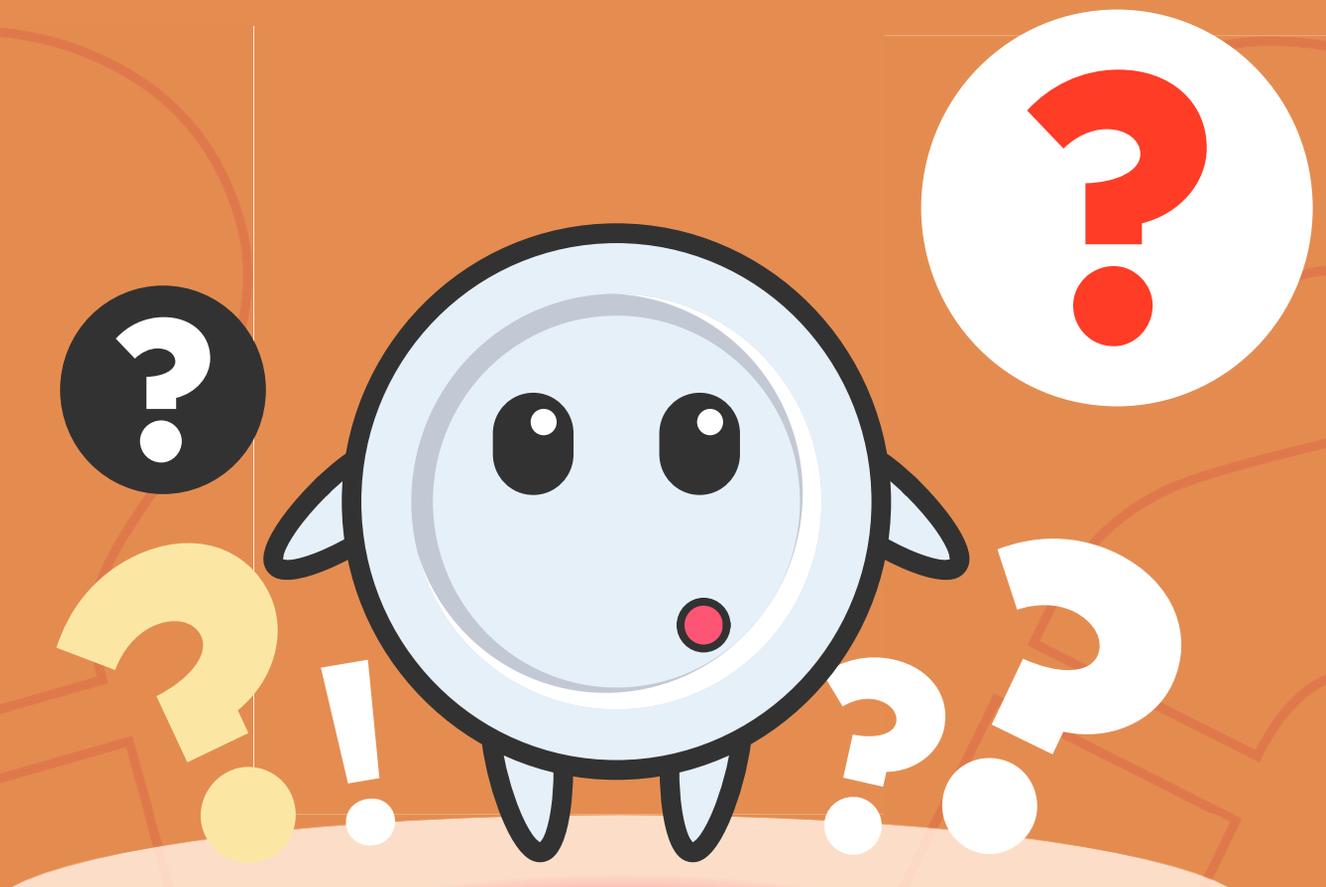


CA Inter
Cost Management

MCQ's
Theory & MCQ's Booklet



By
CA Amit Sharma
(For May 26 & Onwards)

