

- A. Relevant Cost $\rightarrow$ Decision making.
 Debitaire interest $\rightarrow$ Pure finance not included in cost.
 Uniform costing $\rightarrow$ Help in comparing cost.
 Escalation clause $\rightarrow$ Contract costing.
 Point rating $\rightarrow$ Job evaluation.
- B. i) Chief accountant's salary is an administrative overhead cost $\rightarrow$ True.
 ii) Cost drivers are accounting techniques used to control cost $\rightarrow$ False.
 iii) An accounting system that collects financial and operating data on the basis of the underlying nature and extent of the cost drivers is called Target Costing $\rightarrow$ False.
 iv) Budget rate is used to carry out adjustment for the difference between overheads absorbed and overheads incurred $\rightarrow$ True.
 v) Operation budget normally cover a period of one year or more $\rightarrow$ False.

- C. i) They can be economically identified with the item being costed is true with respect to direct cost.
 ii) When unit variable cost increase and sales price remain unchanged then the break-even point (in unit) increase.
 iii) If there is a change in cost due to change in the level or activity or pattern or method or production, it is known as Differential cost.

iv)

	2008-09	2007-08
Sales. —	750,000	600,000
Δ Profit	Rs. 52,500	
Difference of sales between these year	$= (750,000 - 600,000)$	
	$= \text{Rs. } 150,000$	
$\therefore$ P.V. ratio	$= \frac{52,500}{150,000} \times 100$	
	$= 35\%$	

Sale = 100 $\therefore$ variable = 35.
 When, Sale price was reduced with 10%, then, it w
 be $(100 - 10)\% = 90\%$.

$$\therefore C = (90 - 65) = 25.$$

$$\therefore \text{P.V. ratio} = \frac{25}{90} = \frac{25}{90}\%$$

$$\therefore \text{Contribution} = 750,000 \times 35\% = 262,500$$

$$\text{c) Fixed cost} = \frac{190,000}{72500}$$

$$\therefore \text{Total contribution required} = (190,000 + 22500)$$

$$\therefore \text{Sales} = \frac{262,500}{\frac{25}{90}} = 945,000$$

$$\therefore \text{The sales volume would be Rs. } 945,000.$$

v)

$$TP = TS - TC$$

$$\therefore TC = TS - TP$$

Unit	Sale Price
175000	625
350000	580
700000	475

$$\therefore \text{Margin}$$

$$= 475 \times \frac{20}{100}$$

$$= \text{Rs. } 95$$

$$\therefore \text{Total Target cost} = (475 - 95) = \text{Rs. } 380$$

$\therefore$ At full capacity level, the target cost per unit will be Rs. 380.

Q.2.

Different types or methods or Transfer pricing:-

There are several methods or fixation or transfer price. They are discussed below:-

① Cost based pricing:- In this method cost is the base and the following method fall under this category.

i) Actual cost or production:- This is in fact, the simplest method or fixation or transfer price. In this method the actual cost or production is taken as transfer price for inter divisional or transfer. The actual cost or production may consist of only variable cost or total cost incl. fixed cost.

ii) Full cost plus:- In this method the total cost of sales plus some percentage of profit is charged by the transferring division to the transferee division. The percentage of profit may be on the capital employed or on the cost of sales.

iii) Standard cost:- This cost is 'predetermined cost' based on technical analysis of material, labour and overhead. In this method transfer price is fixed based on standard cost. The transferring unit absorbs the variance, i.e. difference between standard cost and actual cost. It's quite simple for operation. It is essential to revise the standard at regular intervals.

Marginal cost pricing:- In this method, only the marginal cost is charged as transfer price. The logic used in this method is that fixed cost are any case unavoidable and hence should not be charged to the buying division.

