Variance = (SH-AH) x SR
Fixed Overhead Variance = Budgeted FO- AFO

8. Enumerate the Advantages and disadvantages of Standard costing

The advantages of the standard costing are given below:

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1.Efficiency measurement-- The comparison of actual costs with standard costs enables the management to evaluate performance of various cost centers. In the absence of standard costing system, actual costs of different period may be compared to measure efficiency. It is not proper to compare costs of different period because circumstance of both the periods may be different. Still, a decision about base period can be made with which actual performance can be compared.

2.Finding of variance-- The performance of variances are determined by comparing actual costs with standard costs. Management is able to spot out the place of inefficiencies. It can fix responsibility for deviation in performance. It is possible to take corrective measures at the earliest.

3.Management by exception-- The targets of different individuals are fixed if the performance is according to predetermined standards. In this case, there is nothing to worry. The attention of the management is drawn only when actual performance is less than the budgeted performance. Management by exception means that everybody is given a target to be achieved and management need not supervise each and everything. The responsibilities are fixed and every body tries to achieve his/her targets.

4.Cost control-- Every costing system aims at cost control and cost reduction. The standards are being constantly analyzed and an effort is made to improve efficiency. Whenever a variance occurs, the reasons are studied and immediate corrective measures are undertaken

5.Right decisions-- It enables and provides useful information to the management in taking important decisions. It can also be used to provide incentive plans for employees etc. **6.Eliminating inefficiencies--** The setting of standards for different elements of cost requires a detailed study of different aspects. The standards are set differently for manufacturing, administrative and selling expenses.The determination of manufacturing expenses will require time and motion study for labor and effective material control devices for materials. All these studies will make it possible to eliminate inefficiencies at different steps.

9. Limitations of Standard Costing

1.It cannot be used in those organizations where non-standard products are produced. If the production is undertaken according to the customer specifications, then each job will involve different amount of expenditures.

2.The process of setting standard is a difficult task, as it requires technical skills. The time and motion study is required to be undertaken for this purpose. These studies require a lot of time and money.

3.There are no inset circumstances to be considered for fixing standards. The conditions under which standards are fixed do not remain static. With the change in circumstances, if the standards are not revised the same become impracticable.

4.The fixing of responsibility is not an easy task. The variances are to be classified into controllable and uncontrollable variances. Standard costing is applicable only for controllable variances.

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10. **What is Standard costing. Discuss in detail**.

Definition

The CIMA, London has defined standard cost as “a predetermined cost which is calculated from management’s standards of efficient operations and the relevant necessary expenditure.” They are the predetermined costs on technical estimate of material labor and overhead for a selected period of time and for a prescribed set of working conditions. In other words, a standard cost is a planned cost for a unit of product or service rendered. The technique of using standard costs for the purposes of cost control is known as standard costing. It is a system of cost accounting which is designed to find out how much should be the cost of a product under the existing conditions. The actual cost can be ascertained only when production is undertaken. The predetermined cost is compared to he actual cost and a variance between the two enables the management to take necessary corrective measures.

AdvantagesStandard costing is a management control technique for every activity. It is not only useful for cost control purposes but is also helpful in production planning and policy formulation. It allows management by exception. In the light of various objectives of this system, some of the advantages of this tool are given below:

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1.Efficiency measurement-- The comparison of actual costs with standard costs enables the management to evaluate performance of various cost centers. In the absence of standard costing system, actual costs of different period may be compared to measure efficiency. It is not proper to compare costs of different period because circumstance of both the periods may be different. Still, a decision about base period can be made with which actual performance can be compared.

2.Finding of variance-- The performance variances are determined by comparing actual costs with standard costs. Management is able to spot out the place of inefficiencies. It can fix responsibility for deviation in performance. It is possible to take corrective measures at the earliest. A regular check on various expenditures is also ensured by standard cost system.

3.Management by exception-- The targets of different individuals are fixed if the performance is according to predetermined standards. In this case, there is nothing to worry. The attention of the management is drawn only when actual performance is less than the budgeted performance. Management by exception means that everybody is

given a target to be achieved and management need not supervise each and everything. The responsibilities are fixed and every body tries to achieve his/her targets.

4.Cost control-- Every costing system aims at cost control and cost reduction. The standards are being constantly analyzed and an effort is made to improve efficiency. Whenever a variance occurs, the reasons are studied and immediate corrective measures are undertaken. The action taken in spotting weak points enables cost control system.

5.Right decisions-- It enables and provides useful information to the management in taking important decisions. For example, the problem created by inflating, rising prices. It can also be used to provide incentive plans for employees etc.

