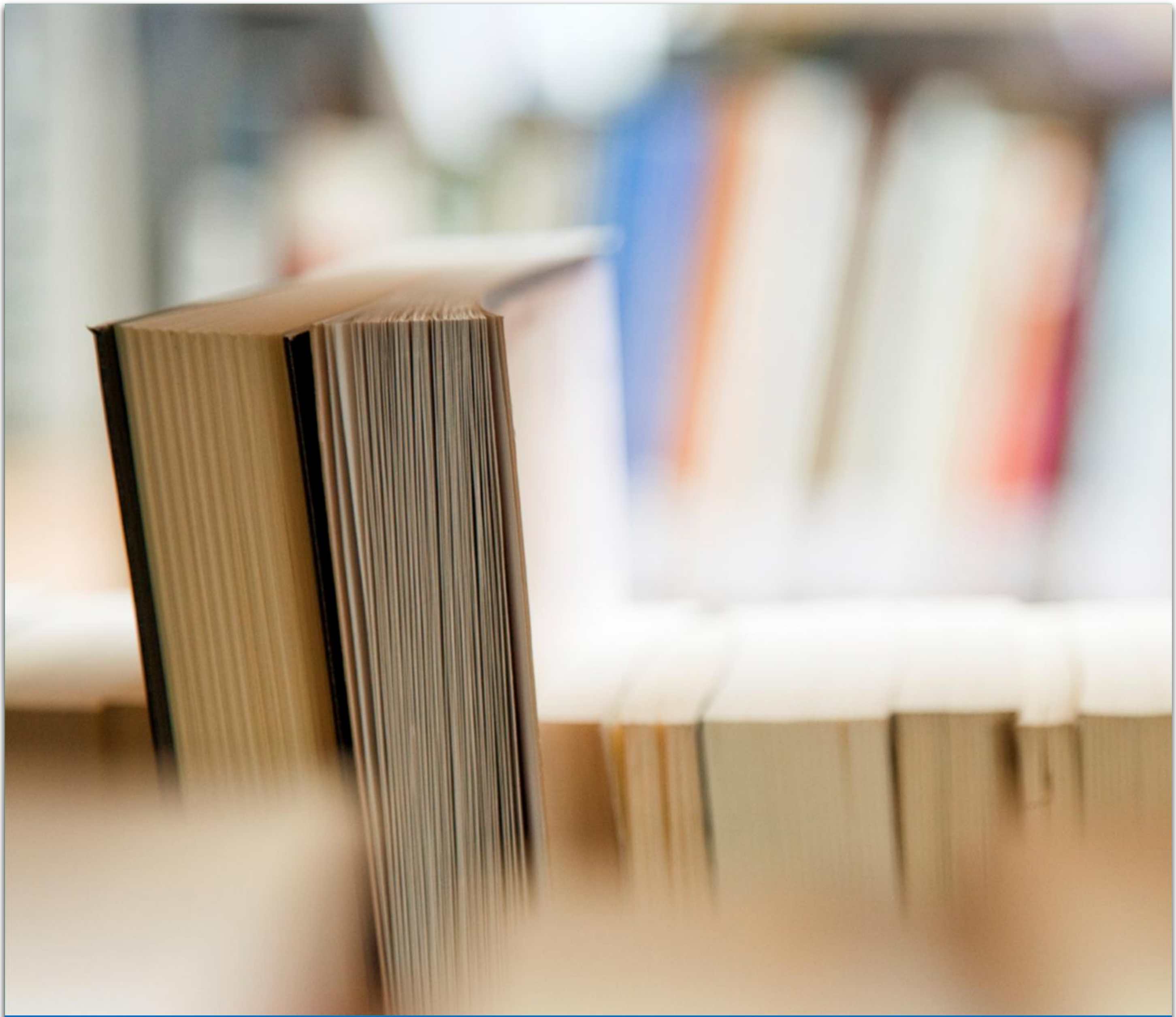

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UNIT: 2 Accounting and auditing

Sub Unit: 5 Cost and Management Accounting: Marginal costing and Break-even analysis; Standard costing; Budgetary control; Process costing; Activity Based Costing (ABC); Costing for decision-making; Life cycle costing, Target costing, Kaizen costing and JIT

Content

Topics

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SECTION – 1: Unit at a Glance

Sub Unit-1: Basic accounting Principles; Concepts and Postulates

Accounting and Book Keeping

Accounting is the process of recording financial transactions pertaining to a business. The accounting process includes recording, classifying, summarizing, analysing, and reporting these transactions to those who are associated with the business.

Book keeping is the process of recording financial transactions on a daily basis. With the help of book keeping business entity is able to track all transaction related information relating to operating, investing and financial activities.

Objectives of accounting

- To maintain full and systematic records of business transactions
- To ascertain profit or loss of the business.
- To depict financial position of the business.
- To provide accounting information to the interested parties.

Classification of Accounting

- Financial accounting
- Cost accounting
- Management Accounting

Accounting Principles

Accounting principles are the general rules and guidelines that companies are required to follow at the time of preparing and reporting financial statement to the users of accounting information.

GAAP

GAAP (Generally Accepted Accounting Principles): It is a Technical concept that describes the basic rules, concepts, conventions and procedures that represent accepted accounting practices at a particular time.

Accounting Principles can be classified as

a) **Accounting Concept**

- Separate entity concept
- Going concern Concept
- Dual Concept
- Money Measurement Concept
- Cost Concept or Historical cost concept
- Accounting period concept
- Realisation Concept
- Matching Concept
- Accrual Concept

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b) **Accounting Conventions**

An accounting convention refers to common practices which are universally followed in recording and presenting accounting information of the business entity. Conventions denote customs or traditions or usages which are in use since long. To be clear, these are nothing but unwritten laws.

- Convention of Consistency
- Convention of full disclosure
- Convention of Conservatism
- Convention of Materiality

Financial statement

Financial statements are written records that convey the business activities and the financial performance of a company.

Users of Financial Statement

- Creditors;
- Debtors;
- Potential Investors;
- Employees;
- Lenders;
- Government.

Components of Financial statement

- Income Statement or Profit & Loss account
- Balance Sheet or The Position Statement
- Statement of Changes in Financial Position (Cash flow statement.)

Sub Unit: 2 Partnership Accounts: Admission, Retirement, Death, Dissolution and Insolvency of partnership firms

Partnership

The term **partnership** is used to mean a business structure wherein **two or more individuals,** come together for undertaking a **lawful business** and have agreed to **share the profits and losses** arising from it. The **management and operation** of the business should be performed either by **all the partners or any of them, acting for all the partners.**

Partnership Deed

A Partnership Deed is a written agreement or document among the partners specifying rules and regulations and is signed by all the partners and stamped as per the Stamp Act with an aim to prevent possible disputes & disagreements among the partners at a future date. The registration of Deed of Partnership is made under the Indian Registration Act, 1908. In absence of partnership deed partnership Act is applied.

Content of Partnership Deed

- The name of the firm
- Names and addresses of the partners
- Nature of business
- Date of commencement
- Duration/Period
- The amount of capital to be brought in by each partner
- The amount of drawings that may be permitted in anticipation of profits and the manner of withdrawal.
- Sharing of profit or loss
- Rate of interest on capital
- Rate of interest on drawings
- Salary payable to the partners

Types of Partner

- Active Partner
- Sleeping or Dormant Partner
- Nominal partner
- Partners in Profits only
- Minor partner
- Partners by Estoppel or Holding Out

Dissolution and Insolvency of Partnership firms

Dissolving a partnership firm means discontinuing the business under the name of said partnership firm.