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“

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CA AMIT SHARMA



1

CHAPTER

INTRODUCTION TO COST MANAGEMENT ACCOUNTING

Q.N.	Questions
1.	<p>What are the main objectives of Cost and Management Accounting ??</p> <ul style="list-style-type: none"> (i) Ascertainment of Cost: The main objective of Cost Accounting is accumulation and ascertainment of cost. Costs are accumulated, assigned and ascertained for each cost object. This cost object may be a unit, job, operation, process, department or service. (ii) Determination of Selling Price and Profitability: The Cost Accounting System helps in determination of selling price and thus profitability of a cost object. Though in a competitive business environment selling prices are determined by external factors but cost accounting system provides a basis for price fixation and rate negotiation. (iii) Cost Control: Maintaining discipline in expenditure is one of the main objectives of a good cost accounting system. It ensures that expenditures are in consonance with predetermined set standard and any variation from these set standards is noted and reported on continuous basis. (iv) Cost Reduction: It may be defined "as the achievement of real and permanent reduction in the unit cost of goods manufactured or services rendered without impairing their suitability for the use intended or diminution in the quality of the product." (v) Assisting Management in Decision Making: Cost and Management Accounting by providing relevant information, assist management in planning, implementing, measuring, controlling and evaluating of various activities. A robust cost and management accounting system provides internal and external information to the industry which will be relevant for decision making.
2.	<p>To exercise control over cost, which steps are followed ?</p> <ul style="list-style-type: none"> (a) Determination of pre-determined standard or results: Standard cost or performance targets for a cost object or a cost centre are set before initiation of production or service activity. These are desired cost or result that need to be achieved. (b) Measurement of actual performance: Actual cost or result of the cost object or cost centre is measured. Performance should be measured in the same manner in which the targets are set i.e., if the targets are set up operation-wise, and then the actual costs should also be collected and measured operation-wise to have a common basis for comparison. (c) Comparison of actual performance with set standard or target: The actual performance so measured is compared against the set standard and desired target. Any deviation (variance) between the two is noted and reported to the appropriate person or authority. (d) Analysis of variance and action: The variance in results so noted is further analysed to know the reasons for variance and appropriate action is taken to ensure compliance in future. If necessary, the standards are further amended to take developments into account.

3. Which are the three-fold assumptions involved in the definition of cost reduction may be summarised as under:

The three-fold assumptions involved in the definition of cost reduction may be summarised as under:

- (a) There is a saving in unit cost.
- (b) Such saving is of permanent nature.
- (c) The utility and quality of the goods and services remain unaffected, if not improved.

4. What is the difference between Cost Control and Cost Reduction ?

Cost Control	Cost Reduction
1. Cost control aims at maintaining the costs in accordance with the established standards.	1. Cost reduction is concerned with reducing costs. It challenges all standards and endeavours to improvise them continuously
2. Cost control seeks to attain lowest possible cost under existing conditions.	2. Cost reduction recognises no condition as permanent, since a change will result in lower cost.
3. In case of cost control, emphasis is on past and present	3. In case of cost reduction, it is on present and future.
4. Cost control is a preventive function	4. Cost reduction is a corrective function. It operates even when an efficient cost control system exists.
5. Cost control ends when targets are achieved.	5. Cost reduction has no visible end and is a continuous process.

5. Explain the Scope of Cost Accounting.

Scope of Cost Accounting consists of the following functions:

- (i) **Costing:** Costing is the technique and process of ascertaining costs of products or services. The cost ascertainment procedure is governed by some cost accounting principles and rules. Generally, cost is ascertained using historical costs, standard costs, process cost, operation cost etc.
- (ii) **Cost Accounting:** This is a process of accounting for cost which begins with the recording of expenditure and ends with the preparation of periodical statement and reports for ascertaining and controlling cost. Cost Accounting is a formal mechanism of cost ascertainment.
- (iii) **Cost Analysis:** It involves the process of finding out the factors responsible for variance in actual costs from the budgeted costs and accordingly fixation of responsibility for cost differences. This also helps in taking better cost management and strategic decisions.
- (iv) **Cost Comparisons:** Cost accounting also includes comparisons of cost involved in alternative courses of action such as use of different technology for production, cost of making different products and activities, and cost of same product/ service over a period of time.
- (v) **Cost Control:** It involves a detailed examination of each cost in the light of advantage received from the incurrance of the cost. Thus, we can state that cost is analyzed to know whether cost is not exceeding its budgeted cost and whether further cost reduction is possible or not.



- (vi) Cost Reports:** This is the ultimate function of cost accounting. These reports are primarily prepared for use by the management at different levels. Cost Reports helps in planning and control, performance appraisal and managerial decision making.
- (vii) Statutory Compliances:** Maintaining cost accounting records as per the rules prescribed by the statute to maintain cost records relating to utilization of materials, labour and other items of cost as applicable to the production of goods or provision of services as provided in the Act and these rules.