6.Eliminating inefficiencies-- The setting of standards for different elements of cost requires a detailed study of different aspects. The standards are set differently for manufacturing,administrative and selling expenses. Improved methods are used for setting these standards. The determination of manufacturing expenses will require time and motion study for labor and effective material control devices for materials. Similar studies will be needed for finding other expenses. All these studies will make it possible to eliminate inefficiencies at different steps.

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Limitations of Standard Costing

1.It cannot be used in those organizations where non-standard products are produced. If the production is undertaken according to the customer specifications, then each job will involve different amount of expenditures.

2.The process of setting standard is a difficult task, as it requires technical skills. The time and motion study is required to be undertaken for this purpose. These studies require a lot of time and money.

3.There are no inset circumstances to be considered for fixing standards. The conditions under which standards are fixed do not remain static. With the change in circumstances, if thestandards are not revised the same become impracticable.

4.The fixing of responsibility is not an easy task. The variances are to be classified into controllable and uncontrollable variances. Standard costing is applicable only for controllable variances. For instance, if the industry changed the technology then the system will not be suitable. In that case, we will have to change or revise the standards. A frequent revision of standards will become costly.

11. Explain the elements of Costs.

Elements of costs

The cost of any product or service is the sum of various segments of the cost. Such segments are treated as elements of cost e.g. the cost of a chair prepared out of a piece of wood involves following cost elements: Cost of raw materials (piece of wood) Labor cost (wages paid to operator) Overhead cost (Building and other services required for manufacturing chairs)

In general all types of manufacturing involve the following elements of cost:

1) Direct material cost,

2) Direct labor cost

3) Direct expenses,

4) Overhead cost;

(i) Factory overheads,

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(ii) Administrative overheads,

(iii) Selling and distribution overheads.

Direct materials cost: Direct material cost in the cost of material (may be raw material unprocessed material fully or partly processed material, components etc) used for the manufacture of the units. It is directly traceable to the production units. The direct material cost includes the purchase price as well as incidental expenses such as freight, insurance, loading and unloading expenses, import duties etc. the expenses incurred or the primary packing materials are also treated a direct material cost. The expenses incurred for grease and oil, nails, etc leaning materials other consumable stores etc of engaged in the manufacturing of the product. It also includes the wages paid to all such workers who are solely engaged in a particular type of production, job or contract which are directly attributable to that specific cost unit e.g. wages paid to the worker engaged in handling the product inside the department. Wages paid to the time keeper watchman sweeper etc are common nature expenses and are treated as indirect labor expenses. They are treated as indirect expenses and are treated as overhead costs. Direct expenses are such expenses other than those incurred on direct material and direct labor which can be directly attributed to the cost unit. Such expenses are specially incurred on a particular job, contract or work order, e.g. cost of

trial units, cost of special designs drawings molds of patterns cost of hiring special tools and equipment, consultancy for specific job etc. It should be noted that direct cost, direct labor cost and direct expenses are collectively known s prime cost.

Overhead costs: are the indirect costs which cannot be directly attributed to any particular cost unit (i.e. a product, a job contract etc). They are also referred as overheads. Aforesaid materials direct labor and direct expenses are treated as direct cost and all expenses other than direct cost are treated as overheads or indirect expenses Overheads are classified into the three groups: (1) Factory overheads (2) Administrative overheads, and (3) Selling and distribution overheads

Factory overhead: Factory overheads include all indirect expenses which are incurred in connection with the manufacture of a product. They are also known as works overheads, or factory burden or works burden. Factory overheads may be fixed or variable.

Fixed factory overheads are those costs which do not vary with the volume of production e.g. rent on factory building salary of watchman, time keeper, supervisor, expenses on labor, welfare activities etc.

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Variable factory overheads vary directly with the volume of production. They include cost of fuel and power, cost of repair and maintenance cost of normal idle time of normal wastage and silage etc.

Administrative overheads include all those indirect expenses which are incurred in respect of general administration and management of an enterprise. These expenses are of common nature and are incurred for the business as a whole. They are apportioned among cost units on some appropriate basis. Like factory overheads, administrative overheads also tends be fixed and variable. The fixed administrative overheads include rent and rates on office buildings, salaries to clerical staff, salaries to executives, salaries to Managing director and directors' legal charges audit fees etc. The variable expenses may include items like stationery postage, telephone charges, Lighting and heating expenses. They are more of a semi-variable mature.

Selling and distribution expenses are indirect costs which pertain to the marketing the product or services. They are not directly related to the cost of the products, jobs, contracts or services. Sometimes selling and distribution costs are separated with a view to apportion these overheads on some accurate basis. Like other overheads they also comprise on variable elements