

The Institute of Chartered Accountants of Nepal
Suggested Answer of CAP-II, Cost & Management Accounting, June 2013

All questions are compulsory. Working notes should form part of the answer. Make assumptions wherever necessary.

1. Bridgewater Tyre Company's budgeted unit sales for the year 2013 were:

Bike tyres	60,000
Bus tyres	12,500

The budgeted selling price for Bus tyres was Rs. 15,000 per tyre and for Bike tyres was Rs. 4,500 per tyre. The beginning finished goods inventories were expected to be 2,500 Bus tyres and 6,000 Bike tyres, for a total cost of Rs. 2,00,25,500, with desired ending inventories at 2,000 and 5,000, respectively, with a total cost of Rs. 1,63,23,900. There was no anticipated beginning or ending work-in-process inventory for either type of tyres. The standard material quantities for each type of tyre were as follows:

	<u>Bus</u>	<u>Bike</u>
Rubber	35Kgs	15Kgs
Steel Belts	4.5Kgs	2.0Kgs

The purchase prices of rubber and steel were Rs. 150 and Rs. 100 per Kg, respectively. The desired ending inventories for rubber and steel were 60,000 and 6,000 Kgs, respectively. The estimated beginning inventories for rubber and steel were 75,000 and 7,500 Kgs respectively.

The direct labor hours required for each type of tyre were as follows:

	<u>Molding Department</u>	<u>Finishing Department</u>
Bus tyre	0.20	0.10
Bike tyre	0.10	0.05

The direct labor rate for each department is as follows:

Molding Department	Rs. 650 per hour
Finishing Department	Rs. 750 per hour

Budgeted factory overhead costs for 2013 were as follows:

Particulars	Rs.
Indirect Material	85,28,000
Indirect Labour	79,40,000
Depreciation of Building and Equipment	49,16,000
Power and Light	63,00,000
Total	2,76,84,000

Required:

(3+3+5+3+6=20)

Prepare each of the following budgets for the year ended 2013:

- Sales budget
- Production budget
- Direct material budget
- Direct labor budget
- Cost of goods sold budget.

Answer No. 1

a)

Bridgewater Tyre Company
Sales Budget
For the year ended December 31, 2013

Product	Unit Sales Volume	Unit Selling Price Rs.	Total Sales Rs.
Bike Tyres	60,000	4,500	27,00,00,000
Bus Tyres	<u>12,500</u>	15,000	<u>18,75,00,000</u>
Total	<u>72,500</u>		<u>45,75,00,000</u>

b)

Production Budget
For the year ended December 31, 2013

	<u>Units</u>	
	<u>Bike tyres</u>	<u>Bus tyres</u>
Sales (from sales budget)	60,000	12,500
Add: Desired ending inventory, Dec. 31	<u>5,000</u>	<u>2,000</u>
Total	65,000	14,500
Less estimated beginning inventory, Jan. 1	<u>6,000</u>	<u>2,500</u>
Total production	<u>59,000</u>	<u>12,000</u>

c)

Direct Materials Budget
For the year ended December 31, 2013

	<u>Direct Materials</u>		<u>Total</u>
	<u>Rubber (Kgs.)</u>	<u>Steel Belts (Kgs.)</u>	
Quantities required for production:			
Bike tyres:			
59,000 × 15 Kgs.	8,85,000		
59,000 × 2.0 Kgs.		1,18,000	
Bus tyres:			
12,000 × 35 Kgs.	4,20,000		
12,000 × 4.5 Kgs.		54,000	
Add: Desired ending inventory, Dec. 31	<u>60,000</u>	<u>6,000</u>	
Total	13,65,000	1,78,000	
Less: Estimated beginning inventory, Jan. 1	<u>(75,000)</u>	<u>(7,500)</u>	
Total quantity to be purchased	12,90,000	1,70,500	
Unit price	Rs. 150	Rs. 100	
Total direct materials purchased	<u>Rs. 19,35,00,000</u>	<u>Rs. 1,70,50,000</u>	<u>Rs. 21,05,50,000</u>

d)

