T.Y.B.COM (Semester - 6)

Subject : Cost accounting

Most important theory questions

Chapter 1 Cost control

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3) Work in progress control account
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1) Activity based costing
2) Target costing
3) Benchmarking

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Chapter 1 cost control

Store ledger control account

1) Records material cost: This account records material transaction
2) This account is debited for the purchase of material and credited for issue of material from the stores.
3) The balance in this account indicates the total balance of all the individual stores accounts
4) Abnormal losses or gains if this account, are transferred to costing profit and loss account
5) Entries are made on the basis of goods, received, note and store requisition, etc.

Dr. Store ledger Control A/c. Cr

Particulars.	Amt	Particulars.	Amt.
To balance b/d.	xx	By W.I.P Control A/c	xx
To bank A/c.	xx	By Prodn o/H Cont. A/c	xx
		By bank A/c	xx
		By Balance c/d.	xx
	xx		xx

Cost ledger control account

1) This account is also known as general ledger adjustment account
2) This account is made to complete double entry
3) All items of expenditure are credited to this account.
4) Sales are debited to this account.
5) Net profit or loss from cost and profit and loss account is transferred to this account.
6) The balance in this account at the end of the particular period represent the net total of all the balance of the impersonal account.

Dr. Cost ledger control A/c. [ULA A/c] Cr

Particulars.	Amt	Particulars	Amt
		By balance b/d.	xx
To profit & loss A/c [Sales]	xx	By Store ledger cont. A/c	xx
		By prodn o/H A/c.	xx
		By adm. o/H A/c.	xx
		By sell. o/H A/c.	xx
To Balance c/d.	xx	By costing P&L A/c.	xx
	xx		xx

Work in progress control account

1) This account is debited with the total cost of production, which includes direct material, direct employee, direct expenses, production, overheads recovered,
2) Credited with the amount of finished goods completed and transferred.
3) The balance in this account represent total balances of work in process, as shown by several job accounts.

Dr. Work in progress A/c. Cr.

Particulars.	Amt	Particulars.	Amt
To Balance b/d.	xx	By finished goods A/c.	xx
To ULA A/c	xx		
To SLA A/c	xx		
To wage control A/c	xx		
To Prodn o/H A/c	xx	By Balance c/d.	xx
	xx		xx

Non-integrated system

- Non-integral system is a system of accounting under which two separate sets of account books are maintained one for cost accounts and other for financial accounts.
- Since separate ledger are maintained for cost and financial account in the system
- The cost accountant is responsible for recording of the cost accounting transaction
- The financial accountant is responsible for financial transaction
- Non-integral system of accounting is also known as non-integrated system or interlocking system or cost, ledger, accounting system

Ledger under non-integral

Basically two types of ledgers are maintained under non-integral system

a) The principal financial ledgers 1). General ledger 2). Debtor ledger 3). creditors ledger

b) The principal cost ledgers 1). Cost ledger 2). Stores ledger 3). Work in progress ledger 4). Finished goods ledger

Chapter 2 Contract Costing

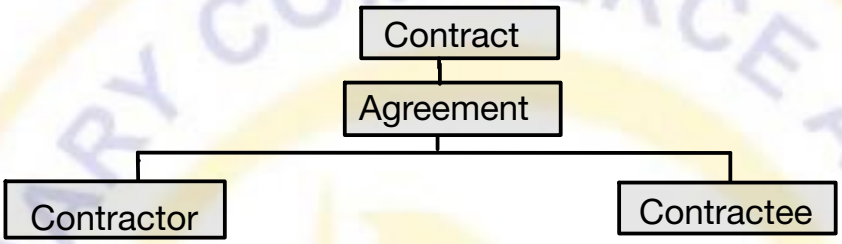
Meaning

A **Contract** is nothing but a big job having the following special features

- A high price of thousands or lakhs of rupees.
- The period taken for completion may be many months or even years.
- The actual work may be done at a site away from the main office of the contractor.

Contract costing

Contract costing is the method of costing used to find out the cost of each contract.
Contract costing is defined as a form of specific order costing where cost are attributed to contracts.



Contract Contract is the agreement between the contractor and the contractee containing details, such as nature of job, time of commencement, and completion, total price due, mode of payment and so on.

Contractor Contractor is the person who undertakes the contract.

Contractee Contractee is the person for whom the contract job is undertaken

Features of contract costing

1) A formal contract is made between contractee and contractor.
2) Work is undertaken to customers special requirement
3) The work is for a relatively long duration.
4) The work is frequently constructional in nature.
5) The method of costing is similar to job costing.
6) The work is frequently based on site
7) It is applied in industries, engaged in the construction of building, roads, bridges, or other construction work.

Contract price

The contractee's account is debited and the contract account is credited with the contract price, on completion of the contract.

Contractee's A /c ……Dr

To Contract A /c

When the contractee makes any payment towards the contract price, Bank account is debited and contractee's account is credited with the amount so received.