6. Explain Difference between Cost Accounting & Management Accounting.

Basis	Cost Accounting	Management Accounting
Nature	It records the quantitative aspect only.	It records both qualitative and quantitative aspect.
Objective	It records the cost of producing a product and providing a service.	It provides information to Management for planning and co-ordination.
Area	Only deals with cost ascertainment.	It is wider in scope as it includes financial accounting, budgeting, taxation, planning etc.
Recording of Data	Uses both past and present figures.	It is focused with the projection of figures for future.
Development	Its development is related to industrial revolution.	Its development is related to the need of modern business world.
Rules & Regulations	It follows certain principles and procedures for recording costs of different products.	It does not follow any specific rules and regulations.

7. Explain Difference between Cost Accounting & Financial Accounting.

Basis	Cost Accounting	Financial Accounting
Nature	It classifies records, present and interprets transactions in monetary terms.	It classifies, costs records, present, and interprets it in a significant manner.
Objective	It provides information about the financial performance of an entity.	Ascertainment of cost for the purpose of cost control and decision making.
Users of Info	The users of financial accounting statements are shareholders, creditors, financial analysts and government and its agencies, etc.	The cost accounting information Is generally used by internal management. But sometimes regulatory authorities also.
Recording of Data	It records Historical data.	It makes use of both historical and pre- determined costs.

Analysis of cost and profit	It shows profit or loss of the organization either segment wise or as a whole.	It provides the cost details for each cost object i.e. product, process, job, operation, contracts etc.
Time Period	Prepared usually for an year.	Prepared as & when required

8. What is the role of a cost and management accounting system ?

Cost Accounting is concerned with accumulation and allocation of costs to different cost objects, whereas, Management Accounting concerned with provision of information to internal users for decision making. The role of a cost and management accounting system is to:

- Provide relevant information to management for decision making,
- Assist management for planning, measurement, evaluation and controlling of business activities,
- Help in allocation of cost to products and inventories for both external and internal users.

9. Explain the functions of Cost and Management Accounting.

The functions of Cost and Management Accounting include:

- (i) Collection and accumulation of cost for each element of cost.
- (ii) Assigning costs to cost objects to ascertain cost.
- (iii) Cost and Management Accounting Department sets budget and standards for a particular period or activity beforehand and these are compared with the assigned and ascertained cost. Any deviation with the set standards are analysed and reported to control costs.
- (iv) The main function is provision of relevant information to the management for decision making. An Information system environment is set up which is popularly known as Management Information System (MIS) which provides relevant and timely information related to both internal and external to the organisation to enable management at all levels to take decisions. Decisions include cost optimisation, price fixation, implementation of any plan related with product, process, marketing etc.
- (v) The performance of a responsibility centre is measured and evaluated against the set standards. The function of Cost and Management Accounting is to gather data like time taken, wastages, process idleness etc., analyse the data, prepare reports and take necessary actions.

10. Who are Internal Users of Cost and Management Accounting.

Internal users, who use the Cost and Management Accounting information may include the followings:

- (a) **Policy Makers-** The policy makers are those who formulate strategies
 - to achieve the goals (short & long term both) to fulfil the objectives of the organisation.
 - to position the organisation into the competitive market environment.
 - to design the organisational structure to get the policy and strategies implemented. Etc.
- (b) **Managers-** The managers use the information
 - to know the cost of a cost object and cost centre
 - to know the price for the product or service
 - to measure and evaluate performance of responsibility centres
 - to know the profitability-product-wise, department-wise, customer-wise etc.



- to evaluate the strategic options and to make decisions
- (c) **Operational level staff-** The operational level staff like supervisors, foreman, team leaders require information
- to know the objectives and performance goals for them
 - to know product and service specifications like volume, quality and process etc.
 - to know the performance parameters against which their performance is measured and evaluated.
 - to know divisional (responsibility centre) profitability etc.
- (d) **Employees-** Employees are concerned with the information related with time and attendance, incentives for work, performance standards etc.