Dissolving a partnership firm is different from dissolving a partnership. In the former case, the firm ends its name and hence cannot do business in the future. But in case of dissolving a partnership, the existing partnership is dissolved– by consent or on happening of a certain event, but the firm can retain its existence if remaining partners enter into a new partnership agreement.

Modes of Dissolution of a firm

- Dissolution without the Intervention of Court
- Dissolution by court

Sub Unit: 3 Corporate Accounting: Issue, forfeiture and reissue of shares; Liquidation of companies; Acquisition, merger, amalgamation and reconstruction of companies

Company

A company is a legal entity formed by a group of individuals to engage in and operate a business enterprise in a commercial or industrial capacity. Companies may be either public or private; the former issues equity to shareholders on an exchange, while the latter is privately-owned and not regulated.

Share

A share is a single unit of ownership in a company or financial asset. It is essentially an exchangeable piece of value of a company which can fluctuate up or down, depending on several different market factors. So, share is nothing but the small unit of the total capital of the company.

Share capital

Total amount raised by the company by issuing shares is known as the share capital and the subscriber of the share is popularly known as shareholders.

Types of share

- Equity share
- Preference share

Types of share capital

- Authorised or Registered or Nominal capital
- Issued Capital
- Subscribed capital
- Called up capital
- Paid up capital

Subscription of share

- Full Subscription
- Under subscription
- Over subscription

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Valuation of shares

Before investing in any company, it is important for us to understand the real worth of its shares. This will be possible if we can calculate the intrinsic value of the share. The process of calculating this intrinsic value is known as share valuation.

Methods of valuation of shares

- Assets-Backing Method or Intrinsic Value Method
- Yield-Basis Method
- Fair Value Method

Forfeiture of shares

If a shareholder, who is called upon to pay any call fails to pay the amount, even after sending several reminders, the company may forfeit his shares.

What is Re-issue of shares?

Re-issue of forfeited shares is a mere sale of shares for the company. Such shares may be re-issued at par, at a premium or even at a discount. So, re issue of shares is nothing but issue of forfeited shares as fresh issue.

Liquidation of company

The winding up or liquidation of a company means the termination of the legal existence of a company by stopping its business, collecting its assets and distributing the assets among creditors and shareholders in the manner laid down in the Act.

At the end of the winding up the company will have no assets or liabilities and will be a formal step for it to be dissolved. ***So winding up and dissolution are not same. Winding up is a process and dissolution is the end result.***

An administer , called ***" liquidator"*** is appointed who takes control of the company and he is responsible for collecting the assets and pays its debts and finally distributes any surplus among the members in accordance with their rights.

Liquidator is ***appointed*** by the Tribunal in case of winding up by the Tribunal and company or creditors in case of voluntary winding up.

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Modes of liquidation of company

Section 270(1) of the Companies Act, 2013 deals with the types of winding up of a company. As per this section there are two modes of winding up of a company namely-

i) Compulsory winding up u/s 271 by the Tribunal and,

ii) Voluntary winding Up, u/s 304 by passing an appropriate resolution at a general meeting of members.

Acquisition of company

An acquisition refers to a corporate transaction wherein a company purchases a portion or entire shares/assets of another company. A new company does not emerge from an acquisition; rather, the smaller company is often consumed and ceases to exist, and its assets become part of the larger company.

Purchase consideration

Purchase Consideration refers to the consideration payable by the purchasing company to the vendor company for taking over the assets and liabilities of Vendor Company.

Methods of calculating purchase consideration

- Lump sum method
- Net Assets method
- Net Payment Method

Merger

Two or more companies are combined to form an altogether new entity; or one or more target companies get absorbed into an existing company i.e. merged company.

Amalgamation

Amalgamation is the combination of one or more companies into a new entity. In an amalgamation a new company is mandatorily formed to house the assets and liabilities of the combined companies. The amalgamating companies cease to exist.

Reconstruction

Reconstruction is an exercise of restating assets & liabilities by company / entity whose financial position as reflected by its balance sheet is not healthy but future is promising.

Types of reconstruction

- Internal reconstruction
- External reconstruction

Sub Unit: 4 Holding Company accounts

Holding company

Section 2(46) of the Companies Act, 2013 defines Holding Company. The company is said to be the holding company if that particular company holds/owns at least 50% of the other companies and has the authority to make management decisions, influences and controls the company's board of directors

Types of holding companies

- Parent holding company:
- Offspring company:
- Pure holding company:
- Proprietary holding company:
- Intermediate holding company:
- Finance holding company:
- Investment holding company:
- Primary holding company:
- Mixed holding company:

Subsidiary company

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Section 2(87) of the Companies Act, 2013 defines the Subsidiary Company. The subsidiary company is the company that is controlled by the holding or parent company. It is defined as a company/body corporate where the holding company controls the composition of the Board of Directors. As per the Companies Amendment Act, 2017, Section 2(87)(ii), if the holding company have control over more than one-half of the voting power of another company, that particular company will be identified as the subsidiary company.

Minority Interest

A minority interest is ownership or interest of less than 50% of an enterprise.

A minority interest can either be passive or active.

Sub Unit : 5 Cost and Management Accounting: Marginal costing and Break-even analysis; Standard costing; Budgetary control; Process costing; Activity Based Costing (ABC); Costing for decision-making; Life cycle costing, Target costing, Kaizen costing and JIT

Uses of Marginal Costing:

- Business is calculating the break-even level of output.
- Business is considering whether to make or buy a product.
- Business is choosing between two or more alternatives.
- Business is costing a project to determine the minimum possible price to be quoted.
- Business is devising a price strategy.
- Business is abandoning a line of business.
- Business is facing a limiting factor and is deciding about optimum production mix.

Standard cost

The term **'standard cost'** can be defined as the expected cost per unit of the products produced during a period, which is based on various factors.

Standard costing

Standard Costing is a costing method that is used to compare the standard costs and revenues with the actual results, in order to arrive at the variances along with its causes, to inform the management about the deviations and take corrective measures, for its improvement.

Process of standard costing

- Ascertainment and use of Standard Costs;
- Recording the actual costs;
- Comparison of actual costs with standard costs in order to find out the variance;
- Analysis of variance; and
- After analysing the variance, appropriate action may be taken where necessary.

Types of standard

- Idle standard
- Normal standard
- Basic Standard
- Current standard
- Expected or Attainable standard

Variance analysis

Variance analysis is the procedure of computing the differences between standard costs and actual costs and recognizing the causes of those differences. Studies indicated that variance is the difference between standard performance and actual performance.

Budget

A budget may be defined as a financial and/or quantitative statement, prepared and approved prior to a defined period of time, of the policy to be pursued during that period for the purpose of attaining a given objective.

Budgetary control

It is a continuous process of determining the standard for future period of time and comparing the standard with the actual for identifying the deviation for taking corrective measures.

Flexible budget

It is a budget which is flexible and can be revised time to time considering current situation and conditions.