Direct Labor Budget
for the year ended December 31, 2013

	<u>Department</u>		<u>Total</u>
	<u>Molding</u>	<u>Finishing</u>	
Hours required for production:			
Bike tyres:			
59,000 × .10	5,900		
59,000 × .05		2,950	
Bus tyres:			
12,000 × .20	2,400		
12,000 × .10		1,200	
Total	8,300	4,150	
Hourly rate	Rs. 650	Rs. 750	
Total direct labor cost	Rs. 53,95,000	Rs. 31,12,500	Rs. 85,07,500

e)

Cost of Goods Sold Budget
for the year ended December 31, 2013

Direct materials inventory Jan. 1 (W. N. 1)	Rs. 1,20,00,000
Direct materials purchases	<u>21,05,50,000</u>
Total direct materials available	22,25,50,000
Less: Direct materials inventory, Dec. 31 (W. N. 1)	<u>96,00,000</u>
Cost of direct materials used	21,29,50,000
Direct labor	85,07,500
Factory overhead	<u>2,76,84,000</u>

Cost of goods manufactured	24,91,41,500
Add: Finished goods inventory, Jan.1	<u>2,00,25,500</u>
Cost of goods available for sale	26,91,67,000
Less: Finished goods inventory, Dec. 31	<u>1,63,23,900</u>
Cost of goods sold	<u>25,28,43,100</u>

Working notes**W.N.1: Direct material inventory (beginning)**

Rubber	75,000 Kgs. × 150	Rs. 1,12,50,000
Steel belts	7,500 Kgs. × 100	<u>7,50,000</u>
		Rs. <u>1,20,00,000</u>

W.N.2 Direct material inventory (ending)

Rubber	60,000 Kgs. × 150	Rs. 90,00,000
Steel belts	6,000 Kgs. × 100	<u>6,00,000</u>
		Rs. <u>96,00,000</u>

2.

- a) A manufacturing company has pre-determined overhead recovery rates at 200% of the direct wages for works expense, 10% of works cost as management expenses and 20% on cost of production towards selling and distribution expenses. At the year-end it is found that works overhead stand under-absorbed to the extent of 20% of direct wages, management expenses show under-recovery of 10% of the absorbed amount and selling and distribution expenses recovery resulted in over absorption of 30% of the absorbed amount.

Direct cost and selling price of the job X, Y and Z is given below.

	<u>Job X</u>	<u>Job Y</u>	<u>Job Z</u>
Direct materials (Rs.)	50	40	30
Direct wages (Rs.)	30	25	20
Selling price (Rs.)	200	160	120

Find the profit or loss on the respective selling price both on the pre-determined cost and on the basis of full absorption of overheads.

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- b) PQ Limited plans to start a lodging house at a tourist center with a capacity of 32 single occupancy rooms. Cost per day has been estimated as under:

	Cost per day per room (Rs.)
When occupied:	
(i) Electricity and utilities	4
(ii) Linen, laundry and sanitary supplies	9
When unoccupied:	
(iii) Dusting, sweeping and cleaning	<u>2</u>
	<u>15</u>

Over and above these costs, the following expenses represent the estimate of fixed charges per annum (365 days)

Staff expenses	Rs. 3,20,000
Other office expenses`	Rs. 64,000
Taxes, insurance, maintenance and depreciation	Rs. 42,320

PQ Limited defines 100% occupancy to mean all the 32 rooms to fetch revenue for all 365 days.

You are required to answer the following, using a planning period of one year:

(4+4+2=10)

- (a) What would be the tariff per day per room in order to reach break-even at an occupancy level of 50%?
 (b) What would be the profits, if the occupancy level reaches (i) 60% (ii) 70% and (iii) 80% respectively?
 (c) What would be the profits, if the tariff per day is reduced by 10% from the answer in (a) above and the occupancy level is 100%?

