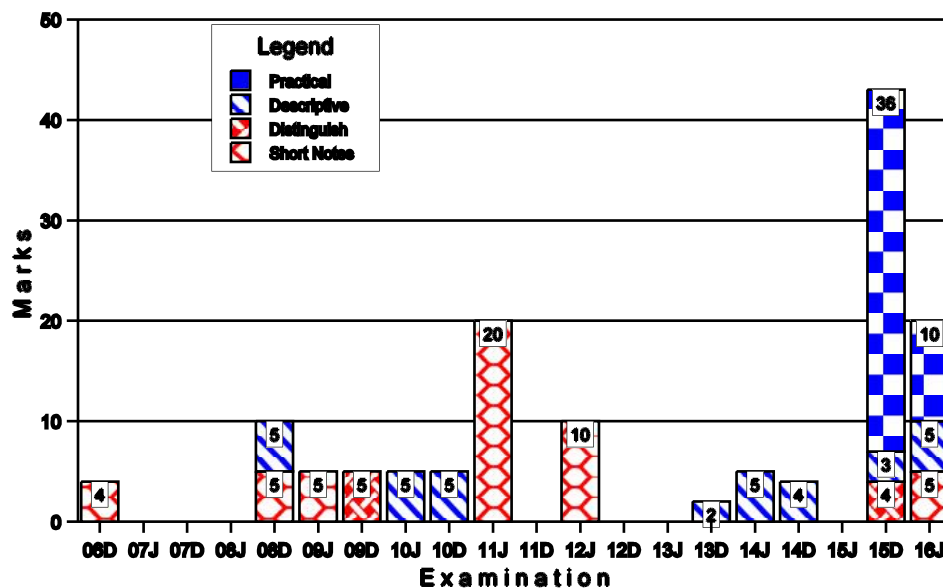


1

Basic Concepts & Accounting Standards

This Chapter Includes : Evolution of Cost Accounting, Cost Accounting Concepts, Generally Accepted Cost Accounting Principles, Cost Accounting Standards

Marks of Short Notes, Distinguish Between, Descriptive & Practical Questions



Summary of Chapter at a Glance

1.1 Definitions

1.1 Costing According to CIMA costing is defined as “the technique and processes of ascertaining costs.”

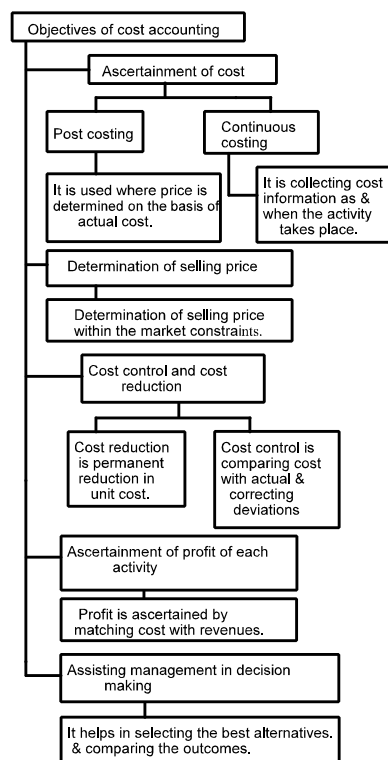
1.2 Cost Accounting According to CIMA “Cost accounting is a process of

Questions of December - 2007 are from CMA Gr. I and from December - 2008 onwards are from CMA Gr. II New Course.

accounting costs from the point at which expenditure is incurred or committed to the establishment of its ultimate relationship with cost centres and cost unit. In its widest usage it embraces the preparation of statistical data, the application of cost control method and ascertaining of profitability of activities carried out or planned”.

1.3 Cost Accountancy According to CIMA Cost accountancy is defined as “the application of costing and cost accounting principles, methods and techniques to science, art and practice of cost control and the ascertainment of profitability. It includes the presentation of information derived there from for the purpose of managerial decision making”.

1.2 Objective of cost accounting



1.3 Advantages of cost accounting

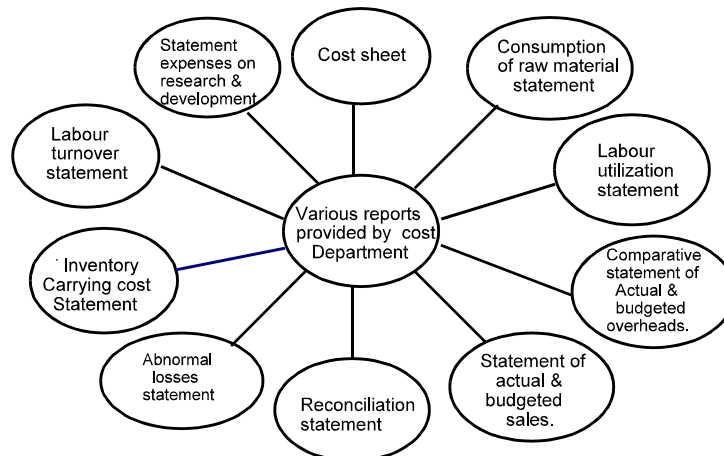
- It helps in cost control.

- It helps in decision making.
- It helps to identify profitable and unprofitable activities.
- It helps in fixation of selling price.
- It aids in formulating prices.
- It identifies idle capacity.
- It helps in inventory control.
- It identifies causes for increase or decrease in profit.
- It prevents frauds and manipulation.
- It checks accuracy in financial statements

1.4 Essentials for Cost accounting system are:

- It requires support of executives or top management.
- It should be suitable to the organisation.
- Cost should be Controllable.
- Cost of system should be accurate.
- The system should be Specially designed.
- Integration with financial accounts.
- Accrual reports.
- Avoid unnecessary details.
- Continuous training of staff is required.

1.5 Various reports provided by Cost Department.



1.6 Cost concepts

- **Cost**

It is defined as “the amount of expenditure incurred on, or attributable to, a given thing.”

- **Cost object**

→ It can be anything for which a separate measurement of cost is desired.

→ Eg: Product, service, project, customer, activity, etc.

- **Direct cost**

→ Those cost which are directly identifiable with the product are direct costs.

→ Eg: direct material, direct labour, direct expenses, etc.

- **Indirect cost**

→ Those cost which cannot be directly identified with the product are indirect cost.

→ Eg: indirect material, labour, etc.

- **Pre-determined cost**

Costs which are determined in advance i.e. before the actual cost is incurred on the basis of some factors are predetermined costs.

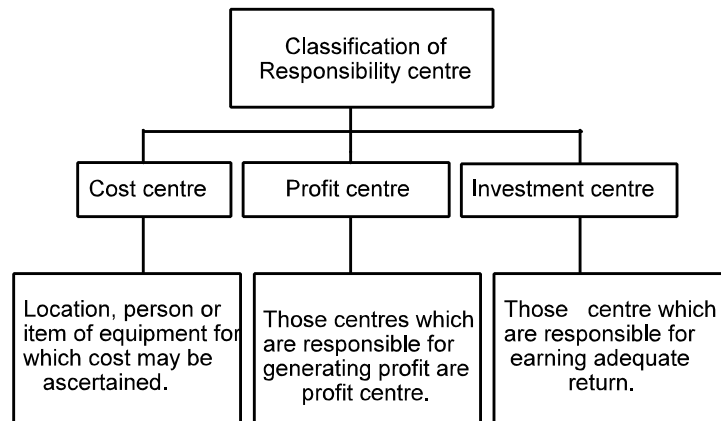
- **Total cost**

→ The sum of all the costs is total cost.