11. Who are External Users of Cost and Management Accounting.

External users, who use the Cost and Management Accounting information may include the followings:

- (a) **Regulatory Authorities-** Regulatory Authorities are concerned with cost accounting data and information for different purpose which includes tariff determination, providing subsidies, rate fixation etc. To do this the regulatory bodies require information on the basis of some standards and format in this regard.
- (b) **Auditors-** The auditors while conducting audit of financial accounts or for some other special purpose audit like cost audit etc. require information related with costing and reports reviewed by management etc.
- (c) **Shareholders-** Shareholders are concerned with information that effect their investment in the entity. Management communicates to the shareholders through periodic communique, annual reports etc. regarding new orders received, product expansion, market share for products etc.
- (d) **Creditors and Lenders-** Creditors and lenders are concerned with data and information which affects an entity's ability to serve lenders or creditors. For example, any financial institutions which provides loan to an entity against book debts and inventories are more concerned with regular reporting on net debt position and stock balances.

12. What are the essential features, which a good Cost Accounting System should possess ?

The essential features, which a good Cost Accounting System should possess, are as follows:

- (a) **Informative and simple:** Cost accounting system should be tailor-made, practical, simple and capable of meeting the requirements of a business concern. The system of costing should not sacrifice the utility by introducing inaccurate and unnecessary details.
- (b) **Accurate and authentic:** The data to be used by the cost accounting system should be accurate and authenticated; else it may distort the output of the system and a wrong decision may be taken.
- (c) **Uniformity and consistency:** There should be uniformity and consistency in classification, treatment and reporting of cost data and related information. This is required for benchmarking and comparability of the results of the system for both horizontal and vertical analysis.
- (d) **Integrated and inclusive:** The cost accounting system should be integrated with other systems like financial accounting, taxation, statistics and operational research etc. to have a complete overview and clarity in results.

- (e) **Flexible and adaptive:** The cost accounting system should be flexible enough to make necessary amendment and modifications in the system to incorporate changes in technological, reporting, regulatory and other requirements.
- (f) **Trust on the system:** Management should have trust on the system and its output. For this, an active role of management is required for the development of such a system that reflects a strong conviction in using information for decision making.

13. Explain the factors to be studied before setting up a system of cost accounting.

Before setting up a system of cost accounting the factors mentioned below should be studied:

- (a) **Objective:** The objective of setting up the costing system, for example whether it is being introduced for fixing prices or for establishing a system of cost control.
- (b) **Nature of Business or Industry:** The industry in which the business is operating. Every business or industry has its own uniqueness and objectives. According to its cost information requirement, cost accounting methods are followed. For example, an oil refinery maintains process wise cost accounts to find out the cost incurred on a particular process, say in crude refinement process etc.
- (c) **Organisational Hierarchy:** Costing system should fulfil the information requirements of different levels of management. Top management is concerned with the corporate strategy, strategic level management is concerned with marketing strategy, product diversification, product pricing etc.
- (d) **Knowing the product:** Nature of the product determines the type of costing system to be implemented. The product which has by-products requires costing system which accounts for by-products as well. In case of perishable or short self- life products, marginal costing is appropriate to know the contribution and minimum price at which products could be sold.
- (e) **Knowing the production process:** A good costing system can never be established without the complete knowledge of the production process. Cost apportionment can be done on the most appropriate and scientific basis if a cost accountant can identify degree of effort or resources consumed in a particular process. This also includes some basic technical know-how and process peculiarity.
- (f) **Information synchronisation:** Establishment of a department or a system requires substantial amount of organisational resources. While drafting a costing system, information needs of various other departments should be taken into account. For example, in a typical business organisation accounts department needs to submit monthly stock statement to its lender bank, quantity wise stock details at the time of filing returns to tax authorities etc.
- (g) **Method of maintenance of cost records:** The organization must determine beforehand the manner in which Cost and Financial Accounts could be inter-locked into a single integral accounting system and how the results of separate sets of accounts i.e. cost and financial, could be reconciled by means of control accounts.
- (h) **Statutory compliances and audit:** Records are to be maintained to comply with statutory requirements and applicable cost accounting standards should be followed.
- (i) **Information Attributes:** Information generated from the Costing system should possess all the attributes of useful information i.e. it should be complete, accurate, timely, relevant. to have an effective management information system (MIS).



14. Explain Digital Costing System.

Digital costing system links different business functions such as production, procurement, inventory management with the digital costing system of its suppliers, customers and the market through data sharing and network interaction.

Digital Costing System provides data to get the following information:

- (i) Cost incurred on a cost object.
- (ii) Data on time spent.
- (iii) Data on resource consumption.
- (iv) Data on current market price of final product and raw materials.
- (v) Data on lead time and availability of materials.
- (vi) Data on product demand and trend.