Process costing

Process costing is a technique and is applied where an unit passes through different processes for completion of its process and the processes are easily distinguishable then the cost of the unit will be cost of process that it goes through

Industries where process costing technique is applied

- Sugar Manufacturing Industries
- Brick Industries
- Petroleum Industries
- Steel Industries

Activity based costing

Activity based costing (ABC) is a method that assigns manufacturing overhead costs to products or process that consume cost in a more logical manner than the traditional approach of simply allocating costs on the basis of machine hours. Activity based costing first assigns costs to the activities that are the real cause of the overhead. It then assigns the cost of those activities only to the products that are actually demanding the activities. So in Activity Based costing the main focus is on the identifying the activities that are used to produce the product.

Costing for decision making

- Key factor or limiting factor
- Fixation of selling price
- Determination of product mix
- Make or buy decision
- Discontinuation of product line
- Profit planning

Life cycle costing

Product life cycle costing involves tracing of costs and revenues of a product over several calendar periods throughout its life cycle. So Life Cycle Costing is a method of identifying the cost and revenue of a product over several calendar years from the product invention to abandonment

Target costing

Target costing is a cost accounting approach in which companies set targets for costs based on the price prevalent in the market and the profit margin they want to earn. Keeping its costs below the relevant targets helps the companies to generate profit.

Target cost = Selling Price – Profit Margin

Kaizen costing

Kaizen costing is a technique of controlling the cost incurred over unproductive activities and resources which does not add any value to the organization. In simple words, it is a practical approach to solving cost-related problems to improve the overall efficiency of the organization.

5's in Kaizen costing

- **Short**
- **Straighten**
- **Shine**
- **Standardize**
- **Sustain**

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Stages of Kaizen Costing

Involve your employee→ Find problems→ Think and find →Solutions→ Implement→ Check→ Standardize→ Repeat.

Just-In-Time (JIT)

Just-in –Time is an inventory management method whereby materials is scheduled to arrive or be replenished exactly when needed in the production process. The Just-in-time system is adopted by the firms, to reduce the unnecessary burden of inventory management, in case the demand is less than the inventory raised.

S

ub Unit: 6 Financial Statements Analysis: Ratio analysis; Funds flow Analysis; Cash flow analysis

Financial statement analysis

Financial Statement Analysis is nothing but the analysis of the financial statement by using different analytical and financial tools to make different business decision. There are three types of analysis namely vertical analysis, horizontal analysis and ratio analysis. Each one of these tools gives decision makers a little more insight into how well the company is performing.

Components of financial statement

1. Balance Sheet
2. Income Statement or Profit or Loss account.
3. Cash Flow Statement
4. Statement of Changes in Owners' Equity

Financial ratio

Financial Ratio is a quantitative relationship between two variables taken from the financial statement. This ratio is a very useful tool for analysing financial health of an organisation.

Classification of Ratio

- Liquidity Ratio
- Profitability Ratio
- Solvency Ratio
- Activity Ratio
- Income Statement Ratio
- Balance Sheet ratio
- Composite or Mixed Ratio
- Primary Ratio
- Secondary Ratio

Inter firm comparison

Inter firm comparison means a **comparison of two or more similar business units** with the objective of finding the competitive position to improve the profitability and productivity of those business units. Thus, inter firm comparison is a **tool used by the management of a company** to compare its operating performance and financial results with those of similar companies engaged in the same industry.

Fund

In narrow sense fund means **cash**. In broader sense fund means **all the financial resources** used in the business. In popular sense funds means **working capital**.

Fund flow statement

The fund flow statement is a statement which indicates various means by which the funds have been obtained during a specific period and the ways to which these funds have been used during that period. The term flow means movement and includes both inflows and outflows of resources.

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Cash flow statement

A cash flow statement is a statement which shows the inflow and outflow of **cash and cash equivalent** during a specific accounting period. A cash flow statement is prepared by classifying all the activities into cash flow from operating activities, cash flow from financing activities and cash flow from investing activities. **Cash equivalents include bank accounts and marketable securities, which are debt securities with maturities of less than 90 days.**

Sub Unit: 7 Human Resources Accounting; Inflation Accounting; Environmental Accounting

Human Resource Accounting (HRM)

The American Accounting Society Committee on Human Resource Accounting defines it as follows –

"Human Resource Accounting is the process of identifying and measuring data about human resources and communicating this information to interested parties."

Methods of Human Resource Accounting

- Replacement Cost Model
- Opportunity cost Model
- Capitalization of Historical cost Model
- Economic Value Model
- **Flamholtz model**

Inflation Accounting

Inflation accounting refers to the adjustment of the financial statements during the inflationary periods. It involves the recording of the income and expenditure of the business at the current prices and reinstating all the three statements of the company and analyse the cost and the trend of the current company.

Methods of Inflation Accounting

- Current Purchasing Power Method
- Current Cost Accounting
- Current value

Environmental Accounting

Environmental accounting is the practice of using traditional accounting and finance principles to calculate the costs that business decisions will have on the environment. Environmental accounting is the practice of incorporating principles of environmental management and conservation into reporting practices and cost/benefit analyses.

Sub Unit: 8 Indian Accounting Standards and IFRS

Accounting Standard (AS)

An accounting standard is a common set of principles, standards and procedures that define the basis of financial accounting policies and practices. In order to ensure transparency, consistency, comparability, adequacy and reliability of financial reporting, it is essential to standardize the accounting principles and policies, accounting standards basically provide framework and standard accounting policies so that financial statements of different enterprise become comparable.

International Financial reporting Standard (IFRS)

International Financial Reporting Standards (IFRS) is a set of accounting standards developed by an independent, not-for-profit organization called the International Accounting Standards Board (IASB). The goal of IFRS is to provide a global framework for how public companies prepare and disclose their financial statements. IFRS provides general guidance for the preparation of financial statements, rather than setting rules for industry-specific reporting. IFRS were established in order to have a common accounting language, so business and accounts can be understood from company to company and country to country.

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Advantages of IFRS

- Greater comparability
- Benefits to new and small investors
- More flexibility

Disadvantages of IFRS

- High costs of Implementation
- Prone to manipulation
- It is not globally accepted.

Sub Unit: 9 Auditing: Independent financial audit; Vouching; Verification ad valuation of assets and liabilities; Audit of financial statements and audit report; Cost audit

Auditing

The primary purpose of the audit is to confirm the authenticity of books of accounts prepared by an accountant. The audit is an intelligent and critical examination of the books of accounts of the business.

Independent financial audit

A **financial audit** is an independent, objective evaluation of an organization's financial reports and financial reporting processes. The primary purpose for financial audits is to give regulators, investors, directors, and managers' **reasonable assurance** that financial statements are accurate and complete.

Vouching
The act of examining documentary evidence in order to ascertain the accuracy of entries in the account books is called "Vouching". Vouching means a careful examination of all original evidence i.e invoices, statements, receipts, correspondence, minutes and contracts etc. with a view to ascertain the accuracy of the entries in the books of accounts and also to find out, as far as possible, that no entries have been omitted in the books of accounts. Therefore, vouching is the act of testing the truth of entries appearing in the primary books of accounts.

Voucher
Voucher is known as the evident for the support of a transaction in the books of account. It may be bill, receipts, requisition form, agreement, decision, bank paying slip etc. The *voucher* is an internal *accounting* control, which ensures that every payment is properly authorized.