→ Total cost = variable cost + fixed costs

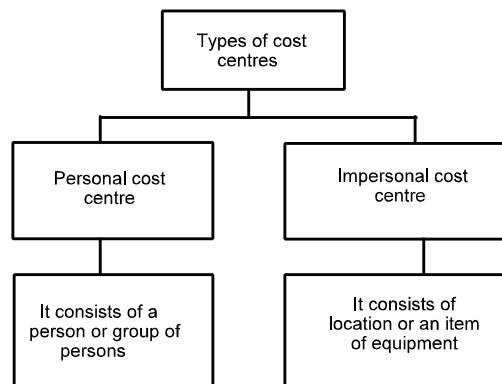
- **Responsibility centre**

It is defined as an activity centre of a business organisation entrusted with a special task.



- **Cost centre**

- It is defined as “a location, person or an item of equipment (or group of these) for which cost may be ascertained.”
- It is used for controlling costs.



- **Cost unit**

It is a unit of production, service time or a combination of these, in relation to which costs may be ascertained or expressed.

Industry or Product

Construction
Nuts & bolts
Power

Cost unit basis

each contract
gross
KWH

Chemicals	litre. Gallon, Kg, etc.
Transport	passenger, Km, etc.

- **Profit centre & Investment centre**

Profit centre - Those centres which are responsible for generating profit are profit centre.

Investment centre - Those centres which are responsible for earning adequate return.

- **Cost allocation & Cost absorption**

→ Cost allocation is defined as the process of allotment or identification of whole items to cost centre or unit.

→ Cost absorption is process of absorbing all indirect costs allocated or apportioned over particular cost centre.

- **Differential cost**

→ It is defined as the change in total cost due to various factors.

→ Differential cost calculations include both variable and fixed costs which are affected by the alternative courses of action.

- **Imputed cost**

→ Notional costs which are not actually incurred but considered in cost accounts are imputed costs.

→ Eg: notional rent in respect of own building, etc.

- **Capitalized cost**

Those costs which are initially recorded as assets and subsequently treated as expense are capitalized costs.

- **Product cost & Period cost**

→ Product costs are those costs which are assigned to the product.

→ It is included in the inventory valuation.

→ Eg: direct material cost, direct wages cost, etc.

→ Period costs are those which cannot be assigned to the particular product.

→ These are charged against revenue.

→ Eg: administrative expenses, selling & distribution expenses, etc.

- **Opportunity cost**

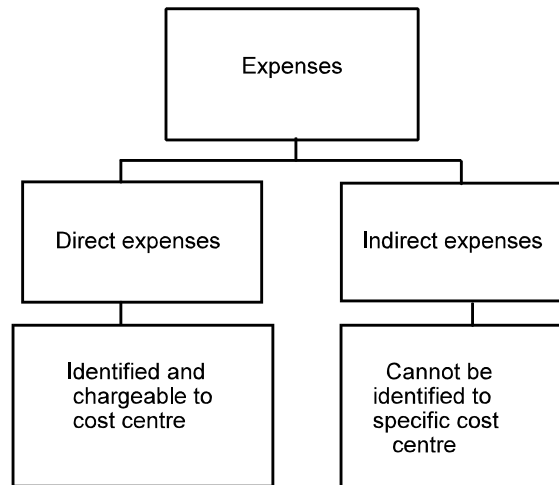
→ It is the cost of next best activity which is to be foregone.

→ It is applied in managerial decision making where various alternatives are available.

- **Out of pocket cost**

- It is the cost which will be actually incurred on the additional unit of output.
- It is relevant in case of trade depression, competition, etc.
- Only payments to outsiders are considered.
- **Shut down cost**
Costs which will continue to be incurred even if business is temporarily shut down are shut down costs. Eg: depreciation, rent, etc.
- **Sunk cost**
 - The cost which had already been occurred in the past & is not relevant for the current period are sunk costs.
 - This is irrecoverable costs.
 - The loss will be treated as sunken loss.
 - Eg: the WDV of machine less its realizable value will not be taken in machine replacement decision.
- **Discretionary cost**
 - These costs are not fixed in nature.
 - They are incurred in accordance with certain policy decision of top management.
 - These are also known as programmed cost.
 - Eg: advertising, research & development etc.
- **Engineered cost**
Those cost which results specifically from clear cause & effect relationship between inputs & outputs.
- **Explicit cost & Implicit cost** → Explicit costs involve immediate outflow of cash.
 - They are entered into the books of account.
 - Eg: salaries, wages, postage & telegram, etc.
 - They are also known as out of pocket costs.
 - Implicit costs do not involve immediate outflow of cash.
 - They are not recorded in the books of account.
 - They are also known as economic costs.
- **Conversion cost**
The sum total of direct wages & production overheads, in relating to conversion of raw materials into WIP and finished goods is conversion cost.
 - Controllable & Un controllable cost

- Controllable costs are those which can be controlled.
- Cost which can be influenced by the action of members of organisation.
- For Eg: direct costs are controllable costs.
- Uncontrollable cost are those which cannot be controlled
- Costs which cannot be influenced by the action of members of organisation.
- There is a very thin line between controllable & uncontrollable cost as no cost is uncontrollable.
- **Pre-production cost**
They are the part of development cost incurred in making a trial production run prior to formal production.
- **Chargeable Expense**
 - These are also called direct expenses.
 - These expenses are directly charged to product or cost unit.
 - These are treated as a part of prime costs.
 - They are directly identifiable.
 - Eg: Cost of patent rights, hire charges of special plant, experimental costs, Royalty paid in mining, costs of special layouts and designs, etc.
- **Relevant Cost**
 - This signifies cost including future costs which are relevant to a particular decision in hand.
 - It helps the management in decision making.
 - Relevant costs are also called out of pocket cost unless these are used in different context.
 - Only those costs are relevant if these help the management in taking right decision to achieve organisation objective.
 - For Eg: if a manufacturer is considering closing down of unprofitable shop, wages payable to workers are relevant costs.

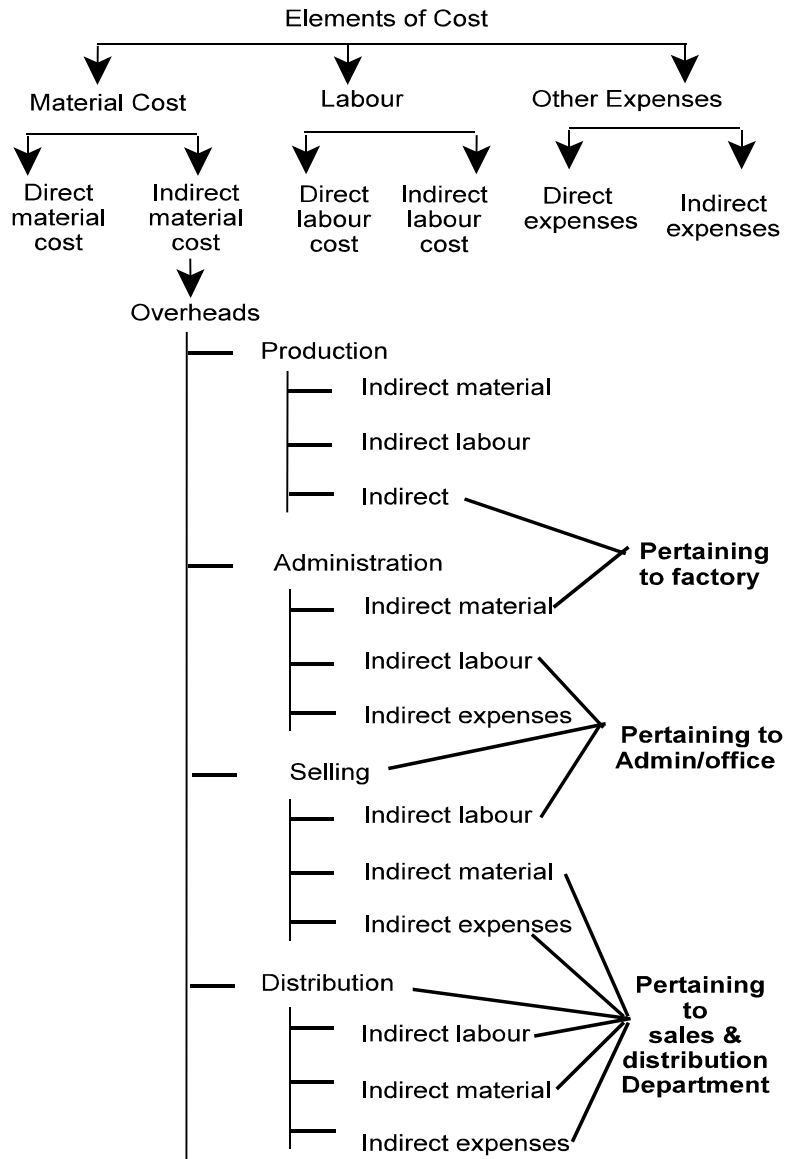
1.7 Expenses :**1.7(a) Direct Expenses**