Answer No. 2

a)

Statement of Cost of Production and Profit or Loss
Under Pre-determined Cost Basis

	(Amount in Rs.)		
	Job X	Job Y	Job Z
Direct materials	50.00	40.00	30.00
Direct wages	30.00	25.00	20.00
Prime cost	80.00	65.00	50.00
Works expenses [200% of direct wages]	60.00	50.00	40.00
Works cost	140.00	115.00	90.00
Management expenses [10% of works cost]	14.00	11.50	9.00
Cost of production	154.00	126.50	99.00
Selling & distribution expenses [20% of cost of production]	30.80	25.30	19.80
Total costs	184.80	151.80	118.80
Profit (Balancing figure)	15.20	8.20	1.20
Selling price	200.00	160.00	120.00

Statement of Cost of Production and Profit or Loss
Under Full Absorption of Overheads Basis

	(Amount in Rs.)		
	Job X	Job Y	Job Z
Direct materials	50.00	40.00	30.00
Direct wages	30.00	25.00	20.00
Prime cost	80.00	65.00	50.00
Works expenses [220% of direct wages]	66.00	55.00	44.00
Works cost	146.00	120.00	94.00
Management expenses [Working note 1]	15.40	12.65	9.90
Cost of production	161.40	132.65	103.90
Selling & distribution expenses [Working note 2]	21.56	17.71	13.86
Total costs	182.96	150.36	117.76
Profit (Balancing figure)	17.04	9.64	2.24
Selling price	200.00	160.00	120.00

Working notes:

1. Management expenses:

	Job X	Job Y	Job Z
	Rs.	Rs.	Rs.
Amount on pre-determined basis	14.00	11.50	9.00
Add: 10% for under absorption	1.40	1.15	0.90
Actual expenses	15.40	12.65	9.90

2. Selling & distribution expenses:

	Job X	Job Y	Job Z
	Rs.	Rs.	Rs.
Amount on pre-determined basis	30.80	25.30	19.80
Less: 30% for over absorption	9.24	7.59	5.94
Actual expenses	21.56	17.71	13.86

b)

(a) Tariff to break-even at 50% occupancy level

Fixed cost	Rs. 4,26,320
Expenses when unoccupied Rs. 2 x 11,680	23,360
Expenses when occupied Rs. 13 x 5,840	75,920
	5,25,600

Tariff per day to break-even: Rs. 5,25,600 / 5,840 = Rs. 90

(b) Profit at various occupancy level

Contribution margin = (Rs. 90 – Rs. 13) = Rs. 77

Profit = (Man-days occupied – BEP man-days) x Contribution margin

Therefore,

Profit at 60% occupancy level = (7,008 - 5,840) x Rs. 77 = Rs. 89,936

Profit at 70% occupancy level = (8,176 - 5,840) x Rs. 77 = Rs. 179,872

Profit at 80% occupancy level = (9,344 - 5,840) x Rs. 77 = Rs. 269,808

(c) Contribution margin at reduced tariff = (0.90 x 90 - 13) = Rs. 68

Profit at 100% occupancy level = Contribution - Fixed Costs
 = 11680 x Rs. 68 - Rs. 4,26,320
 = Rs. 367,920

Working Note:

100% occupancy	= 32 x 365 days	= 11,680 room-days
50% occupancy	= 0.5 x 11680	= 5840 room-days
60% occupancy	= 0.6 x 11680	= 7008 room days
70% occupancy	= 0.7 x 11680	= 8176 room-days
80% occupancy	= 0.8 x 11680	= 9344 room-days

3.

a) From the following information for the month of October 2012, prepare Process III cost account:

Opening WIP in Process III	: 1,800 units at Rs. 27,000
Transfer from Process II	: 47,700 units at Rs. 536,625
Transferred to warehouse	: 43,200 units
Closing WIP of Process III	: 4,500 units
Units scrapped	: 1,800 units
Direct material added in Process III	: Rs. 177,840
Direct Wages	: Rs. 87,840
Production Overheads	: Rs. 43,920

Degree of Completion:

	<u>Opening Stock</u>	<u>Closing Stock</u>	<u>Scrap</u>
Material	80%	70%	100%
Labour	60%	50%	70%
Overheads	60%	50%	70%

The normal loss in the process was 5% of the production and scrap was sold at Rs. 6.75 per unit.