15. Explain benefits of Digital Costing System.

With the help of Artificial Intelligence (AI) and Machine learnings (ML) which helps in analysis of the Big data and apprehend the consumption and demand pattern, the following benefits can be achieved:

- (i) Ascertainment of cost with certainty on a cost object (the cost object is discussed in later paragraph). This helps to analyse the activities for cost allocation and apportionment.
- (ii) Analysis of data on time spent on each activity to study and formulate incentive plans.
- (iii) Helps in material requirement planning and scheduling the material procurement. Data on resource consumption can be analysed for resource optimisation and finding the possibilities for zero wastage and Just-in Time (JIT).
- (iv) Helps to identify and eliminate the non-value-added activities.
- (v) Data on resource consumption is helpful in setting the standards and measurement of variances on real time basis.
- (vi) Data on current market prices of material and consumables helps to estimate cost and setting standards on Marked to Market (M2M) basis.
- (vii) Extrapolation of data on customer behaviour towards the products to predict the market demand. It is helpful in preparation of budgets and planning of production.
- (viii) A better analysis of cost behaviour improves the cost benefit analysis and equipping the management in informed decision making.

16. What is a Responsibility Centre and its different types ?

To have a better control over the organisation, management delegates its responsibility and authority to various departments or persons. These departments or persons are known as responsibility centres and are held responsible for performance in terms of expenditure, revenue, profitability and return on investment. Performance of these responsibility centres are measured against some set standards (input-output ratio, budgets etc.) and evaluated against organisational goal and performance targets.

- (i) **Cost Centres:** The responsibility centre which is held accountable for incurrence of costs which are under its control. The performance of this responsibility centre is measured against pre-determined standards or budgets. The cost centres are of two types:
 - (a) **Standard Cost Centre:** Cost Centre where output is measurable and input required for the output can be specified. Based on a well-established study, an estimate of standard units of

input to produce a unit of output is set. The actual cost for inputs is compared with the standard cost. Any deviation (variance) in cost is measured and analysed into controllable and uncontrollable cost. The manager of the cost centre is expected to comply with the standard and held responsible for adverse cost variances. The input-output ratio for a standard cost centre is clearly identifiable.

- (b) Discretionary Cost Centre:** The cost centre whose output cannot be measured in financial terms, thus input-output ratio cannot be defined. The cost of input is compared with allocated budget for the activity. Examples of discretionary cost centres are Research & Development department, Advertisement department where output of these department cannot be measured with certainty and co-related with cost incurred on inputs.
- (ii) Revenue Centres:** The responsibility centres which are accountable for generation of revenue for the entity. Sales Department for example, is responsible for achievement of sales target and revenue generation. Though, revenue centres do not have control on expenditures it incurs but sometimes expenditures related with selling activities like commission to sales person etc. are incurred by revenue centres.
- (iii) Profit Centres:** These are the responsibility centres which have both responsibility of generation of revenue and incurrance of expenditures. Since, managers of profit centres are accountable for both costs as well as revenue, profitability is the basis for measurement of performance of these responsibility centres. Examples of profit centres are decentralised branches of an organisation.
- (iv) Investment Centres:** These are the responsibility centres which are not only responsible for profitability but also have the authority to make capital investment decisions. The performance of these responsibility centres are measured on the basis of Return on Investment (ROI) besides profit. Examples of investment centres are Maharatna, Navratna and Miniratna companies of Public Sector Undertakings of Central Government.

17. What are the limitations of cost accounting ?

The limitations of cost accounting are as follows:

- 1. Expensive:** It is expensive because analysis, allocation and absorption of overheads requires considerable amount of additional work, and hence additional money.
- 2. Requirement of reconciliation:** The results shown by cost accounts differ from those shown by financial accounts. Thus preparation of reconciliation statements is necessary to verify their accuracy.
- 3. Duplication of work:** It involves duplication of work as organization has to maintain two sets of accounts i.e. Financial Accounts and Cost Accounts.

18. Explain various methods of Costing.

Single or Output Costing :- Under this method, the cost of a product is ascertained, the product being the only one produced like bricks, coals, etc.



Batch Costing :- This method is the extension of job costing. A batch may represent a number of small orders passed through the factory in batch. Each batch here is treated as a unit of cost and thus separately costed. Here cost per unit is determined by dividing the cost of the batch by the number of units produced in the batch.