CIMA has defined direct expenses as “direct expenses are those expenses which can be directly identified with and allocated to cost centers or units.” Thus, they are directly identifiable and chargeable to a product process, job, contract and service. They form a major part of prime cost. Example: Cost of patent rights, hire charges of special plant, experimental costs, Royalty paid in mining, costs of special layouts and designs, etc.

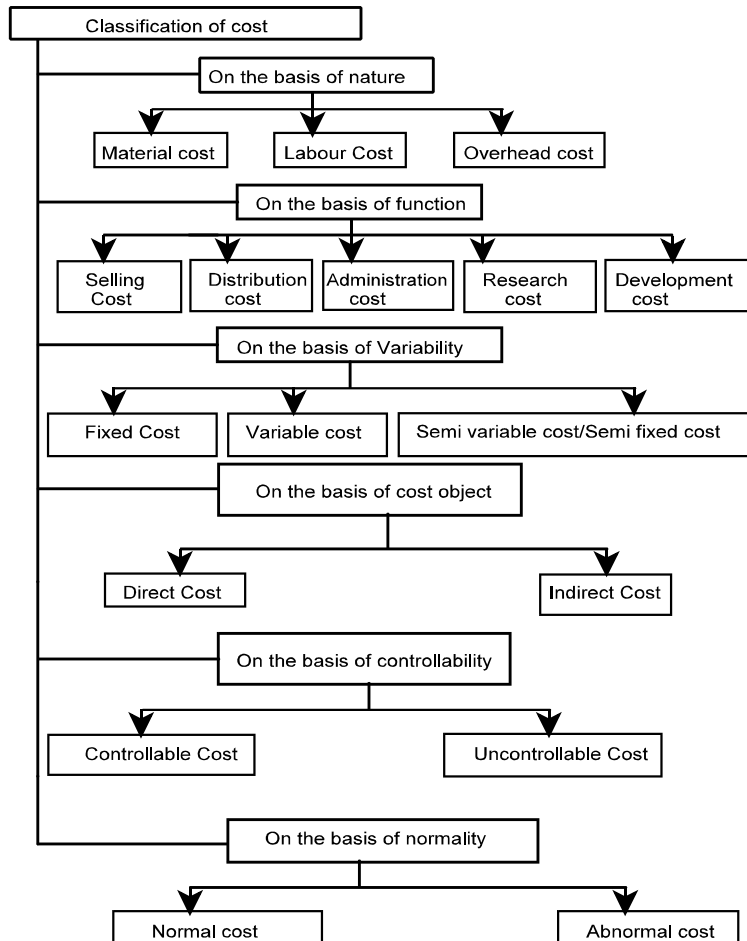
1.7(b) Indirect Expenses

These expenses cannot be identified to product, process, job & service. For example Rent, repair, rates, depreciation of Factory building, etc.

1.8 Elements of Cost



1.9 Classification of Costs

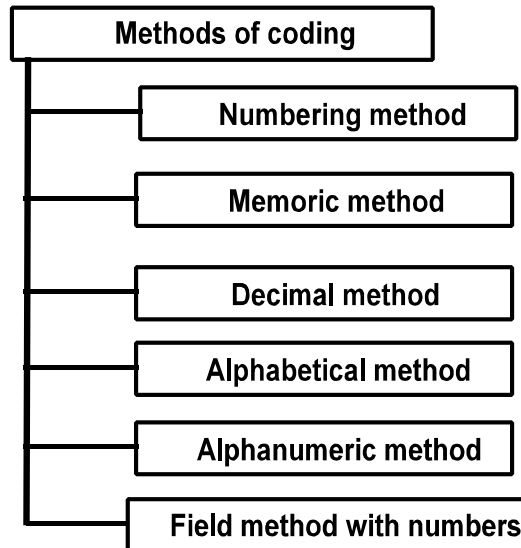


1.10 Coding system

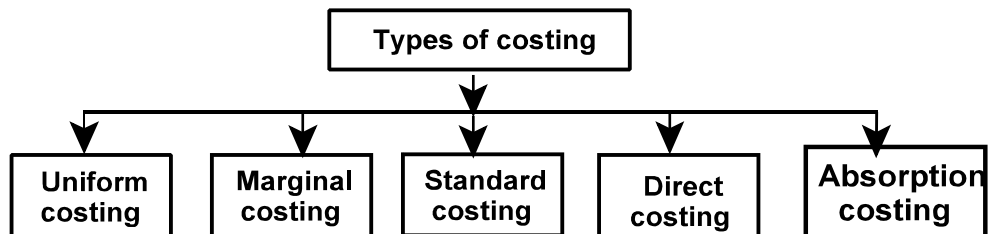
CIMA defines code as “a system of symbol designed to be applied to classified set of item to give a brief account reference, facilitating entry collation and analysis”.

1.11 Advantages of coding system

- It saves time.
- It reduces data storage capacity.
- It reduces ambiguity.
- It facilitates data processing in computerised system.

