

PAPER

4

INTERMEDIATE COURSE
STUDY MATERIAL
GROUP-II

COST & MANAGEMENT
ACCOUNTING
MODULE 1 OF 2



Board of Studies (Academic)
The Institute of Chartered
Accountants of India

(Set up by an Act of Parliament)



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BEFORE WE BEGIN....

In contemporary business environment, existence of an entity depends on the way it faces the challenges posed by the competitive market conditions and deals with the same. Cost leadership being one of the competitive strategies, gives an added advantage to the entity. Cost being an important aspect for survival and growth in business, requires a mandatory awareness about the cost control and cost reduction methods. Fourth industrial revolution, also known as Industry 4.0, lays more emphasis on the digitization of information for effective decision-making, which enables an entity in keeping ahead in competition. Cost and Management accounting, a discipline of accounting, enables an entity in taking timely decisions by provisions of cost, profitability and other relevant information.

Chartered Accountants, as a global business solution provider, play an important role in business, have an onus by helping an entity to achieve its long-term objectives. In this direction, Cost and Management Accounting helps Chartered Accountants in taking timely and informed business decisions. In view of nobility of the objective to provide quality academic inputs to the students of CA course, the Board of Studies (BoS) of ICAI has decided to bring forth Study Material of Cost and Management Accounting. This Study Material contains all relevant and contemporary topics like *Digital Costing, Government e-Marketplace (GeM) Process of tender and quotation, Direct Expenses, Various Short-term decisions, Budgets and motivation, Feedback and Feedforward controlling in budgeting as detailed out in the syllabus.*

Under the Revised Scheme of Education and Training, at the Intermediate Level, students are expected not only to acquire professional knowledge but also to develop the ability to apply the knowledge in real life business situations. The process of learning should also help the students in imbibing professional skills, i.e., the intellectual skills and communication skills, necessary for achieving the desired professional competence.

The entire syllabus has been divided into fifteen chapters. The chapters have been grouped into two modules:

Module-1 Consisting of seven chapters namely:

Chapter-1: Introduction to Cost and Management Accounting

Chapter-2: Material Cost

Chapter-3: Employee Cost and Direct Expenses

Chapter-4: Overheads-Absorption Costing Method

Chapter-5: Activity Based Costing

Chapter-6: Cost Sheet

Chapter-7: Cost Accounting Systems

Module-2 Consisting of eight chapters namely:

Chapter-8: Unit & Batch Costing

Chapter-9: Job Costing

Chapter-10: Process & Operation Costing

Chapter-11: Joint Products & By Products

Chapter-12: Service Costing

Chapter-13: Standard Costing

Chapter-14: Marginal Costing

Chapter-15: Budget and Budgetary Control

The content for each chapter at the Intermediate level has been structured in the following manner –

1. **Comprehensive Learning Outcomes:** Learning outcomes which you need to demonstrate after learning each topic have been detailed in the first page of each chapter. Demonstration of these learning outcomes would help you to achieve the desired level of technical competence.
2. **Chapter Overview:** As the name suggests, this chart/table would give a broad framework of the contents covered in the chapter.
3. **Introduction:** A brief introduction is given at the beginning of each chapter, which would help you get a feel of the topic.
4. **Content:** In each chapter, the topics have been covered following 'step by step' approach. The concepts are explained in student-friendly manner with the aid of Examples/illustrations/diagrams/flow charts/Pictorials as per requirement. These value additions would help you develop conceptual clarity and to get a good and quick grasp of the topic. Diagrams, Pictorials and Flow charts would help you understand the concepts in a better manner. Illustrations would help you understand the application of concepts/ provisions. More illustrations/

Practical questions in Test Your Knowledge section have been added to enable a thorough practice of variety of questions. The flow of content in chapter have been reviewed and changed to make it more student friendly.

5. **Illustration with Answers:** Illustrations and examples has been included in the Study Material systematically, after discussion on each topic, so that application of the concept can be understood very clearly. This would also enable you to learn and sharpen your application skills and test your understanding.

6. **Multiple Choice Questions (MCQ):** In the New Scheme of education and training, assessment for 30 marks in each paper at the intermediate and final level would be by way of case scenario based MCQs. Questions in this segment would comprise of a case scenario followed by a few MCQs based on the case scenario. All case scenario based MCQs would be application oriented. There would be 4 options in each MCQ, out of which the student has to choose the correct option. In the subject of Cost and Management Accounting, a student has to apply the Cost and Management Accounting concepts learnt in solving the MCQs based on the case scenario. In order to hone the application and analytical skills of students, independent MCQs have been included in every chapter of this Study Material. Solving these MCQs will enhance your conceptual clarity and sharpen your analytical skills.

7. **Summary:** A summary of the chapter is given at the end to help you revise what you have learnt. It would especially help you to revise the chapter(s) quickly the day before the examination.