Bank A/c …. Dr

To Contractee's A/c

Work certified

Work certified is that portion of the work completed which has been certified by the contractee's architect or surveyor.

The extent of the work completed is periodically checked and certified by an expert .e.g. a Surveyor, an Architect or a Chartered engineer.

The amount of Work Certified is based on Architect's Certificates.

It includes profit element, since it is based on Contract Price.

Accounting

The value of work certified is debited to contractee's account or work in progress account is credited to the contract account.

Its value is transferred to the debit of a contract account at the beginning of the next accounting period,

Computation The value of work certified is calculated as follows

Value of work certified =. Contract price X Work certified as % of contract price

Retention money

Retention money is that portion of a value certified, which is retained by contractee as a security for any defective work, which may be discovered later within the guarantee period.

the contractor receives the payment only of part of the value of work certified.

A contractee may agreed to pay the contractor 90% of the value of the work certified balance 10% amount certified but not paid, is known as retention money.

Retention money is safeguard against the non-performance of the contract or defective work.

Retention money ensures that the contractor will continue to work and not leave the work incomplete.

Retention money = Value of work certified. — Cash received

Work uncertified

Work Uncertified is that portion of work completed which has not been certified by the contractee's architect or surveyor.

This is valued at cost and thus does not include an element of profit

Total Value of work completed during an accounting year = Work certified + Work uncertified

Accounting

The cost of work uncertified is debited to work in progress Account and credited to contract account.

Its cost is transferred to the debited of contract account at the beginning of the next accounting period

Cost of work uncertified = total cost incurred till date —. Cost of work certified

Chapter 3 Process Costing

Process : A process means a distinct manufacturing operation or stage. In process industries, the Raw Material goes through a number of process in a sequence before the finished product is finally produced. For example, production of coconut oil involves the following distinct processes:1)Copra crushing 2) Refining and 3) finishing.

Process costing : Process costing is a method of costing used to find out the cost of the product in each process.

1) Normal loss

1). The first step is to fix the normal loss on the basis of technical studies or past experience.
2). Normal loss is the loss expected under the normal circumstances.
3). It is the unavoidable or uncontrollable loss
4) It is inherent in the nature of material or process.
5) Normal loss (In Units) = Input X % Of Normal loss
6) Normal loss (Amount) = units of normal loss X Sale price (Scrap value)
7) Normal output or expected output can be derived by deducting the normal loss from the input.

2) Abnormal loss :

1) The Next step is to compare the normal output with actual output of the process to determine the quantity of abnormal loss.
2) This comparison is made by preparing a statement of quantity re-conciliation.
3) If the actual output is less than normal output, it indicates an abnormal loss.
4) abnormal loss may be caused by a normal circumstances, such as accidents, inefficiency of workers, power failures, bad quality of raw materials and so on

Characteristics of abnormal loss

1) It is an unexpected loss.
2) It is manageable if suitable preventative actions are followed.
3) The difference between actual and the predicted loss representes it .

Dr Abnormal loss A/c Cr

Particulars	Units	Amounts	Particulars	Units	Amounts
To process A/c	xx	xx	By Cash / Bank A/c (Scrap value)	xx	xx
			By Costing P&L A/c		xx
		xx			xx

3) Abnormal gain :

1) The Next step is to compare the normal output with actual output of the process to determine the quantity of abnormal gains.
2) This comparison is made by preparing a statement of quantity re-conciliation.
3) If the actual output is more than normal output, it indicates an abnormal gain
4) Abnormal gains may arise due to efficiency of the workers, excellent quality of material, recent repairs of machinery, and so on.
5) The units and the amount is debited to the relevant process account and credited to the abnormal gain account.

Dr — Abnormal Gain A/c — Cr

Particulars	Units	Amounts	Particulars	Units	Amounts
To Normal loss A/c	XX	XX	By process A/c	XX	XX
To Costing P&L A/c		XX		XX	XX
		XX			

Joint-Product VS By-Product

No.	Joint Products (JP)	By-Products (BP)
1.	JP have equal economic importance.	BP have less economic importance.
2.	JP are produced at the same time.	BP are produced incidentally or additionally.
3.	JP are produced from the same input.	BP are produced from the scrap.
4.	JP have greater effect on costs.	BP have small effect on costs.

Chapter 4 Marginal costing

1). Profit volume ratio (P/V Ratio)

1). The profit volume ratio, which is also called the contribution ratio or marginal ratio, express the relation of contribution to sales.

2) It is always calculated on percentage basis or in times compared to the sales value.

3) It remains constant at all The level of activities provided per unit sale price and the variable cost remains constant.

4) PV ratio remains unaffected by any variation in fixed cost.

5) High P/V Ratio indicates high profitability

6) Low PV ratio indicates low profitability

7) $\text{PV ratio} = \frac{\text{Contribution}}{\text{Sales}} \times 100$

8) $\text{PV ratio} = \frac{\text{Change in profit}}{\text{Change in sales}} \times 100$

2) Break even point (BEP) Sales:

1). Breakeven point means the point of no profit and no loss.