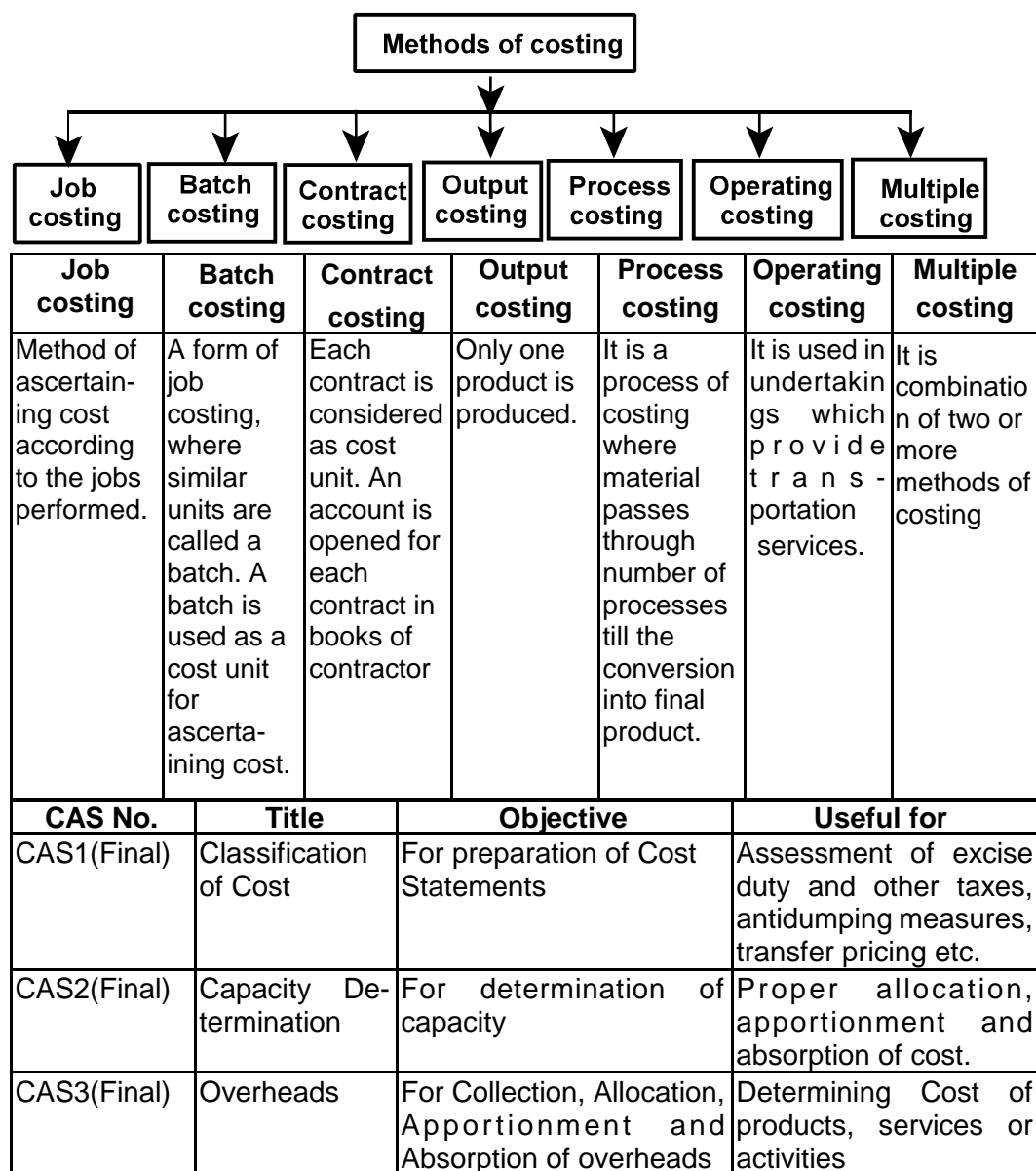


1.12 Types of costing



Uniform costing	Marginal costing	Standard costing	Historical costing	Direct costing	Absorption costing
When all the firms agree to follow same costing system.	Where cost is charged after segregating fixed & variable cost.	Standard costing is a predetermined cost to be used as a measure with which actual cost may be compared.	Cost is ascertained when actually it has incurred.	It is a method of costing in which all direct cost is charged from operations.	Charging all cost of product or period is absorption costing.

1.13



Revised CAS3(Exposure Draft)	Overheads	To bring uniformity and consistency in the principles and methods of determining the Overheads with reasonable accuracy.	Determining the Overheads with reasonable accuracy.
CAS4(Final)	Cost of Production for Captive Consumption	To determine the assessable value of excisable goods used for captive consumption.	Determining Cost of products, services or activities
CAS5(Final)	Average (equalized) Cost of Transportation	To determine averaged/equalized transportation cost	Calculating the amount of deduction from assessable value of excisable goods, freight subsidy, Insurance claim valuation, etc.
CAS6(Final)	Material Cost	To bring uniformity and consistency in the principles and methods of determining the material cost with reasonable accuracy in an economically feasible manner.	Applicable to all cost statements which require measurement, assignment, classification and presentation of material costs. To be followed in all cost statements requiring assurance including attestation.
CAS7(Final)	Employee Cost	To bring uniformity and consistency in the principles and methods of determining the Employee cost with reasonable accuracy.	Applicable to cost statements which require classification, measurement, assignment, presentation and disclosure of Employee cost including those requiring attestation.
CAS8(Final)	Cost of Utilities	To bring uniformity and consistency in the principles and methods of determining the Cost of	Applicable to cost statements which require classification, measurement,

		Utilities with reasonable accuracy.	assignment, presentation and disclosure of Cost of Utilities including those requiring attestation.
CAS9(Final)	Packing Material Cost	To bring uniformity and consistency in the principles and methods of determining the Packing Material Cost with reasonable accuracy.	Applicable to cost statements which require classification, measurement, assignment, presentation and disclosure of Packing Material Cost including those requiring attestation.
CAS10 (Final)	Direct Expenses	To bring uniformity and consistency in the principles and methods of determining the Direct Expenses with reasonable accuracy.	Applicable to cost statements which require classification, measurement, assignment, presentation and disclosure of Direct Expenses including those requiring attestation.
CAS11 (Final)	Administrative Overheads	To bring uniformity and consistency in the principles and methods of determining the Administrative Overheads with reasonable accuracy.	Applicable to cost statements which require classification, measurement, assignment, presentation and disclosure of Administrative Overheads including those requiring attestation.
CAS12 (Final)	Repairs And Maintenance Cost	To bring uniformity and consistency in the principles and methods of	Applicable to cost statements which require classification,

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		determining the Repairs and Maintenance Cost with reasonable accuracy.	measurement, assignment, presentation and disclosure of Repairs and Maintenance Cost including those requiring attestation.
CAS13 (Final)	Cost of Service Cost Centre	To bring uniformity and consistency in the principles and methods of determining the Cost of Service Cost Centre with reasonable accuracy.	Applicable to the preparation and presentation of cost statements, which require classification, measurement and assignment of Cost of Service Cost Centre, including those requiring attestation.

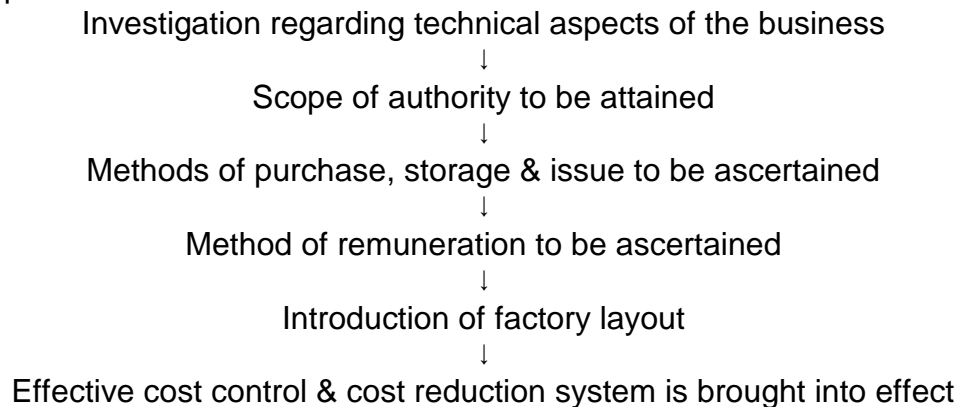
SHORT NOTES**2006 - Dec [8]** Write short note on the following:

(d) Installation of a cost system

(4 marks)

Answer :**Installation of a cost system:**

Steps:



↓
System is introduced gradually

2008 - Dec [8] Write short note on the following :

(d) Uniform Costing

(5 marks)

Answer :

Uniform Costing: It is the practice of using the same costing principles and/or practices by a number of firms in the same industry. It helps in inter firm comparison, fixation of price, cost control and cost reduction and in seeking tax relief or protection from Government. For better perception and judgment of performance of individual units/undertakings by a comparative study, the performance/achievement must be expressed in the same denomination so that like is compared with like.