② Market based pricing:- Under this method, the transfer price will be determined according to the market price prevailing in the market. It acts as a good incentive for efficient production to the selling division and any efficiency in production and abnormal cost will not be borne by the buying division. The force and demand will supply will determine the market price in the long run and profit generated will be a very good parameter for measuring efficiency. One of the variation of this method is that from the market price, selling and distribution overhead should be deducted and price thus arrived should be charged as transfer price. The reason behind this is that no selling effort

are required to sell the goods/services to the buying division. Market price based transfer price has the following advantages:-

i) Actual costs are fluctuating and hence difficult to ascertain on the other hand market prices can be easily ascertained.

ii) Profit resulting from market price based transfer price are good parameter for performance evaluation and selling and buying division.

② Negotiated pricing: - In the above two methods, transfer prices are fixed on the basis of either the cost price or market price. However the transfer prices may be fixed on the basis of 'negotiated prices' that are fixed through negotiation between the selling and buying division. Sometimes it may happen that the concern product may be available in the market at a cheaper price than charged by selling division. It is beneficial for both the division and negotiate the price and arrive at a price, which is mutually beneficial to both the division. Such price are called as 'negotiable price'. Negotiable skills are required for the managers to arriving at a mutually acceptable price, otherwise there is a possibility of conflicts between the division.

③ Opportunity Cost pricing: - The pricing recognize the minimum price that the selling division is ready to accept and maximum price that the buying division is ready to pay. The final transfer price may be based on these minimum expectations of both the division. The most ideal situation will be when the minimum price expected by the selling division is less than the maximum price accepted by the buying division. It may happen very rarely and there is possibility of conflicts over the opportunity cost.

From the above discussion it is very clear that fixation of transfer price is a delicate decision. There might be a clash of interests between the selling and buying division and hence while fixing the transfer price, overall interest of the organisation should be taken into consideration.

Normal loss. This loss is due to the following factors:
 (i) evaporation, (ii) shrinkage, (iii) breakage, (iv) leakage.

Feature:-
1) This con is ~~not~~ ^{an} ineliminable
inherent quality.

- iii) The cost of normal produce.
- iv) The realisable value of normal lot is credited to proven account.

Dealings in process with account:-

[illegible]

Abnormal loss or wastage - The avoidable loss which is caused during the normal production cycle for the abnormal incident are known as abnormal loss or wastage. This is due to following reasons:- (1) Accident, (2) fire, (3) theft, (4) burglary, (5) efficiency.

Feature:-

- ① It is avoidable loss.
- ② It is valued at cost price
- ③ It is immovable type of loss.
- ④ Net loss on abnormal reasons is transferred to costing P/L A/c

Abnormal loss A/c.

Dr.

Particular	Qty.	Rate	Price	Particular	Qty.	Rate	Price
To Process A A/c	₹	₹	₹	By. Bank/cash A/c	₹	₹	₹
To Process B A/c	₹	₹	₹	(Scrap value)			
To Process C A/c	₹	₹	₹	Profit/Loss A/c	₹		
(Process in which such loss is arrived)							

₹ ₹

₹ ₹

Abnormal gain - In case of actual production of process is more than the expected production, the excess is known as abnormal gain. The presence of abnormal gain should not affect the cost of goods units in the normal circumstances.

Feature:-

- (i) It is arrived due to the excess estimation of normal loss.
- (ii) It is valued at cost price of the process.
- (iii) It is adjusted against normal loss.
- (iv) Net profit in it is transferred to costing profit and loss A/c.

Two steps are suggested for valuation, when there is a abnormal gain in the process.

- (i) Determine the normal reduction, assuming that there is abnormal gain.
- (ii) Determine the total accumulated cost of the process.
- (iii) Determine the cost P/O of normal production, by dividing the result of step (ii) by the step (i).
- (iv) The rate arrived at step (iii) should be applied for the valuation of units representing abnormal gain and output of the process transferred to either, normal process or finished stock account.