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b) Shyam Enterprises operating an integral system of accounting. The following transactions incurred for the year end 2012.

<u>Transaction</u>	<u>Amount (Rs.)</u>
Raw material Purchased (40% in cash)	10,00,000
Material issued to production	6,00,000

Wages paid (50% Direct)	2,00,000
Wages charged to production	1,20,000
Factory Overhead paid	1,20,000
Factory Overhead charged to Production	110,000
Selling and distribution overhead paid	30,000
Finished goods finalized at cost	6,50,000
Sales (70% in credit)	11,00,000
Closing stock of finished goods	-
Payment received from Customer	3,00,000
Paid to supplier	5,00,000

You are required to pass journal Entries in the books of Shyam Enterprises under integrated system of accounting for the period ended 2012.

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Answer No. 3

a)

Statement of Equivalent Production
(Process III)

Input		Output	Equivalent production						
			Material Received from Process II		Material added in Process III		Labour and overheads		
Details	Quantity Units		Quantity units	Quantity units	%	Quantity units	%	Quantity units	%
Op WIP	1800	Work on Op. WIP	1,800	-	-	360	20	720	40
Process II Transfer	47700	Introduced and completed during the month (Bal. fig.)	41400	41,400	100	41,400	100	41,400	100
		Normal Loss (5% of 45,000 units)	2,250	-	-	-	-	-	-
		Closing WIP	4,500	4,500	100	3,150	70	2,250	50
			49,950	45,900		44,910		44,370	
		Abnormal gain	-450	-450	100	-450	100	-450	100
Total	49,520		49,500	45,450		44,460		43,920	

Working Note

- (i) Production units = Opening units + Units transferred from Process II – Closing Units
= 1800 units + 47,700 units - 4500 units
= 45000 units
- (ii) Abnormal gain(units) = Production-Normal Loss-Transfer to warehouse
= 45,000-(5% of 45,000)-43,200
= 450

Statement of Cost

	Cost Rs.	Equivalent units	Cost per equivalent unit Rs.
Material Received from Process II	536,625		
Less: Scrap value of normal loss (2,250 units x Rs. 6.75)	15,187.50		
	521,437.50	45,450	11.4728
Material added in Process III	177,840	44,460	4.0000

Labour	87,840	43,920	2.0000
Overheads	43,920	43,920	1.0000
	8,31,037.50		18.4728

Statement of Apportionment of Process Cost

			Rs.
Opening WIP	Material From Process II		27,000
Completed opening WIP -1,800 units	Material added in Process III	360 units x Rs. 4=Rs. 1440	
	Wages	720 units x Rs. 2= Rs. 1440	
	Overheads	720 units x Rs. 1= Rs. 720	3,600
Introduced and completed 41,400 units		41400 units x Rs. 18.4728	7,64,773
Total cost of 43,200 finished goods units			7,95,373
Closing WIP -4,500 units	Material from Process II	4,500 units x Rs. 11.4728	51,628
	Material in process III	3,150 units x Rs. 4	12,600
	Wages	2,250 units x Rs.2	4,500
	Overheads	2,250 units x Re.1	2,250
			70,978
Abnormal gain -450 units		450 units x Rs. 18.4728	8,313

Process III A/c

	Units	Rs.		Units	Rs.
To Balance b/d	1800	27,000	By Normal Loss	2250	15,187
To Process II a/c	47700	5,36,625	By Finished goods stock	43200	7,95,373
To Direct Material		1,77,840			
To Direct Wages		87,840			
To Production overheads		43,920	By Closing WIP	4500	70,978
To Abnormal gain	450	8,313			
	49,950	881,538		49,950	881,538

b) Journal Entries in the books of Shyam Enterprises under integrated system of accounting for the period ended 2012.