2009 - June [8] Write short note on the following:

(c) Profit Centre;

(5 marks)

Answer :

Profit Centre: Profit centre is a responsibility centre for which both costs and revenues are accumulated.

As defined by CIMA, London profit centre "a part of business accountable for costs and revenues" It may be called a Business Unit or Strategic Business Unit. The object of profit centre is to maximise the centre's profit i.e. difference between revenues and expenses.

2011 - June [4] (a) Write a brief note on Management Accounting.

(5 marks)

Answer :

Management Accounting : Management accounting is concerned with accounting information which is useful for the management. It is "the presentation of accounting information in such a way as to assist the management in the creation of policy and day to day operation of the undertaking" It includes the methods and concepts necessary for effective planning, for choosing between alternative business actions and for control through the evaluation and interpretation of performance. It embraces within its fold several subjects and cost accounting is one of them.

2011 - June [5] (b) Write note on Chargeable Expenses.

(5 marks)

Answer :

Chargeable Expenses:

- These are also called direct expenses.
- These expenses are directly charged to product or cost unit.
- These are treated as a part of prime costs.
- They are directly identifiable.
- E.g. Cost of patent rights, hire charges of special plant, experimental costs, Royalty paid in mining, costs of special layouts and designs, etc.

2011 - June [8] Write short notes on the following :

- (a) Profit Centre, (5 marks)
(c) Cost Control and Cost Reduction, (5 marks)

Answer :

- (a) Please refer 2009 - June [8] (c) on page no. 27

Answer:

(c) Cost Control & Cost Reduction : Cost control and cost reduction are two different concepts. Cost control has achieved the cost targets as its objective while cost reduction is directed to explore the possibility of improving the targets themselves.

Cost reduction is a continuous process and has no visible end while cost control ends when targets are achieved.

- Cost control aims at maintaining the costs in accordance with established standards.
- Cost control seeks to attain lowest possible cost under existing conditions.
- Cost control is a preventive function.
- Cost reduction is concerned with reducing costs.
- Cost reduction recognizes no condition as permanent ,since a change will result in a lower cost.
- Cost reduction is a corrective function.

2012 - June [8] Write short notes on the following :

- (a) Absorption Costing;
(b) Cost Control and Cost Reduction; (5 marks each)

Answer :

(a) Absorption Costing :

This is total cost technique under which total cost is charged as production cost. Under absorption costing, all manufacturing costs are 'absorbed' in the cost of produced. In this system, fixed factory overheads are absorbed on the basis of a predetermined overhead rate based on normal capacity. Under/over absorption overheads are adjusted before computing profit for a particular period. Costing stock is also valued at total cost which includes fixed factory overheads (and sometimes administration overhead also).

Limitations of Absorption Costing :

- (i) A portion of fixed cost is carried over to the subsequent accounting period as part of closing stock. This is an unsound practice because costs pertaining to a period should not be allowed to be vitiated by the inclusion of costs pertaining to the previous and vice versa.
- (ii) Absorption costing is dependent on the levels of output which may vary from period to period, and consequently cost per unit changes due to the existence of fixed overhead. Unless fixed overhead rate is based on normal capacity, such changed costs are not helpful for the purposes of comparison and control.

Answer:

(b) Please refer 2011 - June [8] (c) on page no. 28

2016 - June [5] (b) Write a short note on:

- (i) Profit Centre and
- (ii) Responsibility Centre. How do they differ? (5 marks)

DISTINGUISH BETWEEN

2009 - Dec [5] (a) Distinguish between Cost control and Cost reduction. (5 marks)

Answer :

Difference between Cost Control and Cost Reduction can be summarized in the following table:

Cost control	Cost reduction
1. The word 'control' indicates an exercise in restraint. When	1. Cost reduction involves exceeding the target. It believes

<p>expenses are controlled. they are restrained from growing larger than they should grow. Cost control is cost management. It is meeting the budgeted targets set.</p>	<p>in the premise that there is always scope for further improvement. There is a concern for reducing the expenses that are too high.</p>
2. It is an organized and intentional effort to limit the growth of cost' within limits.	2. It is an organized and intentional one time or continuous initiative taken with the goal to reduce cost from current level to a lower level.
3. It is a reactive measure to stem cost growth to stay within budget. It is an effort to limit the growth of cost.	3. It is a proactive effort to actually reduce costs from baseline.
4. In business practices. Cost control is a much better plan of action. It involves creation of responsibility centres with clearly defined authorities and responsibilities.	4. It is an initiative taken with the goal to reduce costs from the current level to a desired lower level on a permanent basis. It is a reaction to a problem.
5. Motivating and encouraging employees to accomplish budgetary goals is one of the essential aspects of cost control.	5. The goal of cost reduction can be achieved in two ways. First-reduce the cost/unit and second-increase productivity. Reducing wastages. Improving efficiency, searching for alternatives, etc., can effect cost reduction.

2015 - Dec [II] (d) (1) What are the differences between Cost Control and Cost Reduction? (4 marks)

Answer:

Difference between Cost Control and Cost Reduction can be summarized in the following table:

Cost Control	Cost Reduction
1. The word 'control' indicates an exercise in restraint. When	1. Cost reduction involves exceeding the target. It believes

<p>expenses are controlled. They are restrained from growing larger than they should grow. Cost control is cost management. It is meeting the budgeted targets set.</p> <p>2. It is an organized and intentional effort to limit the growth of cost within limits.</p> <p>3. It is a reactive measure to stem cost growth to stay within budget. It is an effort to limit the growth of cost.</p> <p>4. In business practices. Cost control is a much better plan of action. It involves creation of responsibility centres with clearly defined authorities and responsibilities.</p> <p>5. Motivating and encouraging employees to accomplish budgetary goals is one of the essential aspects of cost control.</p>	<p>in the premise that there is always scope for further improvement. There is a concern for reducing the expenses that are too high.</p> <p>2. It is an organized and intentional one time or continuous initiative taken with the goal to reduce cost from current level to a lower level.</p> <p>3. It is a proactive effort to actually reduce costs from baseline.</p> <p>4. It is an initiative taken with the goal to reduce costs from the current level to a desired lower level on a permanent basis. It is a reaction to a problem.</p> <p>5. The goal of cost reduction can be achieved in two ways. First-reduce the cost/unit and second-increase productivity. Reducing wastages. Improving efficiency, searching for alternatives, etc., can effect cost reduction.</p>
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DESCRIPTIVE QUESTIONS

2008 - Dec [4] (a) "Costs may be classified in a variety of ways according to their nature and the information needs of the management" –Explain.

(5 marks)

Answer :

Cost classification is the process of grouping costs according to their characteristics. Costs are classified or grouped according to their common

characteristics. Costs may be classified according to elements, according to functions or operations, according to their behaviour, according to controllability or according to normality.

The breakup of the aggregate costs into relevant types, is an essential pre-requisite of decision making as well as of controlling costs. Classification of costs on different basis is thus necessary for various purposes. For the purpose of decision-making and control, costs are distinguished on the basis of their relevance to different type of decisions and control functions. The importance of distinguishing costs as direct or indirect lies in the fact that direct costs of a product or an activity can be accurately allocated while indirect costs have to be apportioned on the basis of certain assumptions. This is so because direct costs are controllable at the operational level whereas indirect costs are not amenable to such control.