8. **Test Your Knowledge:** This comprises of Multiple-Choice Questions (MCQs), Theoretical Questions and Practical Problems with solutions which test the breadth and depth of your understanding of the topic.

9. **Skill Specification Assessment:** An indicative skill specification Assessment Grid has been incorporated in the study material for better understanding of the students. An effort has been made to arrange the questions/illustrations/exercise accordingly.

In this Study Material, formats of Financial Statements (i.e. Balance Sheet, Income Statements etc) and financial terms used are for illustrative purpose only. For appropriate format and applicability of various Standards, students are advised to refer the study material of appropriate subject (s).

Further the solutions/answers contained in the study material are based on certain assumptions and other logical alternative assumption/ approach/ presentation may be possible.

We have made every effort to make the Study Material student-friendly and to enable the students to have conceptual clarity on various topics of this subject.

Every effort has been made to remove typing errors (if any)/ clerical errors (if any)/ missing content (if any)/ formatting errors (if any), or any other error, so as to make Study Material error free, however if inadvertently any error is present and found by readers, they may send it to us immediately, so that it can be rectified at our end.

In case you need any further clarification/ guidance, you may send your queries through ICAI BoS App.

SKILL SPECIFICATION ASSESSMENT GRID

Skill Level	Manner of Assessment of Skills	Illustrative verbs used to construct learning outcomes
Level-I: Knowledge and Comprehension	Understanding or grasping ability (Defining, stating, enlisting, identifying, and explaining concepts / provisions / theories / principles relating to the relevant subject area.)	List – Preparing a list of State – Mentioning clearly or fully the details of. Define – Explaining the exact meaning of. Describe – Giving detailed narration of something or key features. Distinguish – Mentioning or highlighting the difference between. Explain – Making the meaning of. Identify – Recognizing something. Illustrate – Explaining something with the help of an example. and similar verbs Combination of verbs: Comprehend and Explain; Identify and explain and similar verbs.

<p>Level-II:</p> <p>Application and Analysis</p>	<p>Applying and analyzing the concepts learned during the grasping level.</p> <p>(Application: Applying concepts / provisions / theories / principles in problem solving in non-complex scenarios.)</p>	<p>Application:</p> <p>Apply – Putting theoretical knowledge for practical purpose.</p> <p>Calculate – Arriving at some value by following numerical/ analytical procedures.</p> <p>Compute - Arriving at some value by following numerical/ analytical procedures.</p> <p>Determine- Ascertain or establish exactly by calculation or workings.</p> <p>Find/ Find out- Ascertain or establish exactly by calculation or workings.</p> <p>Demonstrate – Proving something with certainty using practical means.</p> <p>Prepare – Making something ready for any use.</p> <p>Reconcile – Making or proving consistency/ compatibility.</p> <p>Solve – Find an answer or solution to something</p> <p>Tabulate – Exhibiting the required information in a tabular form.</p>
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		Combination of verbs: Compare and contrast and similar verbs.
	(Analysis: Applying, comparing and analysing concepts / provisions / theories / principles in problem solving in moderately complex scenarios.)	Analysis: Analyze - Examining something in detail. Categorize - Arranging something in a predefined group or class or division. Compare - Examining the differences or similarities between. Construct - Building or compiling. Discuss - Writing about or examining in detail. Interpret - Translating in intelligible or familiar or understandable terms. Combination of verbs: Analyse and apply and similar verbs.

SYLLABUS

PAPER – 4: COST AND MANAGEMENT ACCOUNTING

(One Paper- Three hours- 100 Marks)

Objectives:

- (a) To develop an understanding of the basic concepts and applications to establish the cost associated with the production of products and provision of services and apply the same to determine prices.
- (b) To develop an understanding of cost accounting statements.
- (c) To acquire the ability to apply information for cost ascertainment, planning, control and decision making.
- (d) To apply costing methods to determine the costs for different purposes.
- (e) To apply appropriate techniques to support short term decisions.

Contents:

1. Overview of Cost and Management Accounting

(i) Introduction to Cost and Management Accounting

- (a) Objectives and Scope of Cost and Management Accounting,
- (b) The users of Cost and Management accounting information, Functions of management accounting.
- (c) Role of cost accounting department in an organisation and its relation with other departments.
- (d) Installation of Costing System
- (e) Relationship of Cost Accounting, Financial Accounting, Management Accounting and Financial Management.
- (f) Cost terms and Concepts
- (g) Cost Reduction and Cost Control

- (h) Elements of Costs
- (i) Cost behavior pattern, Separating the components of fixed, variable, semi-variable and step costs.
- (j) Methods of Costing, Techniques of Costing.
- (k) Digital Costing.