Job Costing:- Under this method of costing, cost of each job is ascertained separately. It is suitable in all cases where work is undertaken on receiving a customer's order like a printing press, motor workshop, etc.

Contract Costing:- Under this method, the cost of each contract is ascertained separately. It is suitable for firms engaged in the construction of bridges, roads, buildings etc.

Process Costing:- Under this method, the cost of completing each stage of work is ascertained, like cost of making pulp and cost of making paper from pulp. In mechanical operations, the cost of each operation may be ascertained separately; the name given is operation costing.

Operating Costing:- It is used in the case of concerns rendering services like transport, supply of water, retail trade etc.

Multiple Costing:- It is a combination of two or more methods of costing outlined above. Suppose a firm manufactures bicycles including its components; the parts will be costed by the system of job or batch costing but the cost of assembling the bicycle will be computed by the single or output costing method. The whole system of costing is known as multiple costing.

19. Explain various techniques of Costing.

Uniform Costing:- When a number of firms in an industry agree among themselves to follow the same system of costing in details, adopting common terminology for various items and processes they are said to follow a system of uniform costing. Advantages of such a system are: (i) A comparison of the performance of each of the firms can be made with that of another, or with the average performance in the industry. (ii) Under such a system, it is also possible to determine the cost of production of goods which is true for the industry as a whole.

Marginal Costing:- It is defined as the ascertainment of marginal cost by differentiating between fixed and variable costs. It is used to ascertain effect of changes in volume or type of output on profit.

Standard Costing and Variance Analysis :- It is the name given to the technique whereby standard costs are pre-determined and subsequently compared with the recorded actual costs. It is thus a technique of cost ascertainment and cost control. This technique may be used in conjunction with any method of costing.

Historical Costing:- It is the ascertainment of costs after they have been incurred. This type of costing has limited utility.

- Post Costing : It means ascertainment of cost after production is completed.
- Continuous costing : Cost is ascertained as soon as the job is completed or even when the job is in progress.

Absorption Costing:- It is the practice of charging all costs, both variable and fixed to operations, processes or products. This differs from marginal costing where fixed costs are excluded.

2

CHAPTER

MATERIAL COSTING

Q.N	QUESTIONS
1.	<p>Explain the importance of proper recording and control of material.</p> <p>Importance of proper recording and control of material are as follows:</p> <ul style="list-style-type: none"> (a) Quality of final product: The quality of output depends on the quality of inputs. (b) Price of the final product: Material constitutes a significant part of any product and the cost of final product is directly related with cost of materials used to produce the product. (c) Production continuity: The production firms need to ensure that production process runs smoothly and should not be paused for the want of materials. In order to avoid production interruptions, an adequate level of stock of materials should be maintained. (d) Cost of Stock holding and stock-out: An entity has to incur stock holding costs in the form of interest and/or opportunity cost for the fund used, stock handling losses like evaporation, obsolescence etc. Under-stocking causes in loss of revenue due to stock-out and breach of commitment. (e) Wastage and other losses: While handling and processing of materials, some wastage and loss arise. Based on the nature of material and process, these are classified as normal and abnormal for efficient utilisation and control. (f) Regular information about resources: Regular and updated information on availability and utilisation of materials are necessary for the entity for timely and informed decision making.
2.	<p>What are the objectives of a system of material control ?</p> <p>The objectives of a system of material control are as following:</p> <ul style="list-style-type: none"> (i) Minimising interruption in production process: Material Control system ensures that no activity, particularly production, suffers from interruption for want of materials and stores. It requires constant availability of every item that may be needed in production process (ii) Optimisation of Material Cost: The overall material costs includes price, ordering costs and holding costs. Since all the materials and stores are acquired at the lowest possible price considering the required quality and other relevant factors. (iii) Reduction in Wastages: Material Control System has an objective of avoidance of unnecessary losses and wastages that may arise from deterioration in quality due to defective or long storage or from obsolescence. It may be noted that losses and wastages in the process of manufacture are a concern of the production department. (iv) Adequate Information: The system of material control maintains proper records to ensure that reliable information is available for all items of materials and stores. This not only helps in detecting losses and pilferages but also facilitates proper production planning. (v) Completion of order in time: Proper material management is very necessary for fulfilling orders of the firm. This adds to the goodwill of the firm.



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