Types of voucher

- Receipt or Credit Voucher
- Payment or Debit Voucher
- Transfer or Journal voucher or Non-cash Voucher
- Supporting Voucher
- Primary Voucher
- Collateral Voucher

Verification
Verification means the act of assuring the correctness of value of assets and liabilities in the organization. It refers to the examination of proof of title and their existence or confirmation of assets and liabilities on the date of Balance Sheet

Verification and vouching
Vouching relates to confirmation of the correctness and authenticity of accounting entries as appeared in the books of accounts whereas verification confirms the existence, ownership and valuation of assets as appears in the balance sheet.

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Valuation of assets and Liabilities
Valuation means finding out correct value of the assets on a particular date.

Vouching, Verification and Valuation

- In vouching, accounting entries are checked with the bona-fide vouchers.
- Verification proves the **existence, ownership** and **title** of assets.
- Valuation certifies the **correct value of asset**.
- Vouching is done after **original entry** in the books of accounts.
- Verification and valuation are done at the **end of the financial year**.
- Vouching is done by **Senior Auditor** and **Audit Clerk**.
- Verification and valuation are done by the **Auditor** himself.
- Bona-fide vouchers are sufficient **evidence** for vouching
- For Valuation Auditor has to depend upon **certification** from owner/partner/director.
- Verification is done by physical verification, title deeds and receipt of payment, etc.

Audit report
Lancaster has defined a report as “a report is a statement of collected and considered facts, so drawn up as to give clear and concise information to persons who are not already in possession of the full facts of subject matter of the report.”

Types of audit report

- Clean or Unqualified Report
- Qualified Report
- Adverse or Negative Report
- Disclaimer Report

Cost audit

Cost audit may be defined as “the verification of cost records and accounts and a check on the adherence to the prescribed cost accounting procedures and the continuing relevance of such procedures.”

Circumstances under Which Cost Audit is Desirable

The following are the circumstances under which cost audit is ordered:

- Price Fixation.
- Cost variation within the industry.
- Inefficient Management.
- Tax Assessment.
- Trade Disputes.

Types of Cost Audit

- Efficiency Audit
- Propriety Audit
- Statutory Audit

Sub Unit: 10 Recent Trends in Auditing: Management audit; Energy audit; Environment audit; Systems audit; Safety audit

Management audit

Management audit is a method of independent and systematic evaluation of the management activities at all levels of management to ascertain the functions, efficiency and achievement of' the management (policies, programs, procedures) as compared to standards set by the company.

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Energy audit

Energy Audit attempts to balance the total energy inputs with its use and serves to identify all the energy streams in the systems and quantifies energy usages according to its discrete function. Energy Audit helps in energy cost optimization, pollution control, safety aspects and suggests the methods to improve the operating & maintenance practices of the system. Energy audit helps to assess present pattern of energy consumption in different cost centres of operations and it also helps to highlight the wastage of energy in major areas.

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Stages of energy audit

Data Collection→ Field work→ Analysis of energy consumption and performance of energy accounting→ Analysis and development of energy saving measures→ Energy Audit Report

Environmental audit

Environmental auditing involves examination of interaction between business and surroundings and ensures how organisation, management and equipment are functioning to protect environment.

System audit

A system audit is a disciplined approach to evaluate and improve the effectiveness of a system. Audits are carried out in order to verify that the individual elements within the system are effective and suitable in achieving the stated objectives.

Safety audit

It is an audit where information is collected about one or more aspects of the workplace in order to evaluate the risk levels for health or safety issues.

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SECTION – 2: KEY STATEMENTS

Every candidates appearing for NET/SET examination should follow these key (main) points those can help them a better understanding regarding this unit very quickly.

Basic Key Statements: Accounting (2.1.1), Book Keeping (2.1.1), Accounting Principles (2.1.2), **GAAP** (2.1.2), Accounting Concept (2.1.2), Accounting Conventions (2.1.2), Capital expenditure (2.1.3), Deferred Revenue Expenditure(2.1.3), Financial statement (2.1.4), Partnership Deed (2.2.1.1), Merger (2.3.6), amalgamation (2.3.7), reconstruction (2.3.8), holding company (2.4.1), Marginal cost(2.5.2.2), Profit volume ratio (2.5.2.2), flexible budget (2.5.4.4), Kaizen costing (2.5.10), Just-In-Time (JIT)(2.5.11), components of financial statement (2.6.1.1), financial ratio (2.6.2.1), Inter firm comparison (2.6.2.6), Cash equivalents (2.6.4), Human Resource Accounting (2.7.1), Inflation Accounting (2.7.2), Methods of Inflation Accounting (2.7.2.1), Environmental Accounting (2.7.3), Independent financial audit (2.9.2), vouching (2.9.3). Types of voucher (2.9.3.3), Verification (2.9.4), valuation of assets and liabilities (2.9.5.1), audit report (2.9.6), Types of audit report (2.9.6.1), Cost audit (2.9.7),

Standard Key Statements: Types of Partners (2.1.4), Dissolution of a firm(2.2.5.1), Garner vs Murray (2.2.5.4), Fixed Capital vs Fluctuating Capital (2.2.5.5), Forfeiture of shares (2.3.3), liquidation of company (2.3.4), Types of standard (2.5.3.4), activity based costing (2.5.6), Key factor(2.5.7) Life cycle costing (2.5.8), Target costing (2.5.9), Types of Cost Audit(2.9.7.3), management audit(2.10.1), energy audit(2.10.2), environmental audit(2.10.3), system audit(2.10.4), safety audit(2.10.5).

Advanced Key Statements: Subscription of share (2.3.1.4), Types of share capital(2.3.1.3), Pro rata allotment(2.3.1.5), Valuation of shares(2.3.1.6), Re-issue of shares (8.3.2), purchase consideration (2.3.5.1), Types of holding companies (2.4.1.1), subsidiary company (2.4.1.2), Minority Interest (2.4.1.6), Cash break-even point(2.5.2.2), Margin of Safety(2.5.2.2), standard cost(2.5.3), 5's in Kaizen costing(2.5.10.1), Accounting Standard(2.8.1), International Financial reporting Standard(2.8.2), Indian Accounting Standards(Ind As)(2.8.3).

[N.B. – Values in parenthesis are the reference number]

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Sub Unit: 5 Cost and Management Accounting: Marginal costing and Break-even analysis; Standard costing; Budgetary control; Process costing; Activity Based Costing (ABC); Costing for decision-making; Life cycle costing, Target costing, Kaizen costing and JIT

2.5.1 Some Important concept related to cost accountancy

What is cost?

Cost is commonly defined as 'sacrificed resource' for a particular thing.

What is costing?

It is a process for determining the cost. It may be called a technique for ascertaining the cost of production of any product or service in the business organization.

What is cost accounting?

Cost Accounting is basically the next step to costing. Cost accounting involves analyzing relevant costing data, interpret it and present various management problems to management.

What is Cost Accountancy?

It is subject which provides the knowledge of costing and cost accounting. Cost Accountancy facilitates management with cost control initiatives, ascertainment of profitability and informed decision making. It also includes determination of selling price for the products, division and unit wise profitability. Forecasting of expenses and future probable incomes is also a part of the practice of Cost Accountancy.

Objectives of cost accounting

- To ascertain the cost per unit of the different products manufactured by a business concern;
- To provide requisite data and serve as a guide for fixing prices of products manufactured or services rendered;
- To ascertain the profitability of each of the products and advise management as to how these profits can be maximised;
- To help in the preparation of budgets and implementation of budgetary control;
- To exercise effective control if stocks of raw materials, work-in-progress, consumable stores and finished goods in order to minimise the capital locked up in these stocks;
- To supply useful data to management for taking various financial decisions such as introduction of new products, replacement of labour by machine etc.