Store Ledger Control A/C	Rs.10,00,000	
To Sundry Creditors A/C		Rs.6,00,000
To Cash/Bank A/C		Rs.400,000
(Material purchased)		
.....		

Work-in-Progress Control A/C	Rs.6,00,000	
To Store Ledger Control A/C		Rs.6,00,000
(Material issued to production)		
.....		

Wages Control A/C To Cash/Bank A/C (Wages Paid)	Rs.200,000	Rs.200,000
Work-in-Progress Control A/C To Wages Control A/C (Wages charged to production)	Rs.1,20,000	Rs.1,20,000
Factory Overhead Control A/C To Cash/Bank A/C (Factory overhead paid)	Rs.120,000	Rs.120,000
Work –in Progress Control A/C To Factory Overhead Control A/C (Factory overhead charged to production)	Rs.110,000	Rs.110,000
Selling and Distribution Overhead Control A/C To cash/Bank A/C (Selling/distribution overhead paid)	Rs.30,000	Rs.30,000
Finished Stock Ledger Control A/C To Work-in-progress Control A/C (Cost of finished goods transferred from work in progress)	Rs.650,000	Rs.650,000
Cost of Sales A/C To Finished Stock Ledger Control A/C To Selling and Distribution control A/C	Rs.6,80,000	Rs.650,000 Rs.30,000
Sundry Debtors Account Cash/Bank A/C To Sales Control Account (Finished stock sold)	Rs.770,000 Rs.330,000	Rs.11,00,000
Cash/Bank Account To Sundry Debtors A/C (Amount received from customer)	Rs.300,000	Rs.300,000
Sundry Creditors A/C To Cash/Bank A/C (Payment made to creditors)	Rs.500,000	Rs.500,000

4.

- a) The cost structure of an article the selling price of which is Rs. 45,000 is as follows:
- | | |
|-----------------|-----|
| Direct Material | 50% |
| Direct Labour | 20% |
| Overheads | 30% |

An increase of 15% in the cost of direct materials and of 25% in the cost of direct labour is anticipated. These increased costs in relation to the present selling price would cause a 25% decrease in the amount of present profit per article.

Required:

(5+3=8)

- i) Prepare a statement of profit per article at present, and
 ii) Calculate the revised selling price to produce the same percentage of profit to sales as before.
- b) Both direct and indirect labor of a department in a factory is 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 the standard rate fixed at 10,000 tons per month (of 25 days) a general incentive of Rs. 10 per ton 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 labor, @ 10% by inspection staff, @ 12% by maintenance staff and @ 8% by supervisory staff.
 ii) If the excess production is more than 20% above the standard, direct labor also gets a special bonus @ Rs. 5 per ton for all production in excess of 120% of standard.
 iii) Inspection staff is penalized @ Rs. 20 per ton for rejection by customer in excess of 10% of production
 iv) Maintenance staff is penalized @ Rs. 20 per hour of breakdown.
- From the following particulars for a month work out the production bonus earned by each group:

(i) Actual working days	: 20
(ii) Production	: 11,000 tons
(iii) Rejection by customers	: 200 tons
(iv) Machine breakdown	: 40 hours

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- c) Discuss briefly the principles to be followed while taking credit for profit on incomplete contracts.

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Answer No. 4

a)

Let the total cost of the article be "X".