(ii) Elements of Cost and Preparation of Cost Sheets

- (a) Functional classification and ascertainment of cost
- (b) Preparation of Cost Sheets for Manufacturing sector and for Service sector

2. Ascertainment of Cost and Cost Accounting System

(i) Material Cost

- (a) Introduction to procurement procedures. Valuation of receipts, issue and closing stock of Material, Stock verification.
- (b) Material requirement analysis through digital costing including Government e-Marketplace (GeM). Introduction to Costing through Enterprise Resource Planning (ERP). Process of tender and quotation.
- (c) Inventory control-
 - Techniques of fixing level of stocks- minimum, maximum, re-order point, safety stock, determination of optimum stock level,
 - Determination of Optimum Order quantity- Economic Order Quantity (EOQ),
 - Techniques of Inventory control- ABC Analysis, Fast, Slow moving and Non moving (FSN), High, Medium, Low (HML), Vital, Essential, Desirable (VED), Just-in-Time (JIT)- Stock taking and perpetual inventory system, use of inventory control ratios, Digital Inventory control
- (d) Treatment of Normal/Abnormal Losses w.r.t. waste, scrap, spoilage, defective, obsolescence.

(ii) Employee Cost

- (a) Introduction to Attendance and Payroll procedures
- (b) Elements of wages- Basic pay, Dearness Allowance, Overtime, Bonus, Holiday and leave wages, Allowances and perquisites.
- (c) Employee Cost Control
- (d) Employee Turnover- Methods of calculating employee turnover, causes of employee turnover, effects of employee turnover.
- (e) Remuneration systems and incentive schemes- Premium Bonus Method (Halsey Plan and Rowan Plan)

(iii) Direct Expenses

Identification of direct expenses with the main product or service and its treatment.

(iv) Overheads

- (a) Functional analysis- Factory, Administration, Selling, Distribution, Research and Development.
- (b) Behavioral analysis- Fixed, Variable and Semi- Variable.
- (c) Allocation and Apportionment of overheads using Absorption Costing Method.
- (d) Factory Overheads- Primary and secondary distribution,
- (e) Administration Overheads- Method of allocation to cost centres or products,
- (f) Selling & Distribution Overheads- Analysis and absorption of the expenses in products/ customers, impact of marketing strategies, cost effectiveness of various methods of sales promotion.
- (g) Treatment of Research and development cost in cost accounting.

(v) Concepts of Activity Based Costing (ABC)**(vi) Integration of cost and financial data**

- (a) Recording of financial data and its segregation.
- (b) Introduction to Non- integrated and Integrated Accounting system.

- (c) Items included in cost accounts only but financial accounts and vice versa.
- (d) Reconciliation of profit as per Cost and Financial Accounts (under Non-Integrated Accounting System).

3. Methods of Costing

(i) Single Output/ Unit Costing

(ii) **Job Costing:** Job cost cards and databases, collecting direct costs of each job, attributing overheads to jobs, Application of job costing.

(iii) **Batch Costing:** Determination of optimum batch quantity, Ascertainment of cost for a batch, Preparation of batch cost sheet, Treatment of spoiled and defective work.

(iv) Process/ Operation Costing

- (a) Process cost recording, Process loss, Abnormal gains and losses, Equivalent units of production, Inter-process profit, Valuation of work in process.
- (b) Joint Products- Apportionment of joint costs, Methods of apportioning joint cost over joint products,
- (c) By-Products- Methods of apportioning joint costs over by-products, treatment of By-product cost.

(v) Costing of Service Sectors

Determination of Costs and Prices of services.

4. Cost Control and Analysis

(i) Standard Costing

- (a) Setting up of Standards, Types of Standards, Standard Costing as method of performance measurement.
- (b) Calculation and Reconciliation of Material Cost, Labour cost, Variable Overhead, Fixed Overhead

(ii) Marginal Costing

- (a) Basic concepts of marginal costing, Contribution margin, Break-even analysis, Break –even and profit volume charts, Contribution to sales ratio, Margin of Safety, Angle of Incidence, Cost-Volume-Profit Analysis (CVP),

- (b) Determination of Cost of a product/ service under marginal costing method, determination of cost of finished goods, work-in-progress,
- (c) Comparison of Marginal costing with absorption costing method- Reconciliation of profit under both the methods,
- (d) Short term decision making -
 - Make or buy decision
 - Discontinuation decision
 - Multiproduct break-even analysis
 - Limiting factor (key factor)

(iii) Budget and Budgetary Control

- (a) Meaning of Budget, Essentials of Budget, Budget Manual, Budget setting process, Preparation of Budget and monitoring procedures.
- (b) The use of budget in planning and control
- (c) Flexible budget, Preparation of Functional budget for operating and non- operating functions, Cash budget, Master budget,
- (d) Introduction to Principal/ Key budget factor, Zero Based Budgeting (ZBB), Performance budget, Control ratios and Budget variances.
- (e) Budgets and motivation
- (f) Feedback and Feedforward controlling in budgeting.

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