

Issue	Points to remember		Page
Advantages of Cost Plus Pricing	1. Guaranteed Contribution 2. Assured Profit 3. Reduced risks and uncertainties 4. Most suitable in long run	5. Considers market factors 6. Full Recovery of all costs 7. Price Stability 8. Simplicity	3.2
Disadvantages	1. Ignores demand 2. Ignores competition 3. Arbitrary Cost allocation	4. Ignores opportunity costs 5. Price–Volume relationships	3.2
ROCE Pricing	1. ROCE Pricing is used when each division is treated as an Investment Centre.. 2. Determination: The Firm should determine an average mark-up on cost, which is necessary to produce a desired rate of ROCE. The issues to be considered are – (a) Basis and Assumptions on which the Capital Employed is computed, (b) Components to be covered in the ROCE, and (c) Fairness of the ROCE. 3. Advantages: Allowing each Firm (and hence the industry as a whole) to earn an adequate ROCE would – (a) attract additional capital, (b) increase the number of factories and production of the commodity, which would ultimately lead to competition and reduction in costs and prices.		3.3
Marginal Cost Pricing – Situations	1. When goods are of perishable nature. 2. When the Firm has already purchased huge quantities of Raw Materials, and the prices of these Materials is falling considerably in the market. 3. To launch or introduce a new product in the market at competitive prices (using Penetration Pricing Strategy).	4. To eliminate Competitors from the market. 5. To obviate shut-down costs. 6. To push up sales of another highly profitable product. 7. To capture / retain future market. 8. To capture / retain foreign market. 9. To ensure sale of old and defective stocks, seconds, etc.	3.3
Conversion Cost Method	Based on the assumption that Profit should be related to Value Added in the form of Conversion Costs since Materials Cost do not contribute to Profits. Price = Conversion Cost + Profit Margin on Conversion Cost + Materials Cost.		3.3
Std. Cost Method	Selling Price = Standard Costs + Suitable Profit Margin.		3.3
Efficiency Curve Method	1. Recognises improvements in production efficiency due to repetitive nature of operations and large batch quantities. 2. As efficiency improves, the unit cost of production comes down and this is reflected in pricing.		3.3
Differential Selling Price	Use of Differential Selling Price, which is above Marginal Cost but below Total Cost, is primarily intended to absorb surplus capacity. It can be achieved by – 1. Different Markets – Export Pricing, 2. Different products.		3.4
Going Rate Pricing	1. It is a method of Competitive pricing method wherein a Firm tries to keep its price at the average level charged by the industry. 2. Advantages: (a) Useful where it is difficult to measure costs, (b) Yields fair return to all Firms in the industry, (c) Most conducive for industry's harmony, (d) Signifies the pricing practice in homogeneous product markets. 3. This method can be used in Pure Competition and Oligopoly Markets.		3.4