Now,

	Present condition	Revised condition
Direct Material	0.5x	0.575x
Direct Labour	0.2x	0.250x
Overheads	<u>0.3x</u>	<u>0.300x</u>
Total	<u>1.0x</u>	<u>1.125x</u>
Selling Price	Rs. 45,000	Rs. 45,000
Profit	(Rs. 45,000 – x)	(Rs. 45,000 – 1.125x)

From the above exercise, following equation can be made:

$$(Rs. 45,000 - x) - (Rs. 45,000 - 1.125x) = 25\% \text{ of } (Rs. 45,000 - x)$$

$$\text{Or, } -x + 1.125x = Rs. 11,250 - 0.25x$$

$$\text{Or, } 0.375x = Rs. 11,250$$

$$\text{Or, } x = Rs. 30,000.$$

Statement of profit per article under present condition

		Rs.
Direct Material	Rs. 30,000 × 0.5	15,000
Direct Labour	Rs. 30,000 × 0.2	6,000
Overheads	Rs. 30,000 × 0.3	<u>9,000</u>
Total Cost		30,000
Profit (balancing figure)		<u>15,000</u>
Selling Price		<u>45,000</u>
Percentage of profit to cost	[Rs. 15,000 / Rs. 30,000 × 100]	50%
Percentage of profit to selling price	[Rs. 15,000 / Rs. 45,000 × 100]	33.33%

Statement of profit per article under revised condition

		Rs.
Direct Material	Rs. 30,000 × 0.575	17,250
Direct Labour	Rs. 30,000 × 0.250	7,500
Overheads	Rs. 30,000 × 0.300	9,000
Total Cost		<u>33,750</u>
Profit (50% of cost or 33.33% of selling price)		<u>16,875</u>
Selling Price		<u><u>50,625</u></u>

b)

- (i) No. of working days during month : 20
(ii) Standard production for 20 days @ 10,000 tons per month of 25 days
= 10,000 x 20/25 = 8,000 tons
(iii) Actual production during the month = 11,000 tons
(iv) Excess production during the month = 11,000 – 8,000 = 3,000 ton
(v) Excess production above 20% of standard : 3,000 – 20% of 8,000
= 3,000 – 1,600 = 1,400 tons

Statement showing Bonus earned by each category of staff:

	Category	General Incentive @ Rs. 10 per ton			Special Incentive @ Rs. 5 per ton		Penalty Rs	Bonus earned Rs
		%	Tons	Amount	Tons	Amount		
(a)	Direct labor	70	2,100	21,000	1,400	7,000	-	28,000
(b)	Inspection Staff	10	300	3,000	-	-	-*	3,000
(c)	Maintenance staff	12	360	3,600	-	-	800**	2,800
(d)	Supervisory staff	8	240	2,400	-	-	-	2,400
	Total	100	3,000	30,000	1,400	7,000	800	36,200

* Penalty for rejection: Not applicable (Actual rejection is less than allowed level)

** Penalty for machine breakdown for 40 hours @ Rs. 20 per hour.

c)

Under Contract Accounting it may be noticed that certain contracts are completed, while others are still in progress at the end of a financial year. These incomplete contracts may require a few more years for their completion. The figures of profit made (the excess of credit over the debit items in a contract) on completed contracts can be safely taken to the credit of Profit and Loss Account, but this practice is not being followed in the case of incomplete contracts.

In the case of incomplete contracts the entire profit is not being credited to Profit and Loss Account because some provision is to be made for meeting contingencies and unforeseen losses. There are no hard and fast rules regarding the calculation of figure of profit to be taken to the credit of profit and loss account. However, the following principles may be followed:–

- i. Profit should be considered in respect of work certified and uncertified work should be valued at cost.
- ii. If the amount of work certified is less than 1/4th of the contract price, no profit should be taken to Profit and Loss Account. The entire amount in such contracts should be kept as reserve for meeting out contingencies.
- iii. If the amount of work certified is 1/4th or more but less than 1/2 of the contract price, then 1/3rd of the profit disclosed as reduced by the percentage of cash received from the contractee should be taken to the Profit and Loss Account. The balance should be allowed to remain as a reserve.
- iv. If the amount of work certified is 1/2 or more of the contract price, then 2/3rd of the profit disclosed as reduced by the percentage of cash received from the contractee, should be taken to the Profit and Loss Account. The balance should be treated as reserve.
- v. If the contract is near completion, the total cost of completing the contract may be estimated if possible. By deducting the total estimated cost from the contract price, the estimated total profit of the contract should be calculated. The proportion of total estimated profit on cash basis, which the work certified bears to the total contract price should be credited to profit and loss account.
- vi. The entire loss, if any, should be transferred to the Profit and Loss Account.