2010 - June [3] (a) What is meant by 'Relevant Cost'? Explain with the help of illustration. (5 marks)

Answer :

Relevant costs (or revenues) are those costs which are appropriate to a specific management decision. These are represented by future cash flows whose magnitude will vary depending upon the outcome of the management decision made.

- (a) **Relevant cost are the future costs:** A decision is about the future; it cannot alter what has been done already. A cost that has been incurred in the past is totally irrelevant to any decision that is being made now. Costs that have been incurred include not only costs that have already been paid, but also costs that are subject of legally binding contracts.
- (b) **Relevant costs are cash flows:** Only cash flow information is required. This means that costs or charges which do not reflect additional costs, should be ignored for the purpose of decision-making.
- (c) **Relevant costs are incremental costs:** Only costs which will differ under some or all the available opportunities should be considered.

Illustration: For example, if an employee is expected to have no other work to do during next week, but will be paid his basic wages (of, say ₹1000 per week) for attending work and doing nothing. His manager might decide to give him a job which earns only ₹400 and it will be incurred anyway whether the employee is given work or not.

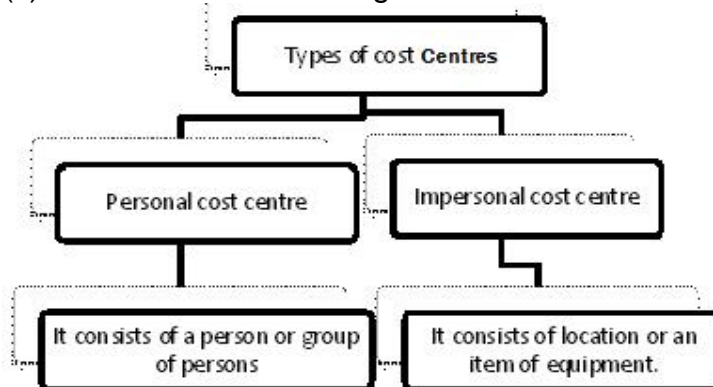
2010 - Dec [2] (b) Explain 'Cost Centre' and 'Cost Unit'.

(5 marks)

Answer :

Cost centre

- (a) It is defined as "a location, person or an item of equipment (or group of these) for which cost may be ascertained."
- (b) A cost centre is the smallest organizational sub-unit for which separate cost allocation can be done.
- (c) It is used for controlling costs.



Cost unit

It is a unit of production, service time or a combination of these, in relation to which costs may be ascertained or expressed. A cost unit is a unit of product or unit of service to which costs are ascertained by means of allocation, apportionment and absorption.

Industry or Product

Construction
Nuts & bolts
Power
Chemicals
Transport

Cost unit

each contract
gross
KWH
litre. Gallon, Kg, etc.
passenger, Km, etc.

2013 - Dec [1] {C} Answer the following:

- (f) State the cost units applicable to the following industries:
Cement, Goods Transport, Education, BPO

(2 marks)

Answer:

- **Cost unit applicable to Cement industry - Tonnes** (also any unit of

weight is acceptable e.g. quintal Kg. etc.)

- **Cost unit applicable to Goods transport- Tonnes – Kilometer** (also Any unit that is a product of weight and length (distance) (like ton-miles, quintal-miles, etc.)
- **Cost Unit applicable to Education- Student Year**
- **Cost Unit applicable to BPO - Accounts handled**

2014 - June [1] {C} Answer the following:

(e) How should packing costs be treated in Cost Accounts? (2 marks)

Answer:

Treatment of Packing Cost:

There are two types of packing materials:

1. **Primary:** Primary containers are essential to put the goods in a saleable condition like ink in a bottle, jam in a jar etc. The cost of primary containers should be charged off as a production overhead and included in production cost.
2. **Secondary:** Secondary containers are required for delivery/transportation like crates, etc. The cost of secondary containers should be charged as a selling and distribution overhead. The cost of reusable container should be charged when they could not be used any more due to damage, wear and tear etc.

In some cases, the primary packing materials may be made decorative with a view to promote sales, and in such a case a part of the primary packing materials should be apportioned as a selling cost.

2014 - June [3] (c) Name 3 factors that should be disclosed in the cost statements as per CAS-3. (3 marks)

Answer:

Following factors should be disclosed in the cost statement as per CAS-3:

- (i) The basis of assignment of overheads to the cost objects.
- (ii) Overheads incurred in foreign exchange.
- (iii) Overheads relating to resources received from or supplied to related parties.
- (iv) Any Subsidy / Grant / Incentive or any amount of similar nature received / receivable reduced from overheads.

- (v) Credits / recoveries relating to overheads.
- (vi) Any abnormal cost not forming part of the overheads.

2014 - Dec [2] Answer the question:

- (d) (ii) What is imputed cost? Give an example of imputed cost. Explain its position in a product cost sheet and in the decision making evaluation process. (4 marks)

Answer:

Imputed Cost: Imputed costs are hypothetical or notional costs, not involving cash outlay, computed only for the purpose of decision making. In this respect, imputed costs are similar to opportunity costs. Interest on funds generated internally, payment for which is not actually made is an example of imputed cost.

Example: If the owner of a company engages himself for facilitating the production or gets actively engaged in production or rendering of services, this would be an imputed cost.

Cost reported under various elements of cost will not include Imputed Costs. If such cost is not involved as cash outlay computed only for the purpose of decision making. When alternative capital investment projects are being considered out of which one or more are to be financed from internal funds, it is necessary to take into account the imputed interest on own funds before a decision is arrived at.

2015 - Dec [II] (d) (4) In a certain melting process, a material called 'coke' is put into the furnace along with other materials. Coke is also used as fuel to heat the furnace. How will you treat the cost of coke in the final product according to Cost Accounting Standards? (3 marks)

Answer:

Cost of Coke to the extent it is put into the furnace, subject to if being significant in value compared to other raw materials and measurable, should be taken as raw material cost under CAS. If it is insignificant in quantity or value, it should be taken as production overhead.

The quantity and value of coke used as fuel should be treated as indirect material and classified as production overhead.

2016 - June [3] (b) How should the following items be treated as per CAS 7?

- (i) Unavoidable idle time
- (ii) Normal idle time

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(iii) Abnormal idle time

(5 marks)

PRACTICAL QUESTIONS

2015 - Dec [I] (j) An examination centre has many rooms. 800 students are allotted seats @ 50 students per room. Every room requires two invigilators at ₹ 2,000/- per invigilator.

Based on cost behaviour, under which type of cost will you classify the invigilator costs, if the cost object is (i) an individual student (ii) a batch of 50 students? (2 marks)

Answer:

If the cost object is an individual student, invigilator cost is Fixed Cost.

If batch of 50 is cost object then, invigilator cost is Variable Cost.

2015 - Dec [II] (b) PQ Ltd. wishes to use standard costing system to report variances to the Management.

The following data is given:

Nature of product: Single product PQ, an electronic component, produced by manual assembly of purchased parts.

The following persons are involved in production:

Category	Details
DW	Direct workers involved in the assembly.
PA	Production Assistants who are helpers in the shop floor.
SS	Supervisory staff in the production shop floor.
OS	Office staff exclusively meant for production.

Other Information

Shift:	Single shift from 9-00 a.m. to 5-00 p.m.
Tea breaks:	15 minutes pre-lunch

Lunch:	15 minutes post-lunch
Waiting time for spares, parts, etc.	1 hour 2 hours/week (on an average 20 minutes/day)

Normally, according to past average, 5 units of PQ are finished by a direct worker during one shift.