What is Management accounting?

Management accounting is the presentation of financial data and business activities for the internal management of the organization. Management accounting basically present the business financial data and information to the internal management of the company in such a manner that it can be used by the management for taking different managerial decisions.

Objectives of management accounting

- **Helping out in planning and formulating the policies**
- **Proper interpretation of the financial status**
- **Effective Communication**
- **Solving critical business problems**
- Facilitates Control over the organisational activities
- **Evaluate policy efficiency**
- Helping in qualitative decision-making

2.5.2 Uses of Marginal Costing:

Marginal costing is used for short run decision making, when:

- Business is calculating the break-even level of output.
- Business is considering whether to make or buy a product.
- Business is choosing between two or more alternatives.
- Business is costing a project to determine the minimum possible price to be quoted.
- Business is devising a price strategy.
- Business is abandoning a line of business.
- Business is facing a limiting factor and is deciding about optimum production mix.

2.5.2.1 What is Cost-Volume-profit (CVP) analysis?

Cost- Volume- Profit (CVP) analysis is a technique for studying the relationship between cost, volume and profit. The CVP relationship is an important tool used for the profit planning of a business.

2.5.2.2 Some Important terms:

Marginal cost

Marginal cost is the additional cost incurred for the production of an additional unit of output. The formula is calculated by dividing the change in the total cost by the change in the product output. Decision relating to additional production of output should be taken on the basis of the marginal cost with the marginal revenue that will be realized by an additional unit of output.

Contribution

The *term contribution* represents the difference between sales price and variable cost. Contribution means, "contribution towards absorption of fixed costs and profits".

Formula for contribution:

**** Sales**	****
Less, Variable cost	***
Contribution	***
Less, Fixed Cost	***
Profit	***

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a) Contribution= Sales- variable cost
b) Contribution= Fixed cost+ Profit
c) Contribution= sales*P/V ratio
So, Variable cost= Sales*(1-P/V ratio)
Again, Sales- variable cost= Fixed cost+ Profit= Contribution

Breakeven point

BEP is that level of output at which total cost is equal to the total revenue. So at BEP the organisation earns zero profit and Zero loss. BEP may also refer to the revenues that are needed to be reached in order to compensate for the expenses incurred during a specific period. So it is a situation where there is no profit, no loss to the company. Break-Even Point tells about the volume of sales needed to cover all operating expenses. If sales equals to Break-even point then the company neither earns profit nor suffers from loss. If company cannot achieve BEP, the company suffers from loss.

A) B/E(in units)= $\frac{Fixed\ Cost}{Contribution\ per\ unit}$

B) B/E (in sales value)= $\frac{Fixed\ Cost}{\frac{P}{V}ratio}$

Profit volume ratio

P/V Ratio (Profit Volume Ratio) is the ratio of contribution to sales which indicates the contribution earned with respect to one rupee of sales. It also measures the rate of change of profit due to change in volume of sales. Its fundamental property is that if per unit sales price and variable cost are constant then P/V Ratio will be constant at all the levels of activities. A change is fixed cost does not affect P/V Ratio. A high P/V Ratio indicates that a slight increase in sales without increase in fixed costs will result in higher profits. A low P/V ratio which indicates low profitability can be improved by increasing selling price, reducing marginal costs or selling products having high P/V ratio.

a) P/V ratio= $\frac{Contribution}{Sales}$

b) P/V ratio= $\frac{Contribution\ per\ unit}{Selling\ price\ per\ unit}$

c) P/V ratio= $\frac{Change\ in\ contribution}{Change\ in\ sales}$

d) P/V ratio= $\frac{Change\ in\ profit}{Change\ in\ sales}$

e) P/V ratio= $\frac{Profit}{Margin\ of\ safety\ ratio}$

Cash break-even point

Breakeven point implies the amount of sales which is required to cover all operating expenses. But, fixed costs include certain non-cash expenses like depreciation and amortization of expenses, for which no cash is needed in short-run. Therefore, company can exclude depreciation and other non-cash expenses in the short-run. If only the cash costs are included in fixed costs we get cash BEP.

Cash BEP (in units)= $\frac{Cash\ Fixed\ cost}{Cash\ contribution\ per\ unit}$

Cash fixed cost**= Fixed costs- Non-cash expenses**

Margin of Safety

Margin of safety is the amount of actual sales beyond Break Even sales are known as Margin of Safety. Margin of safety determines that how much extent sales can decrease before the business will move out of profit and into a loss making situation. It gives an indication of the vulnerability of profit to reduction in demand and is frequently used as a risk measure. It is useful to determine financial soundness of business enterprise. If margin of safety is high, then the financial position of the enterprise is sound.

a) Margin of safety=Total Sales- B/E Sales

b) Margin of safety= $\frac{Total\ sales - \frac{B}{E}Sales}{Total\ sales} \times 100$

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2.5.2.3 Advantages of marginal costing

- Effective cost control – It divides cost into fixed and variable. Fixed cost is excluded from product. As such, management can control marginal cost effectively.
- Helpful to management – It enables the management to start a new line of production which is advantageous. It is helpful in determining which is profitable whether to buy or manufacture a product. The management can take decision regarding pricing and tendering.
- Helps in production planning – It shows the amount of profit at every level of output with the help of cost volume profit relationship. Here the break-even chart is made use of.
- Better results – When used with standard costing, it gives better results.
- Fixation of selling price – The differentiation between fixed costs and variable costs is very helpful in determining the selling price of the products or services. Sometimes, different prices are charged for the same article in different markets to meet varying degrees of competition.
- Helpful in budgetary control – The classification of expenses is very helpful in budgeting and flexible budget for various levels of activities.
- Preparing tenders – Many business enterprises have to compete in the market in quoting the lowest price. Total variable cost, when separately calculated, becomes the ‘floor price’. Any price above this floor price may be quoted to increase the total contribution.
- “Make or Buy” decision – Sometimes a decision has to be made whether to manufacture a component or a product or to buy it ready-made from the market. The decision to purchase it would be taken if the price paid recovers some of the fixed expenses.

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2.5.2.4 Limitations of marginal costing

- Difficulty to analyse overhead – Separation of costs into fixed and variable is a difficult problem. In marginal costing, semi-variable or semi-fixed costs are not considered.
- Time element ignored – Fixed costs and variable costs are different in the short run; but in the long run, all costs are variable. In the long run all costs change at varying levels of operation. When new plants and equipment are introduced, fixed costs and variable costs will vary.
- Problem of variable overheads – Marginal costing overcomes the problem of over and under-absorption of fixed overheads. Yet there is the problem in the case of variable overheads.
- Sales-oriented – Successful business has to go in a balanced way in respect of selling production functions. But marginal costing is criticised on account of its attaching over-importance to selling function. Thus it is said to be sales-oriented. Production function is given less importance.

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2.5.3 What is standard cost?

The term **‘standard cost’** can be defined as the expected cost per unit of the products produced during a period, which is based on various factors. Standard costs are based on scientific analysis and engineering studies while estimated costs are based on historical basis.

2.5.3.1 What is standard costing?

Standard Costing is a costing method that is used to compare the standard costs and revenues with the actual results, in order to arrive at the variances along with its causes, to inform the management about the deviations and take corrective measures, for its improvement.