5. Distinguish between:

(4×2.5=10)

- a) Cost Centre and Cost Unit
- b) Job Costing and Batch Costing
- c) Forecast and Budget
- d) Opportunity Cost and Sunk Cost

Answer No. 5

a) Cost Centre and Cost Unit

Cost centre is defined as a location, person or an item of equipment (or group of these) for which cost may be ascertained and used for the purpose of cost control. Cost centres are of two types, viz. Personal and Impersonal Cost Centre. A personal cost centre consists of a person or group of persons and an impersonal cost centre consists of a location or an item of equipment (or group of these).

Cost unit is a unit of product, service or time (or combination of these) in relation to which costs may be ascertained or expressed. We may, for instance, determine the cost per tonne of steel, per tonne kilometre of a transport service or cost per machine hour. Sometimes, a single order or contract constitutes a cost unit. A batch which consists of a group of identical items and maintains its identity through one or more stages of production may also be considered as a cost unit.

b) Job Costing and Batch Costing

Job Costing :The system of job costing is used where production is not highly repetitive and in addition consists of distinct jobs so that the material and labor costs can be identified by order number. This method of costing is very common in commercial foundries and drop forging shops and in plants making specialized industrial equipment. In all these cases, an account is opened for each job and all appropriate expenditure is charged thereto.

Batch Costing: This method is employed where orders or jobs are arranged in different batches after taking into account the convenience of producing articles. The unit of cost is a batch or a group of identical products instead of a single job order or contract. This method is particularly suitable for general engineering factories which produce components in convenient economic batches and pharmaceutical industries.

c) Difference between Forecast and Budget

Forecast	Budget
i. Forecast is merely an estimate of what is likely to happen. It is a statement of probable events which are likely to happen under anticipated conditions during a specified period of time.	i. Budget shows the policy and programme to be followed in a period under planned conditions.
ii. Forecasts, being statements of future events, do not connote any sense of control.	ii. A budget is a tool of control since it represents actions which can be shaped according to will so that it can be suited to the conditions which may or may not happen.
iii. Forecasting is a preliminary step for budgeting. It ends with the forecast of likely events.	iii. It begins when forecasting ends. Forecasts are converted into budget.
iv. Forecasts are wider in scope and it can be made in those spheres, also where budgets cannot interfere.	iv. Budgets have limited scope. It can be made of phenomenon capable of being expressed quantitatively.

d) Opportunity Cost and Sunk Cost

Opportunity cost refers to the value of sacrifice made or benefit of opportunity forgone in accepting an alternative course of action. For example, a firm financing its expansion project by withdrawing money from its bank deposits. In such a case the loss of interest on the bank deposit is the opportunity cost for carrying out the expansion project.

Historical costs incurred in the past are known as sunk costs. They play no role in decision making in the current period. For example, in the case of a decision relating to the replacement of a machine, the written down value of the existing machine is a sunk cost and therefore not considered.

6. Write short notes on:

(4×2.5=10)

- a) Budgetary control
- b) Circumstances under which cost audit is ordered
- c) Advantages of ABC analysis
- d) Objectives of Uniform Costing

Answer No. 6

a) Budgetary control is a methodical control of an organization's operations through establishments of standards and targets regarding income and expenditure and a continuous monitoring and adjustment of performance against them. Budgetary control is the establishment of budgets relating the responsibilities of executives to the requirements of a policy, and the continuous comparison of actual with budgeted results, either to secure by individual action the objectives of that policy or to provide a firm basis of its revision.

