NMIMS GLOBAL ACCESS SCHOOL FOR CONTINUING EDUCATION

NMIMS Global Access School for Continuing Education (NGA-SCE)

Subject: Cost and Management Accounting

Internal Assignment Applicable for December 2020 Examination

Answers to Question No.1:

According to the Chartered Institute of Management Accountants, the definition of management accounting is prescribed as "the process of identification, measurement, accumulation, analysis, preparation, interpretation and communication of information used by measurement to plan, evaluate, and control within an entity and to assure an appropriate use of and accountability for its resources. Management accounting also comprises the preparation of financial reports for non-management groups such as shareholders, creditors, regularity agencies and tax authorities.

It is a decision-making process based on various accounting and financial information and data analysis. It generates appropriate and required information for future decision-making relative to various operations of a firm. The decisions may involve making or buying, further processing, shutting down operations, increasing production capacity, determining selling price and other related decisions.

In the given case, Excellent Clothing Company which is involved in the manufacturing of dresses for women have diversified their business into the production of masks since April'20 to take advantages of the huge demand for masks due to the recent COVID-19 impact. Till now the decisions were taken on adhoc basis by the promoters. Considering the importance of management accounting from the business perspective, we have discussed the significance and components of the key steps involved in decision making process of a company.

Significance of Management Accounting tools in decision making process:

- Management accounting helps in creating value for the customers through proper planning and implementation of the strategies. The ultimate target is to reduce costs and improve efficiency.
- Management accounting tools such as standard costing and target costing are effective for cost control and cost reduction and thus ensure increased customer satisfaction. The flow of goods, services and information enhances the performance of the firm.
- Several Management accounting tools such as budgets and budgetary control, standard costing and marginal costing are used in measuring actual performance.
- Techniques such as marginal costing, helps to generate the information that is useful for taking managerial decisions such as make or buy, adding or dropping of product lines, additional working shift, capital expenditure decision and so on.

- Management accounting helps in fixing responsibility by creating different centres such as cost, profit, investment, etc.

The decision-making process in a firm from management accounting perspective can be discussed below:

1. **Planning:** A business must plan for a success. It is about deciding on a core of action to reach a desired outcome. Planning must occur at all levels. Firstly, it occurs at a high level of setting strategy then it moves to the middle level and lastly at the lower level for its implementation and execution.
   The three phases of planning are as follows:
   - **Strategy:** A business should invest considerable time and effort in developing the strategy in order to select the best alternatives of cost, quality and competitive advantages to fix the optimum selling price of a product or service so that organizational goals can be achieved.
   - **Positioning:** It refers to taking decision regarding where to place the product in terms of geographical coverage such as existing market, new market, domestic or international market and how to organize and utilize resources at the best cost to bring more efficiency and cost effectiveness.
   - **Budgets:** Budgets outline the financial plans for an organization. A company's budgeting process must take into account ongoing operations, capital expenditure plans and corporate financing. Planning helps in preparing the budgets for short term and medium term based on past data and information and keeping in view the organizational goals.

2. **Directing:** It is a process of directing the operations for effective use of resources. The different stages of direction are as follows:
   - **Costing:** Managers provide necessary directions from time to time to optimize cost and bring in efficiency. They also use and develop the appropriate and relevant costing technique to identify and allocate correct costing to a particular product.
   - **Production:** Once the production target is decided, adequate resources are provided in terms of raw materials, labour and other inputs. The responsibility is fixed to produce required production in time with minimum wastages at all levels. Suitable directions are given from time to time to ensure that production reaches to end customer in time and cost is optimized at all levels.
   - **Analysis:** Once the required resources are provided and the production process is monitored, an analysis is made to compare the actual with pre-decided standards and to ascertain gaps to take further corrective actions.

3. **Controlling:** The process of controlling can be defined as a process of monitoring and controlling measures to achieve the desired goals effectively. The tools of monitoring and controlling are as follows:
    - **Monitor:** To ensure that the desired goals are achieved in time, a regular monitoring is done at different intervals. The objective of monitoring is to ascertain whether the firm operates in the desired manner and achieve its goals.
    - **Scorecard:** For adequate and effective monitoring and controlling, strategic management accounting has developed the concept of balance scorecard to improve the quality of internal and external communication. This helps in effectively monitoring the firm's performance against the set gaols.

Thus, we have discussed the significance and stages involved in the decision-making process from the Management Accounting perspective.

Answers to Question No.2:

Definition of Marginal Costing:

According to The Chartered Institute of Management Accountants (CIMA), London, defines marginal costing as "the ascertainment of the marginal costs and of the effect on the profit of changes in volume or type of output by differentiating between the fixed costs and the variable costs."

Marginal costing, also known as variable costing, is a costing method whereby decisions can be taken regarding the ascertainment of total cost or the determination of fixed and variable cost to find out the best process and product for production. It defines the marginal cost of production and shows its impact on profit for the change in the output units. Marginal cost refers to the movement in the total cost, due to the production of an additional unit of output. In marginal costing, all the variable costs are regarded as product related costs while fixed costs are assumed as period costs and it is written off against the profit of the period.