Abnormal Gain A/c				Cr			
Particular	Qty.	Rate	Price	Particular	Qty.	Rate	Price
To Normal loss (Scrap value)	₹	₹	₹	By process	₹	₹	₹
" P/L A/c (net abnormal gain)			₹	(Where abnormal gain is arrived)			

Particular	(Rs.) Product - A	(Rs.) Product - B	(Rs.) Product - C	
Variable cost :-				
Direct Material	8.00	24.00	16.00	mat-
Variable overhead	2.40	1.60	4.00	ima-
Direct labour	17.28	11.52	25.60	m
	<u>27.68</u>	<u>37.12</u>	<u>45.60</u>	plete
Sale price	40.00	54.40	72.00	so
				(
Contribution		17.28	26.40	
(Sale price - variable cost) -	12.32			
Contribution per hour -	3.08	3.60	3.30	red
Ranking -	①	③	②	fig.

$\therefore$ Total hour arrived =
 $(8000 \times 4) + (4000 \times 4.80) + (4800 \times 4.8)$
 $= 32000 + 19200 + 38400$
 $= 89,600$

Sales allocated

$\therefore$ Prorata $\frac{\text{hrs.}}{96000 \times 4} = 38,400$
 $\therefore$ Prorata $89,600 - 38,400 = 51,200$ [64000]

Share of Profitability :-

$A \rightarrow 38,400 \times 3.08 = 118,282$
 $C \rightarrow 51,200 \times 3.30 = 168,960$

$\therefore$ Fixed cost $\rightarrow$

118,282
168,960
<u>287,242</u>
160,000
<u>127,242</u>

4. Principles while taking credit for profit on incomplete profit:
 Several contracts are take more time than one financial year before they are complete. The question arise as to whether the profits enough contracts should be taken into consideration after the completion of the contract or whether a portion of the same should be taken into accounts every year on certain basis. If profit is taken into consideration after the completion of contract and if in a single year several contracts are completed, the profits shown will be very high while another year, if none of the contracts are completed amount of profit shown will be very low. There will be distribution in the amount of profits. Therefore it becomes necessary to compute the amount of profit on partly completed contracts and take credit in appropriate amount in the profit & loss account by using the following Principles;

- Value of certified work only should be taken into consideration while determining the profit. Value of work not certified should not be taken into consideration.
- In case of contracts which are less than 25% complete, no profit should be taken from the consideration and consequently no credit should be taken to profit and loss account.
- In case of contracts which are more than 25% complete but less than 50% complete, the following should be used for computing the profit to be credited to P/L A/c:

$$\frac{1}{3} \times \text{Notional profit} \times \frac{\text{Cash Received}}{\text{Work certified}}$$

Notional profit is the difference between the value of work certified and cost of work certified. It is computed in the following manner

$$\text{Notional profit} = \text{Value of work certified} - [\text{Cost of work to date} - \text{Cost of work completed but not certified}]$$
- In the case of contract complete between 50% and 90% means more than 50% but less than 90%, the following method is used for computing the profit.

$$\frac{2}{3} \times \text{Notional profit} \times \frac{\text{Cash Received}}{\text{Work certified}}$$

• In case of a contract complete 10% or more than that to be considered as more complete. In such case, the estimated profit is first determined by deducting the total cost to date and additional expenditure necessary to complete the contract from contract price. The portion of profit so arrived is credited to the profit and loss a/c by using the following formula.

Method - I Estimated profit $\propto \frac{\text{work certified}}{\text{contract price}}$

Method - II Estimated profit $\propto \frac{\text{work certified}}{\text{contract price}} \propto \frac{\text{Cash Received}}{\text{work certified}}$

Estimated profit $\propto \frac{\text{or Cash Received}}{\text{work certified}}$

Method - II is preferable to method - I.

Because, additional 20% more to complete the contract not determinative by mentioned, the amount of profit to be transferred to the profit and loss a/c is determined using the formula.

Notional profit $\propto \frac{\text{work certified}}{\text{Contract price}}$

- If there is a loss the total amount of loss should be transferred to the profit and loss account by crediting the contract a/c.
- It will be observed that in case of complete contract amount of profit credited to P/L a/c is reduced proportioned to the work certified and cash received. The reason is that being unrealised profit should not be used for distribution of dividend. Similarly, the principle of conservatism should also be applied in computing and crediting the profits.