The objectives of budgetary control are:

- Definition of Goals: Portraying with precision, the overall aims of the business and determining targets of performance for each section or department of the business.
- Defining Responsibilities: Laying down the responsibilities of each individual so that everyone knows what is expected of him and how he will be judged.
- Basis for Performance Evaluation: Providing basis for the comparison of actual performance with the predetermined targets and investigation of deviation, if any, of actual performance and expenses from the budgeted figures. It helps to take timely corrective measures.
- Optimum use of Resources: Ensuring the best use of all available resources to maximize profit or production, subject to the limiting factors.
- Co-ordination: Coordinating various activities of the business and centralizing control, and also facilitating for the management to decentralize responsibility and delegate authority.
- Planned action: Engendering a spirit of careful forethought, assessment of what is possible and an attempt at it. It leads to dynamism without recklessness. It also helps to draw up long range plans with a fair measure of accuracy.
- Basis for policy: Providing a basis for revision of current and future policies.

Disadvantages / Limitation

- Estimates: Budgets may or may not be true, as they are based on estimates. The assumptions about future events may or may not actually happen.
- Rigidity: Budgets are considered as rigid document. Too much emphasis on budgets may affect day-to-day operations and ignores the dynamic state of organizational functioning.
- False Sense of Security: Mere budgeting cannot lead to profitability. Budgets cannot be executed automatically. It may create a false sense of security that everything has been taken care of in the budgets.
- Lack of co-ordination: Staff co-operation is usually not available during budgetary control exercise.
- Time and Cost: The introduction and implementation of the budgetary control system may be expensive.

b) Discuss the circumstances under which a Cost Audit is ordered along with the purpose of Cost Audit.

Circumstances under which Cost Audit is ordered

- i. Price Fixation – The need for fixation of retention price in case of materials of national importance like steel, cement etc., may cause a necessity for cost audit.
- ii. Cost variation within an industry: Cost audit may be necessary to find reasons for such differences.
- iii. Inefficient Management – Where a factory is run inefficiently and uneconomically, institution of cost audit may be necessary.
- iv. Tax assessment – Where a duty or tax is levied on products based on cost of production, the levying authorities may ask for cost audit to determine the correct cost of production.
- v. Trade disputes: cost audit may be useful in settlement of trade disputes about claim for higher wages, incentives etc.

Purposes of Cost Audit

- i. Protective purpose: To examine that there is no undue wastage or losses and the costing system brings out the correct cost of production or processing.

- ii. Constructive purpose – Cost Audit provides information to management useful in regulating production, choosing economical methods of operation and reducing operations cost.

c) Advantages of ABC analysis

Followings are the advantages of ABC analysis system:

- (i) It ensures that, without there being any danger of interruption of production for want of materials or stores, minimum investment will be made in inventories of stocks of materials or stocks to be carried.
- (ii) The cost of placing orders, receiving goods and maintaining stocks is minimized especially if the system is coupled with the determination of proper economic order quantities.
- (iii) Management time is saved since attention need be paid only to some of the items rather than all the items as would be the case if the ABC system was not in operation.
- (iv) With the introduction of the ABC system much of the work connected with purchases can be systematized on a routine basis to be handled by subordinate staff.

d) Objectives of Uniform Costing

- (i) To facilitate the comparison of costs and performance of different units in the same industry; it provides objective basis.
- (ii) To eliminate unhealthy competition among the different units of an industry.
- (iii) To improve production capacity level and labour efficiency by comparing the production costs of different units with each other.
- (iv) To provide relevant cost information or data to the government for fixing and regulating prices of the products.
- (v) To bring standardization and uniformity in the operation of participating units.
- (vi) To reduce production, administration, selling & distribution costs, and to exercise control on fixed costs.