2.5.3.2 Objectives of standard costing

- To provide a formal basis for assessing performance and efficiency.
- To control costs by establishing standards and analysis of variances.
- To assist in setting budgets.
- It supplies the ways to utilise properly material, labour and also overhead which will be economic in character.
- To assist in assigning responsibility for nonstandard performance in order to correct deficiencies or to capitalise on benefits.
- To motivate staff and management.
- To provide a basis for estimating.
- It also helps to motivate the employees of a firm to improve their performance by setting up a 'standard'.
- It also helps the management to take various corrective decisions viz., fixation of price, make-or-buy decisions etc. which will be more beneficial to the firm.

2.5.3.3 Process of standard costing

- Ascertainment and use of Standard Costs;
- Recording the actual costs;
- Comparison of actual costs with standard costs in order to find out the variance;
- Analysis of variance; and
- After analysing the variance, appropriate action may be taken where necessary.

2.5.3.4 Types of standard:

Idle standard

Ideal standards are the standards which can be attained under the most favourable conditions possible.

Normal standard

Normal standards are the average standards which can be attained during a future period of time.

Basic Standard

Basic standard can be defined as the standard which is unaltered and is used over for a longer period of time and do not reflect current conditions. It is also known as the fixed or static standard,

Current standard

It is the standard set for shorter period of time and can easily adapt to the current conditions.

Expected or Attainable standard

It compromises between the extreme of normal standard and idle standard. So it is the standard which can be attained at current conditions and set up.

2.5.3.5 Variance analysis

Variance analysis is the procedure of computing the differences between standard costs and actual costs and recognizing the causes of those differences. Studies indicated that variance is the difference between standard performance and actual performance. It is the process of scrutinizing variance by subdividing the total variance in such a way that management can assign responsibility for off-Standard Performance.

Formula for Calculating Variance

Material Variance

a) Material Price Variance = (Standard Price – Actual Price) x Actual Quantity

b) Material Usage Variance = (Standard Quantity for actual output – Actual Quantity) x Standard Price

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Labour Variance
a) Labour rate variance
= (Standard Rate Per Hour – Actual Rate Per Hour) x Actual Hours
b) Labour Efficiency Variance = (Standard Hours for Actual Out Put – Actual Hours) x Standard Rate

Variable Overheads variance
a) Variable overhead efficiency variance = (Actual Output – Standard Output) x Standard Rate
b) Variable overhead expenditure variance = (Standard Output x Standard Rate) – (Actual Output x Actual Rate)

Fixed overhead variance
a) Fixed overhead expenditure variance = Standard Fixed Overhead – Actual Fixed Overhead
b) Fixed overhead volume variance = (Actual Output x Standard Rate per unit) – Standard Fixed Overhead

Sales Variance
a) Sales volume variance = (Budgeted Quantity – Actual Quantity) x Budgeted Price
b) Sales price variance = (Budgeted Price – Actual Price) x Actual Quantity

2.5.4 What is Budget?

A budget may be defined as a financial and/or quantitative statement, prepared and approved prior to a defined period of time, of the policy to be pursued during that period for the purpose of attaining a given objective. So budget is nothing but the quantitative or numeric expression of planning.

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2.5.4.1 What is budgetary control?

It is a continuous process of determining the standard for future period of time and comparing the standard with the actual for identifying the deviation for taking corrective measures. Chartered Institute of Management Accountants explained Budgetary Control as "the establishment of the budgets relating to the responsibilities of the executive to meet the objective of an organization and the continuous comparison of actual with budgeted estimates so that if remedial is necessary it may be taken at an early stage".

2.5.4.2 Process of budgetary control

The process of controlling budgets can be broken down into several steps:

- Establishing actual position
- Comparing actual with budget
- Calculating variances
- Establishing reasons for variances
- Taking action to exert control

2.5.4.3 Advantages of budgetary control

Control: It facilitates management to control each function, sector, ministry or department in order to accomplish the best possible result.
Coordination: It supports and encourages synchronization between departments of activities for the accomplishment of the overall progress of the organization/institution
Cost reduction: It makes management to become more cost conscious and reduce waste and inefficiency in its operations.
Management by exception: It is a time saving device, as attention is directed to areas of more serious needs.

Performance appraisal: It leads to measure the employee's performance in an efficient way. It increases the operational efficiency of various business actions.
It assists in effective utilization of resources of organization.
It leads to maximization of profit of the organisation.

2.5.4.4 What is flexible budget?

It is a budget which is flexible and can be revised time to time considering current situation and conditions.

2.5.4.5 Distinguish between fixed budget and flexible budget

Fixed Budget	Flexible Budget
A fixed budget is a budget that doesn't change due to any change in activity level or output level.	The flexible budget is a budget that changes as per the activity level or production of units.
The fixed budget is static and doesn't change at all.	Flexible budget, on the other hand, is adjustable as per the necessity of the business.
The fixed budget is very simplistic	A flexible budget is pretty complex.
A fixed budget is estimated on the past data and the anticipation of management regarding future events.	Flexible budget, on the other hand, is estimated on the basis of realistic situations.

2.5.5 What is Process costing?

Process costing is a technique and is applied where an unit passes through different processes for completion of its process and the processes are easily distinguishable then the cost of the unit will be cost of process that it goes through. In process costing a separate account is opened for every process and on completion of the process the cost is transferred to the next process. In process costing output of one process is used as input for another process.

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2.5.5.1 Industries where process costing technique is applied

- Sugar Manufacturing Industries
- Brick Industries
- Petroleum Industries
- Steel Industries

2.5.5.2 Some important concept related to process costing

Normal loss

Normal loss means that loss which is inherent in the processing operations. It can be expected or anticipated in advance i.e. at the time of estimation. The cost of the normal loss is considered as the part of the cost of production. Realisable scrap value of normal loss is credited to the process account.

Abnormal loss

The loss which is over and above the normal loss and occurred due to unexpected situation or abnormal conditions is called as abnormal loss. Process account is credited by abnormal loss with the cost of materials, labour and overhead equivalent to good unit and the loss arises to abnormal loss is transferred to costing profit & loss account.

Abnormal gain

If the actual loss of a process is less than the expected loss of that particular process the difference is popularly known as abnormal gain. The value of abnormal gain is transferred to the debit of process account and the abnormal gain is ultimately closed by crediting it to the costing profit & loss account.

2.5.6 What is activity based costing?

Activity based costing (ABC) is a method that assigns manufacturing overhead costs to products or process that consume cost in a more logical manner than the traditional approach of simply allocating costs on the basis of machine hours. Activity based costing first assigns costs to the activities that are the real cause of the overhead. It then assigns the cost of those activities only to the products that are actually demanding the activities. So in Activity Based costing the main focus is on the identifying the activities that are used to produce the product.

2.5.6.1 Objectives of Activity Based Costing

- To rectify the inaccurate cost information.
- To allocate the overheads on activity basis.
- To help the management in taking quality and timely decision.

2.5.6.2 Process of Activity Based Costing

Implementation of Activity Based Costing (ABC) involves the following steps-

Step 1.Identify the activities which is required to complete products.

Step 2. Assign overhead costs to the activities identified in step 1.

Step 3.Identify the cost driver for each activity.

Step 4.Calculate a predetermined overhead rate for each activity.

Step 5.Allocate overhead costs to products.