The details for labour pay-outs are as follows:

	DW	PA	SS	OS
No. of persons	35	4	7	2
Basic pay	₹ 75/ hour	₹ 300/ shift	₹ 800/ shift	₹ 35,000 / month
Leave Travel Assistance (per annum per person)	₹ 10,000	₹ 8,000	₹ 20,000	₹ 25,000
Rates of pay on holidays (2 holidays per month other than Sundays)	₹ 100/ hour	₹ 500/ shift	₹ 1,000/ shift	₹ 2,000/ day
Attendance bonus for attendance of 80% or more no. of days. Flat rate ₹/person/month	2,000	1,500	3,000	4,000

The factory works on all holidays other than Sundays. Assume all the 52 Sundays are holidays and are weekly offs. 80% of the DW category get the attendance bonus, while in other categories, all the persons get the bonus.

- For the DW category, arrive at the standard labour cost per unit and the standard number of direct labour hours per unit of PQ to enable periodic reporting and corrective action by comparing variances.
- What amounts, on an annual basis, as per cost Accounting Standards would you show under Direct Labour, Works Overhead, Administrative Overhead or charge directly to the P&L A/c?
(Show workings per week × 52 weeks per annum).

(4 + 12 = 16 marks)

8.28

■ *Solved Scanner* CMA Inter Gr. I Paper 8A (New Syllabus)**Answer:**

- (b) (i) Hours per week = $8 \times 6 = 48$
 Average no. of products = $5 \times 6 = 30$
 DW hours paid = ₹ 75/hrs \times 48 hrs/week = ₹ 3,600
 Standard DW hrs/unit of production = $\frac{48}{30} = 1 \text{ hrs } 36 \text{ min. per piece}$
 or, $\frac{8 \text{ hrs}}{5 \text{ pcs}} = 1.6 \text{ hrs/piece.}$

Standard Direct Labour Cost/unit = $\frac{\text{₹}3,600}{30} = \text{₹ } 120/\text{unit}$ or, $1.6 \times$

₹ 75 = ₹ 120

Note: Tea-break, normal waiting time for job should be part of the standard time.

A. Assuming that Production Assistant as Direct workers and Rates of pay for holidays is inclusive of basic wages:

(ii)

Amount in ₹

Particulars	DW	PA	SS	OS
No. of persons	35	4	7	2
Basic Pay				
Per week Amount in ₹	75/hr \times 8 hrs/day \times 6 days/week \times 35 DW = 1,26,000	300/day \times 6 days \times 4 pa = 7,200	800/day \times 6 days \times 7 SS = 33,600	35,000/ m \times 2 OS = 70,000
Per annum Amount in ₹	1,26,000 \times 52 weeks = 65,52,000 (Direct Labour)	7,200 \times 52 weeks = 3,74,400 (Direct Labour)	33,600 \times 52 weeks = 17,47,200 (Production Overhead)	70,000 \times 12 m = 8,40,000 (Administration Overhead)
LTA Amount in ₹	10,000 \times 35 = 3,50,000 (Direct Labour)	8,000 \times 4 = 32,000 (Direct Labour)	20,000 \times 7 = 1,40,000 (Production Overhead)	25,000 \times 2 = 50,000 (Administration Overhead)

Holiday Premium Amount in ₹	$(100-75) \times 8$ hrs/day $\times 2$ days/m $\times 12$ m $\times 35$ DW = 1,68,000 (Production Overhead)	$(500 - 300)/\text{day} \times 2$ days/m $\times 12$ m $\times 4$ PA = 19,200 (Production Overhead)	$(1,000-800)/\text{day} \times 2$ days/m $\times 12$ m $\times 7$ SS = 33,600 (Production Overhead)	$2,000/\text{day} \times 2$ days/m $\times 12$ m $\times 2$ OS = 96,000 (Administration Overhead)
Attendance Bonus Amount in ₹	$2,000 \times 12$ m $\times 80\%$ of 35 DW = 6,72,000 (Production Overhead)	$1,500 \times 12$ m $\times 4$ PA = 72,000 (Production Overhead)	$3,000 \times 12$ m $\times 7$ SS = 2,52,000 (Production Overhead)	$4,000 \times 12$ m $\times 2$ OS = 96,000 (Administration Overhead)

Particulars		Direct Labour ₹	Production Overhead ₹	Administration Overhead ₹
Basic Pay				
DW		65,52,000		
PA		3,74,400		
SS			17,47,200	
OS				8,40,000
LTA				
DW		3,50,000		
PA		32,000		
SS			1,40,000	
OS				50,000
Holiday Premium				
DW			1,68,000	
PA			19,200	
SS			33,600	
OS				96,000

Attendance bonus				
DW			6,72,000	
PA			72,000	
SS			2,52,000	
OS				96,000
Total		73,08,400	31,04,000	10,82,000

Note: As per CAS - 7

- A. **Indirect Labour Cost** is the cost, which cannot be identified with a product unit. It represents the amount of wages which is paid to the workers who are not directly engaged on the production but **it includes wages paid to the workers and assistants working in departments** like purchasing, store keeping, time office, maintenance, and other service and **production departments**. Hence, payment to PA should be treated as Production Overhead.
- B. **Holiday/Overtime premium:** This is defined as 'Overtime is the time spent beyond the normal working hours' which is usually paid at a higher rate than the normal time rate. **The extra amount beyond the normal wages & salaries paid is called Overtime Premium.**
- C. Treatment of Overtime in Cost Records As per CAS - 7, Overtime Premium shall be assigned directly to the cost object or treated as overheads depending on the economic feasibility and specific circumstances requiring such overtime. **When overtime is worked due to exigencies or urgencies of the work, the basic/normal payment is treated as Direct Labour Cost and charged to Production or cost unit on which the worker is employed. Whereas the amount of premium (extra amount) is treated as overhead.**
- D. **Leave Travel Assistance:** Leave Travel Assistance is paid to practically all the employees presently and therefore can be considered as a regular element of labour or staff cost as the case may be. This expenditure is of a fixed nature and can be easily predetermined. **Depending whether the assistance is payable to direct labour, Indirect labour or staff the expenditure should be treated as Direct**

Labour Cost, Production Overhead Cost or Administrative Selling Overhead Cost and should be appropriately charged.

- E. **Attendance Bonus** is paid to workers based on satisfactory attendance over a stated period and is a fringe benefit. **The cost is to be collected under a standing order number and charged as a departmental overhead as the expenses cannot be allocated to cost units directly.**

When the cost is of a regular nature it may be booked as direct wages and charged by an inflated rate over the Direct Labour Cost. **But this is however, not a sound policy.**

2015 - Dec [II] (c) (2) A medicinal herb is collected by tribal people from the forest regions. The Purchase Department staff of X Ltd. visit the tribals in the villages, purchase the herbs and transport the herbs to the factory. The herbs are cleaned, dried, powdered and machine-packed in 100 gm sachets and sold as a certain curative medicine.

Which of the following items of cost will be treated as a direct expense under CAS-10?

If a certain item is not classified as a direct expense, under what element will it get classified?

- (i) Amount paid to the tribals.
- (ii) The product is patented. The cost of the patents.
- (iii) For every sachet sold, the tribal chief gets 5% as royalty. The amount of royalty.
- (iv) A pharmaceutical consultant is paid to test the effectiveness of each batch of medicine processed. The fees so paid.
- (v) Travel expenses of the Purchase Department personnel to the villages.
- (vi) Transport cost from the villages to the factory.
- (vii) Cost of the packing sachets.
- (viii) Cost of the personnel working in the cleaning and drying processes.