Definition of Absorption Costing:

Absorption costing is a method for inventory valuation whereby all the manufacturing expenses are allocated to the cost centres to recognize the total cost of production. These manufacturing expenses include all fixed as well as variable costs. It is a traditional method for cost ascertainment. In absorption costing system, both the fixed and variable costs are regarded as product related cost. In this method, the objective of the assignment of the total cost to cost centre is to recover it from the selling price of the product.

On the basis of function, the expenses are divided into Production, administration, and selling & distribution. The following are the types of absorption costing:

- Activity based costing
- Job costing
- Process Costing

The difference between marginal costing and absorption costing are as follows:

Basis of Difference	Marginal Costing	Absorption Costing
Separation of costs	Costs are separated into variable cost and fixed cost.	Costs are separated into those which can be traced to the cost center or cost units and those which cannot be traced.
Product costs	Variable cost are product cost and fixed costs are period cost.	Both fixed and variable costs are products cost.
Stock valuation	Only variable costs are included in stock valuation, whereas fixed costs are charged to next income statement for the period.	Both fixed and variable costs are included in stock valuation.
Profit	Computed as contribution and net profit.	Computed as gross profit and net profit.
Decision Making	Suitable, more meaningful	Unsuitable

Recovery of costs	Only those costs which can be traced to the products.	All manufacturing costs are recovered.
Reporting	Used for internal reporting to management	Used for external reporting.
Profitability Measurement	The profit volume ratio reflects the profitability of the products by reflecting contribution earned.	Fixed costs are already included in product costs and thus profitability gets influenced.

Answers to Question No.3:

Part (a)

Activity-Based Costing (ABC): It is a costing method that identifies activities in an organization and assigns the cost of each activity to all products and services according to the actual consumption by each, therefore this model assigns more indirect costs into direct costs compared to conventional costing.

According to the Chartered Institute of Management Accountants (CIMA), defines the activity-based costing as an approach to the costing and monitoring of activities which involves tracing resources consumption and costing final outputs. Resources are assigned to activities, and activities to cost objects based on consumption estimates. The later utilize cost drivers to attach activity costs to outputs.

Traditional Costing or Conventional Costing:

Traditional costing is the allocation of factory overhead to products based on the volume of production resources consumed. Under this method, overhead is usually applied based on either the amount of direct labour hours consumed or machine hours used. The trouble with traditional costing is that factory overhead may be much higher than the basis of allocation, so that a small change in the volume of resources consumed triggers a massive change in the amount of overhead applied.

Therefore, activity-based costing was developed to circumvent this issue with traditional costing, using a more detailed analysis of the relationship between overhead costs and cost drivers.

Statement showing computation of cost per unit of each product on the basis of traditional costing method:

Writers' Company **F.Y 2018-19**

Particulars	Fountain Pen	Ball Point
Units manufactured (a)	10000	20000
	Amount (Rs.)	**Amount (Rs.)**
Direct Variable Cost (b)	3,20,000	5,00,000
	(10000 units*Rs.32)	(20000 units*Rs.25)
Direct Fixed Cost (c)	1,00,000	1,60,000
	(10000 units*Rs.10)	(20000 units*Rs.8)
Total Direct Cost or Prime Cost (b+c) =d	**4,20,000**	**6,60,000**
Add: Overhead Cost		
- Rent (indirect) (e)	12,00,000	24,00,000

(Rs. 3,00,000 per month to be allocated on the basis of number of units manufactured)	[(Rs. 3,00,000*12) *10000\30000]	[(Rs. 3,00,000*12) *20000\30000]
Total Cost (d+e) = f	**Rs. 16,20,000**	**Rs. 30,60,000**
Cost per unit (f\a)	**Rs. 162**	**Rs. 153**

Part (b)

Statement showing computation of cost per unit of each product on the basis of Activity-Based Costing (ABC) method:

Writers' Company **F.Y 2018-19**

Particulars	**Fountain Pen**	**Ball Point**
Units manufactured (a)	10000	20000
	Amount (Rs.)	**Amount (Rs.)**
Direct Variable Cost (b)	3,20,000	5,00,000
	(10000 units*Rs.32)	(20000 units*Rs.25)
Direct Fixed Cost (c)	1,00,000	1,60,000
	(10000 units*Rs.10)	(20000 units*Rs.8)
Total Direct Cost or Prime Cost (b+c) =d	**4,20,000**	**6,60,000**
Add: Overhead Cost		
- Rent (indirect) (e) WN	Rs. 16,80,000	Rs. 19,20,000
	(Rs. 240*7000)	(Rs. 240*8000)
Total Cost (d+e) = f	**Rs. 21,00,000**	**Rs. 25,80,000**
Cost per unit (f\a)	**Rs. 210**	**Rs. 129**

Working Notes:

Allocation of Indirect Fixed cost i.e. Rent as per Activity-Based Costing Method:

Activity	**Cost Driver**	**Basis of Apportion**	**Budgeted Cost**	**Cost per cost driver**
Area of Operations	Area occupied (sqr. Feet)	7000:8000	Rs. 36,00,000 (Rs. 3,00,000*12)	Rs. 240 (Rs. 36,00,000/15000)