2.5.7 Costing for decision making

Key factor or limiting factor

Limiting factors also known as key factors or principle budget factors or governing factors which put a limit to the capacity of an organization and stand in the way of accomplishing a desired objective or prevent indefinite expansion or unlimited profits.

Examples of key factors:

Shortage of materials, Shortage of labour, Shortage of plant capacity, shortage of demand, shortage of factory space, etc.

Fixation of selling price

Fixation of selling price is one of the important functions of management. Prices are generally determined by market conditions and other economic factors. Cost-Volume-Profit analysis assists the management in the fixation of selling prices under various circumstances.

Determination of product mix

The most-profitable product mix can be determined by applying marginal costing technique. Fixed cost remaining constant, the most profitable product-mix is determined on the basis of contribution only. That product-mix which gives maximum contribution is to be considered as best product mix.

Make or buy decision

A company may have idle capacity which may be utilised for making a component or a product, instead of buying them from outside sources. In taking such 'make-or-buy' decision, a comparison should be made between the variable (or marginal) cost of manufacture of the product and the supplier's price for it.

Discontinuation of product line

Marginal cost will help the management in taking a decision regarding continuance of a product from the market. Besides marginal cost, the other expenses are selling expenses, salesman commission, distribution expenses, advertisement etc. The selling price may differ from market to market. Discontinuance of a market will eliminate variable expenses but selling and distribution expenses are to be compared with the fixed expenses. Till any market yields contribution, it should not be discontinued.

Profit planning

Profit planning is the planning of future operations to attain maximum profit. Under the technique of marginal costing, the contribution ratio, i.e., the ratio of marginal contribution to sales, indicates the relative profitability of the different products of the business whenever there is any change in volume of sales, marginal cost per unit, total fixed costs, selling price, and sales-mix etc.

2.5.8 Life cycle costing

Product life cycle costing involves tracing of costs and revenues of a product over several calendar periods throughout its life cycle. So Life Cycle Costing is a method of identifying the cost and revenue of a product over several calendar years from the product invention to abandonment

Life Cycle cost of an asset can be defined as "The total cost throughout its life including planning, design, acquisition and support costs and any other costs directly attributable to owning or using the asset".

2.5.9 Target costing

Target costing is a cost accounting approach in which companies set targets for costs based on the price prevalent in the market and the profit margin they want to earn. Keeping its costs below the relevant targets helps the companies to generate profit.

Target cost = Selling Price – Profit Margin

Profit margin may be based on cost or selling price. In target costing, companies leverage their ability to monitor and control their cost to generate a profit. Target costing is a more effective approach because it emphasizes efficiency in order to keep costs low. Target costing is particularly useful in industries that have low profit margins and high competition.

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2.5.10 what is Kaizen costing?

Kaizen costing is a technique of controlling the cost incurred over unproductive activities and resources which does not add any value to the organization. In simple words, it is a practical approach to solving cost-related problems to improve the overall efficiency of the organization. Kaizen costing is implemented in business organizations to manage following types of costs in a business-cost of supply chain, cost of production of goods, legal formalities cost, redesigning of product cost, etc.

2.5.10.1 5's in Kaizen costing

Short-It is nothing but the categorization of items based on their necessity. The unnecessary items should be labelled as red and must be moved out from the organisation.

Straighten-It is the arranging of the essential items in orderly manner for simplifying the operation.

Shine- It relates to maintenance of cleanliness of the workplace.

Standardize- It relates to establishment of standards for cleanliness, usability and maintaining the placement of items in day to day business operations.

Sustain- It is to communicate and educate the employees about the changes made. Thus, developing a sense of self-control and discipline among them to maintain and follow the set standards.

2.5.10.2 Stages of Kaizen Costing

Kaizen costing involves the following steps-

Involve your employee→ Find problems→ Think and find →Solutions→ Implement→ Check→ Standardize→ Repeat.

2.5.11 Just-In-Time (JIT)

Just-in –Time is an inventory management method whereby materials is scheduled to arrive or be replenished exactly when needed in the production process. The Just-in-time system is adopted by the firms, to reduce the unnecessary burden of inventory management, in case the demand is less than the inventory raised. The objective of Just-in-time is to increase the inventory turnover and reduce the holding cost and any other costs associated with it. This concept is again popularized by the Japanese firms, who place an order for the material, the same day the product is to be produced.

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Previous Year Questions Analysis with Explanation

Sub Unit – 5

June-2019

1. Product A requires 10 kg of material at the rate of ₹5 per kg. The actual consumption of material for the manufacturing of product A comes to 12 kg of material at the rate of ₹6 per kg. Direct material cost variance is:

1. ₹ 22 (favourable)
2. ₹ 22 (unfavourable)
3. ₹ 12 (favourable)
4. ₹ 12 (unfavourable)

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	2	2.5.3.5

July- 2018

1. Which one of the following statements is true about estimated costs and standard costs?

(1) Standard costs are based on scientific analysis and engineering studies while estimated costs are based on historical basis.

(2) Standard cost emphasis is on "what cost will be" while estimated cost emphasis is on "what cost should be".

(3) Standard costs are more frequently revised compared to estimated cost.

(4) Estimated costs are more stable than standard costs.

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Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	1	2.5.3

Nov. -2017

1. From the following two statements of Assertion (A) and Reason (R), indicate the correct code :

Assertion (A) : From the marginal costing approach point of view, the marginal cost is compared with the purchase price.

Reason (R) : If the marginal cost is less than the purchase price it should be purchased rather than manufactured.

Codes :

(1) (A) and (R) both are correct.
(2) (A) is correct, but (R) is not correct.
(3) (A) is not correct, but (R) is correct.
(4) (A) and (R) both are incorrect.

2. Which one of the following statements is true about standard labour time?
(1) Standard labour time indicates the time in hours needed for a specific process.
(2) It is standardized on the basis of past experience.
(3) In fixing standard time due allowance should not be given to fatigue and tool setting.
(4) The Production Manager does not provide any input in setting the labour time standards.

3. Which one of the following is not correct with reference to standard costing?
(1) Standard costing is a system where pre-determined costs are used for control of entire Organisation.
(2) Standard may be expressed in quantitative and monetary measures
(3) Only adverse variances are investigated intensively
(4) Standard is determined for each element of cost

4. Which one of the following is not correct?
1. (1) Margin of Safety= Profit/ P/V ratio
2. P/V Ratio= (Change in Contribution/ Change in sales)*100
3. Break-even point in units=Fixed cost/ Contribution per unit
4. Required sales to earn desired profits=Desired profit/ P/V ratio

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	2	2.5.2.2
2.	1	2.5.3.5
3.	3	2.5.3.5
4.	4	2.5.2.2

Sept. 2016

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1. **Match the items of List – I with those of List – II and choose the correct code:**

List – I	**List – II**
a. Material Cost Variance	i. Actual Time (Standard Rate – Actual Rate)
b. Material Usage Variance	ii. Standard Price (Standard Quantity – Actual Quantity)
c. Labour Rate Variance	iii. Standard Material Cost – Actual Material Cost
d. Labour Efficiency Variance	iv. Standard Rate (Standard Time – Actual Time)

Codes:

	A	b	c	d
(1)	iii	i	ii	iv
(2)	ii	i	iv	iii
(3)	iii	ii	I	iv
(4)	iii	ii	iv	i

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	3	2.5.3.5

July 2016

1. From the following information, find out the number of units that must be sold by the firm to earn profit of RS. 80,000 per year.
Sales price : RS.25 per unit
Variable manufacturing costs – RS. 12 per unit
Variable selling costs – RS. 3 per unit
Fixed factory overheads – RS. 5,00,000
Fixed selling costs – RS. 3,00,000
(1) 60,000 units
(2) 88,000 units
(3) 98,000 units
(4) 1,00,000 units

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	2	2.5.2.2

June 2015

1.The basic difference between a static budget and flexible budget is that:
1. A flexible budget considers only variable costs but a static budget considers all costs
2. Flexible budgets allow management latitude in meeting goals, whereas static budget is based on fixed standards.
3. A flexible budget is applicable for a single department only but a static budget for entire production facility.
4. A flexible budget can be prepared for any production level within a relevant range but a static budget is based on one specific level of production.