(4 marks)

- (3) Milk is produced in a factory and packed in half litre sachets. 100 sachets are packed in each metallic reusable container and the containers are transported to milk depots in airconditioned trucks, refrigerated in the depots and sold in retail. State the element of cost under which the factory has to classify the following items as per Cost

8.32**■ Solved Scanner CMA Inter Gr. I Paper 8A (New Syllabus)**

Accountancy Standards.

- (i) Cost of the sachets
 - (ii) Cost of the containers
 - (iii) Transportation costs
 - (iv) Refrigeration costs
 - (v) Depot's expenses—like rent, salary of staff etc.
 - (vi) Cost of advertising for the milk (3 marks)
- (4) ₹ 3,000/- and ₹ 60,000/- are written off raw materials and finished goods respectively for obsolescence. How should these be treated in Cost Accounts? (2 marks)

Answer:

- (c) (2)**
- (i) Payment Cost
 - (ii) Royalty
 - (iii) Fees of pharmaceutical Consultant
 - (iv) Cost of personnel in cleaning and drying- Direct Labour
 - (v) Amount paid to tribal- Raw Materials
 - (vi) Travel expenses of Purchase Department personnel for Raw Materials purchase- Raw Material or Administrative Overhead.
 - (vii) Transport from village to factory- Raw Material
 - (viii) Cost of the packing sachets- Production Overhead

(3)

	A	B	C
(i)	Cost of Sachets	Primary Packing Material	Production Overhead
(ii)	Cost of Containers	Secondary Packing Material	Selling and Distribution Overhead
(iii)	Transportation Costs	Relates of Finished Goods	Distribution Overhead
(iv)	Refrigeration Costs	Storage of Finished Goods	Distribution Overhead
(v)	Depot's Expenses	Marketing Cost	Selling & Distribution Overhead
(vi)	Advertisement Cost	Selling Expense	Selling & Distribution Overhead

- (4)** Obsolete inventory-Cost of Raw Material and Finished goods should be directly written of in the Profit & Loss A/c. No charge is made to cost of production.

₹ 63,000 (₹ 3,000 + ₹ 60,000) should be written off to Profit & Loss A/c.

2015 - Dec [II] (d) (2) What is meant by the following terms? Give an example of each in a situation where a factory makes use of the same production facility to make products A, B, C and D using the same raw material R.

- (i) Opportunity cost
 - (ii) Relevant cost
 - (iii) Replacement cost (2 x 3 = 6 marks)
- (3) Product B, with selling price of ₹ 600 per unit is the main product being produced by a factory. The factory uses component 'A' in the manufacture of B. 'A' is produced in-house. The cost of producing one unit of A is as follows: Direct Material—₹ 120; Direct labour— ₹ 80; Direct expense—₹ 20; Factory overheads: fixed—₹ 20; variable—₹ 15; Administrative expenses:—relating to production—₹ 12;—relating to others—₹ 5;
What is the amount relating to 'A' to be considered as material cost of B as per CAS-6? (3 marks)

Answer:

- (2) (i) **Opportunity Cost:** Opportunity cost is the value of alternatives foregone by adopting a particular strategy or employing resources in specific manner. It is the return expected from an investment other than the present one. These refer to costs which result from the use or application of material, labour or other facilities in a particular manner which has been foregone due to not using the facilities in the manner originally planned. Resources (or input) like men, materials, plant and machinery, finance etc., when utilized in one particular way, yield a particular return (or output). If the same input is utilized in another way, yielding the same or a different return, the original return on the forsaken alternative that is no longer obtainable is the opportunity cost. For example, if fixed deposits in the bank are proposed to be withdrawn for financing project, the opportunity cost would be the loss of interest on the deposits. Similarly when a building leased out on rent to a party is got vacated for own purpose or a vacant space is not leased out but used internally, say, for expansion of the production programme, the rent so forgone is the opportunity cost.

- (ii) **Relevant Cost:** Relevant costs (or revenues) are those costs which are appropriate to a specific management decision. These are represented by future cash flows whose magnitude will vary depending upon the outcome of the management decision made.
- (a) **Relevant cost are the future costs:** A decision is about the future; it cannot alter what has been done already. A cost that has been incurred in the past is totally irrelevant to any decision that is being made now. Costs that have been incurred include not only costs that have already been paid, but also costs that are subject of legally binding contracts.
- (b) **Relevant costs are cash flows:** Only cash flow information is required. This means that costs or charges which do not reflect additional costs, should be ignored for the purpose of decision-making.
- (c) **Relevant costs are incremental costs:** Only costs which will differ under some or all the available opportunities should be considered.
- (iii) **Replacement Cost:** Replacement cost is the cost of an asset in the current market for the purpose of replacement. Replacement cost is used for determining the optimum time of replacement of an equipment or machine in consideration of maintenance cost of the existing one and its productive capacity. This is the cost in the current market of replacing an asset. For example, when replacement cost of material or an asset is being considered, it means that the cost that would be incurred if the material or the asset was to be purchased at the current market price and not the cost at which it was actually purchased earlier, should be take into account.
- (3) As per CAS – 6, Self manufactured item shall valued at DM + DL + DE + F.OH + Ad.OH (production)
 $= 120 + 80 + 20 + 20 + 15 + 12 = ₹ 267$
 For an item to be called material cost under CAS – 6. It has to be significant and economically traceable to the cost object, otherwise it is an indirect material and classified as an overhead of production.
 Component A is significant, bring $267/600 = 44.5\%$ of the sale value of B. Hence it is DM under CAS – 6.

2016 - June [2] (b) The following items appear in the records of Care Ltd. Compute the amount you would consider under material cost as per CAS-6.

Import Duty	20,000
Insurance	15,000
Labour on self-manufactured primary packing containers	20,000
Factory overheads on self-manufactured packing containers	25,000
Trade discount on purchase of raw material (Purchase was recorded excluding the discount)	45,000
CENVAT credit refundable	20,000
Subsidy received from the Govt. for using pollution-free material	8,000
Subsidy received for generating wind energy	12,000
Purchase Price	8,00,000

(5 marks)

2016 - June [4] (b) From the following information, compute the value of direct expenses per 100 bottles according to Cost Accounting Standards: K Ltd. is a company making special ointments for pain relief. The following data is given:

- (i) In order that the ointment does not get sticky on patients' fingers, there is an additive with attractive fragrance, which is mixed with the medicine towards the end of the process before it is sent for packing. The company pays @ ₹ 5,000 per packet for the paste supplied by a contractor. This quantity is sufficient for 50 bottles of ointment. K Ltd. further pays a royalty of ₹ 25 per bottle that uses this paste.
- (ii) The special sealing of the bottles is done with manual intervention and the worker is paid at the rate of ₹ 5 per bottle specially sealed.
- (iii) The manufacture of the ointment has to ensure precise quantity of various inputs. Computer aided manufacture is used. The software development charges relating to such production is ₹ 0.40 per bottle.
- (iv) The Government pays an incentive of ₹ 22 per bottle produced.

(5 marks)

8.36**■ Solved Scanner CMA Inter Gr. I Paper 8A (New Syllabus)**

Repeatedly Asked Questions		
No.	Question	Frequency
1	Write short note on Profit Centre, 09 - June [8] (c), 11 - June [8] (a)	2 Times
2	Write short notes on the Cost Control and Cost Reduction 09 - Dec [5] (a), 11 - June [8] (c), 12 - June [8] (b)	3 Times

Table Showing Marks of Compulsory Questions										
Year	11 D	12 J	12 D	13 J	13 D	14 J	14 D	15 J	15 D	16 J
Descriptive					2	2				
Total					2	2				