2) BEP is the volume of output or sales at which the total cost is exactly equal to the revenue.

3) Below the BEP the concern makes losses.

4). At the BEP, the concern makes neither profit nor loss

5). Above the BEP,the concern earns profit

6) BEP can be ascertained by using a breakeven chart or by calculation

7) $\text{BEP (in Units)} = \frac{\text{Fixed cost}}{\text{Contribution per unit}}$

8). $\text{BEP (in ₹).} = \frac{\text{Fixed cost}}{\text{P/V ratio}}$

3) Margin of safety

1) Margin of safety is the difference between the actual sales and the sales at the breakeven point.

2). Larger MS indicates stronger business. Such business can continue to earn profits, even if the sales decrease. (I.e in recession)

3) Margin of safety (in ₹). = Actual sales — BEP sales

4) Margin of safety in units = Actual sales (units) — BEP sales (units)

5) Margin of safety is directly linked to profits as indicated by the following equation.

Profit = margin of safety X Profit volume ratio

6) Being sales beyond breakeven point, it indicates safety margin available to the form in terms of sales revenue.

Advantages of marginal costing

1) Marginal costing is simple to understand.
2) Reduction of prices during depression or competition time.
3) profit planning with the help of BEP chart.
4). Selecting the most profitable activity
5). Basis of managerial decision making
6) The method of stock valuation becomes very simple since closing stocks are valued at marginal cost. Which leads to better accuracy in calculating profit.
7). Introducing a new product or new line

Disadvantages of marginal costing

1) difficulty in classifying the fixed and variable cost
2). Under valuation of stock - No fixed cost element
3). True only in a short period
4). Time factor is completely ignored - two jobs
5) Not applicable in all types of business
6) Marginal costing does not give full information.
7). Misleading pictures - assumptions
8) Depends on key factors
9) Unpredictable nature of cost.

Chapter 5. Introduction Standard Costing

Advantages of standard costing

1) To measure efficiency.
2) To fix price and formulate policies
3) Delegation of authority and responsibility
4) Help manager to follow management by exception
5) It facilitates cash and inventory planning
6) More accurate pricing of product based on detailed cost analysis
7) Creates cost consciousness
8) Preparation of periodical financial statement.

Limitation of the standard costing

1) Standard highly complex and technical task. Absolutely perfect standard are not found.
2) Not suitable to small business
3) Not suitable to all industries
4) Depends on management support
5) selection of the right type of standard is also a problem
6) Variances Cannot be linked with responsibility. Multiple factors act at the same time.
7) Changing business conditions
8) Feeling of dissatisfaction among employees

Material variances

Material cost variance

The difference between the standard cost of direct materials specified for production and the actual cost of direct material used in production is known as direct material cost variance.

Material cost variance = Standard cost - Actual cost

Material price variance

Material price variance is the difference between the standard price and the actual price for the actual quantity of material used for production.

Material price variance = (SR — AR) X Actual Quantity

Material usage variance

Material usage variance is the difference between the standard quantity specified for actual production and actual quantity used at the standard purchase price

Material usage variance = (SQ —AQ) X SR

Labour variances

Labour cost variance

It is the difference between the standard labour cost and the actual labour cost for the production achieved.

Labour cost variance = Standard cost — Actual cost

Labour rate variance

It is the difference between the standard and actual direct labour rate per hour for the total hours of worked.

Labour rate variance = (SR — AR) X AH

Labour efficiency variance

It is the difference between the standard hours for the actual production achieved and the hours actually worked, valued at the standard labour rate.

Labour efficiency variance = (SH — AH) X SR

Chapter 6. Some emerging concept of cost accounting

Activity based costing

Activity-based costing (ABC) is a costing method that assigns overhead and indirect costs to related products and services.

This accounting method of costing recognizes the relationship between costs, overhead activities, and manufactured products, assigning indirect costs to products less arbitrarily than traditional costing methods.

However, some indirect costs, such as management and office staff salaries, are difficult to assign to a product.

ABC covers only product costing

ABC uses multiple cost drivers for multiple activities.

ACTIVITY BASED COSTING = COST POOL TOTAL / COST DRIVER

Target costing

Target cost is an estimate of product cost which is determined by subtracting a desired profit margin from a competitive market price.

Target costing can be defined as a cost management tool for reducing the overall cost of a product over its product life cycle.

Target cost = Target price Less Target profit.

Target costing is part of a product development process.

Target costing is a cost management technique.

Target costing is known as product costing also

Target costing is based on marketing factor

Benchmarking

Benchmarking is the continuous process of measuring products, services or activities against the best level of performance that may be found either inside or outside the organisation.

There may be Two types of benchmarking, intra group & inter industry

Benefits of benchmarking

Improve strategic planning

Improve organisational method and practises

Improve management practises, work process and services

Promote networking

Drawbacks

Benchmarking is time-consuming, at times, difficult.

Benchmarking will be failure if the project is not to chosen carefully

Resources are usually limited for extensive benchmarking studies.