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2. Labour Rate of Pay Variance can be calculated by which one of the following equations?
A. Budgeted Labour Costs-Actual Labour Costs
B. (Standard Hours - Actual Hours) x Actual Wage Rate
C. (Standard Wage Rate-Actual Wage Rate) x Actual Hours Worked
D. (Standard Wage Rate-Actual Wage Rate) x Standard Hours Worked

3. Given:
Margin of Safety Rs. 80000
Profit Rs. 20000
Sales Rs. 300000
What is the amount of fixed cost?
a) Rs.100000 b) Rs.75000
c) Rs.55000 d) Rs.20000

4. Which one of the following is not true of cash Budget ?
a. The shortage or excess of cash would appear in a particular period.
b. All inflows would arise before outflows for those periods.
c. Only revenue nature cash flows are shown.
d. Proceeds from issue of share capital is shown as an inflow.

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	**4**	2.5.4.5
2.	c	2.5.3.5
3.	c	2.5.2.2
4.	c	2.5.4

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Model Questions

1. When the demand curve is relatively highly elastic, the marginal revenue is
(A) Zero
(B) Unity
(C) Positive
(D) Negative
Answer: (C)
Explanation: The connection between marginal revenue and elasticity works like this: If the demand is elastic, then marginal revenue is positive. If the demand is inelastic, then marginal revenue is negative. If demand is unit elastic, then marginal revenue is zero.

2. In which one of the following market situations the practice of price rigidity is found?
(A) Perfectly competitive market
(B) Monopolistic competitive market
(C) Oligopoly market
(D) Discriminating monopoly market
Answer: (C)
Explanation: The low elasticity does not increase the demand significantly as a result of the *price* cut. This asymmetrical behavioural pattern results in a kink in the demand curve and hence there is *price rigidity* in oligopoly *markets*.

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3. During short-run, the optimum level of output corresponds to that level of output where
(A) MC is the minimum
(B) AVC is the minimum
(C) AC is the minimum
(D) AFC stops declining
Answer: (C)
Explanation: *In* the *short run* the *levels* of usage of some input are fixed and costs associated. This curve indicates the firm's total cost of *production for* each *level of output*. Average variable cost first falls, reaches a *minimum* point.

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4. The opportunity cost is a term which describes
(A) A bargain price for a factor of production.
(B) Production cost related at the optimum level of production.
(C) Average variable cost.
(D) The loss of the reward in the next best use of that resource.
Answer: (D)
Explanation: *Opportunity cost* is the return of a foregone option less than the return on your chosen option. Considering *opportunity costs* can guide you to more profitable decision-making.

5. Which one of the following is not the basic assumption of Cardinal Utility analysis?
(A) Rationality of Consumer.
(B) Utility cardinally measurable.
(C) Diminishing marginal utility of money.
(D) Hypothesis of independent utilities.
Answer: (C)
Explanation: An important assumption of cardinal utility analysis is that when a consumer spends varying amount on a good or various goods or when the price of a good changes, marginal utility of money remains unchanged.

6. Which one of the following is not a property of indifference curve?
(A) Negatively sloping.
(B) Convex to the point of origin.
(C) Indifference curves necessarily have to be parallel.
(D) Two indifference curves do not intersect each other.
Answer: (C)
Explanation: There are four important properties of indifference curves that describe most of them: (1) They are downward sloping, (2) higher indifference curves are preferred to lower ones, (3) they cannot intersect, and (4) indifference curves are convex (i.e. bowed inward)

7. Find the correct matching between items of List-I and the items of List-II.

List – I	List – II
(a) Increase in demand	(i) Leftward movement along the demand curve.
(b) Contraction of demand	(ii) Rightward shift of the demand curve.
(c) Cross demand	(iii) Demand of more than one commodity to satisfy one specific want.
(d) Joint demand	(iv) Demand of one commodity with changes in the prices of another related commodity

Codes:
(i) (ii) (iii) (iv)
(A) (b) (a) (d) (c)
(B) (a) (b) (c) (d)
(C) (b) (a) (c) (d)
(D) (a) (b) (d) (c)
Answer: (A)

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8. According to the Law of Variable Proportions, the second stage of production ends when
(A) Marginal productivity of the variable input becomes maximum.
(B) Both marginal productivity and average productivity of the variable input are equal.
(C) Marginal productivity of the variable input becomes zero and average productivity is positive.
(D) Marginal productivity of the variable input is negative but average productivity is positive.
Answer: (C)
Explanation: In stage 2, the total product continues to increase at a diminishing rate until it reaches its maximum point where the second stage ends. In this stage both the marginal product and the average product of the variable factor are diminishing but remain positive.

9. Total Revenue (TR) function and the Total Cost (TC) function of a perfectly competitive market firm are as follows:
$TR = 480\ Q - 8\ Q^2$
$TC = 400 + 8\ Q^2$
The profit maximizing output would be:
(A) 60
(B) 15
(C) 50
(D) None of the above
Answer: (B)
Explanation: $TR = 480\ Q - 8\ Q^2$
$TC = 400 + 8\ Q^2 = 400 + 8 \times 60^2 = 400+28800=29200$, when output is 60
$TR=480\times60 - 8\times60^2 = 28800-28800=0$ here profit is negetive
$TC = 400 + 8\ Q^2 = 400 + 8\times15^2 = 400+1800=2200$, when output is 15
$TR=480\times15 - 8\times15^2=7200 - 1800=5400$ profit=5400- 2200=3200
$TC = 400 + 8\ Q^2 = 400 + 8\times50^2 = 400+20000=20400$, when output is 50
$TR=480\times50 - 8\times50^2=24000 - 20000=4000$ Loss=4000- 20400=16400

10. Assertion (A): Mark-up pricing is a method of determining price.
Reason (R): $P = ATC + (m \times ATC)$ is the expression for that.
Codes:
(A) (A) is correct but (R) is not correct.
(B) Both (A) and (R) are correct.
(C) Both (A) and (R) are not correct.
(D) (R) is correct, but (A) is not correct.
Answer: (B)
Explanation: Markup Pricing: Refers to a pricing method in which the fixed amount or the percentage of cost of the product is added to product's price to get the selling price of the product. Markup pricing is more common in retailing in which a retailer sells the product to earn profit.

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Abbreviation:

1. **Text: Unit wise separate pdf**
2. **PYQs: Previous Years Questions**
3. **MQs: Model Questions**
4. **LMS: Last Minute Suggestion**
5. **OMT: Online MOCK Test**
6. **DU: Daily Updates**

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