Sealed Bid Pricing	Bid constitutes the Firm's Offer Price. The quotation is generally based on the Incremental Costs plus a Reasonable Mark-Up. • Low price quoted in order to win the contract – Firm may lose on profits. • High prices quoted – chances of gaining the contract may be reduced. • Probability Analysis may be used to analyse the impact of various bid prices.		3.5
Incremental Pricing	1. Involves comparison of the impact of decisions on revenues and cost. If a pricing decision results in a greater increase in revenue than in costs, it is favourable. 2. Analyses – (a) Relevant Cost, (b) Product–Line Relationship, (c) Opportunity Cost, (d) Time factor, (e) CVP, and (f) Risk.		3.5
Non–Cost Factors in Pricing Decisions	1. Provide an incentive to the Firm for adopting improved technology & maximising production, 2. Encourage optimum utilisation of resources, 3. Work towards better balance between demand and supply, 4. Promote exports and / or other avenues to utilize the Firm's spare capacity, and		3.6

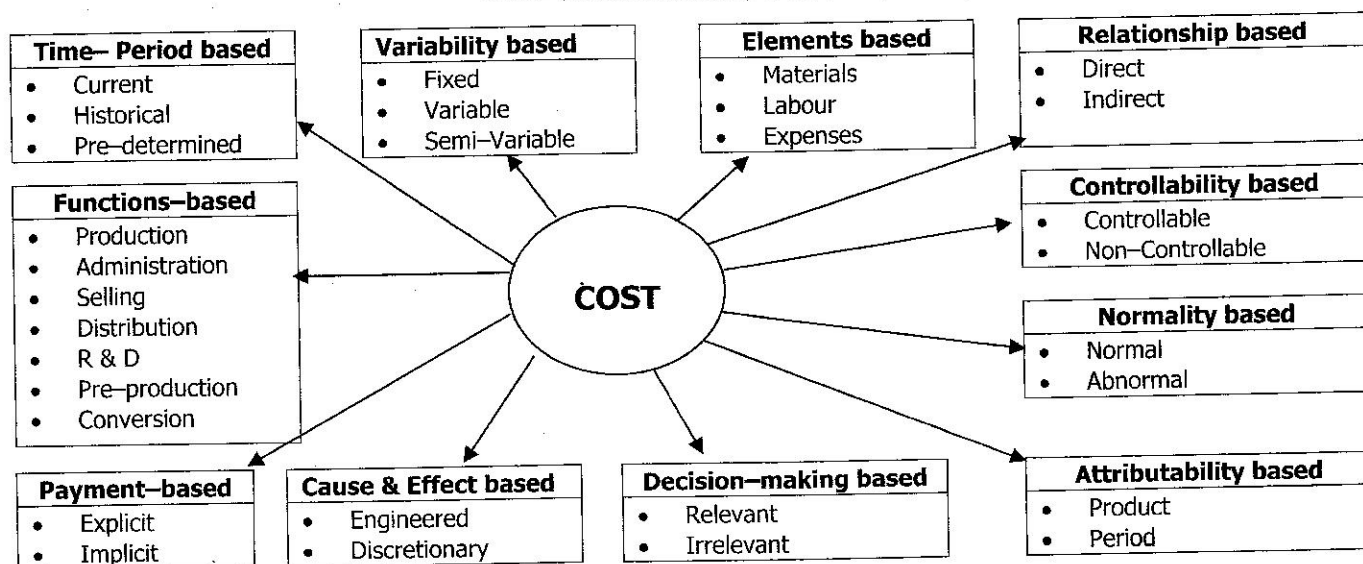
Issue	Points to remember	Page
	5. Avoid adverse effects on the rest of the economy. Note: Non-Cost Factors are relevant in – (a) Price Discrimination, and (b) Peak Load Pricing.	
Curvilinear CVP Analysis	Optimum Output is the point where the gap between the Total Cost and Total Revenue curves is the maximum . If volume is increased beyond this level, Profits are reduced since the Incremental Cost is more than the Incremental Revenue.	3.6
Pricing in Pure Competition Market	1. Features: (a) Large number of Buyers & Sellers, (b) Homogenous product, (c) Free entry or exit, (d) Perfect knowledge of Purchasers and Sellers on prices & quantities, (e) Absence of Market Segmentation, (f) Absence of Transportation Cost, and (g) Perfect mobility of Factors of Production. 2. Price determination conditions: (a) Firm has no pricing policy of its own as it has to accept the prevalent market price. (b) Firm can sell nothing at any higher price. (c) Decision is not on price, but on the quantity to sell. (d) Every Firm can continue to produce so long as its Marginal Cost is less than or equal to its Selling Price.	3.7
Pricing in Monopoly	1. Features: (a) One Seller of a particular good or service, (b) Absence of Competition, (c) Absence of Close Substitutes, and (d) Power to influence price. 2. Price determination conditions: (a) A Monopolist can raise the price of its products without frightening away all his customers. Extent of price increase depends on the elasticity of demand for the product. (b) Optimal Price is determined at the level of output at which Marginal Revenue equals Marginal Cost.	3.7
Pricing in Monopolistic Competition	1. Features: (a) Product Differentiation, (b) Existence of many Sellers and Buyers, (c) Availability of Close Substitutes (similar but not identical). 2. Price Determination conditions: (a) For short run optimal price: Marginal Revenue = Marginal Cost. (b) For long run optimal price: Average Revenue = Average Cost, and Marginal Revenue = Marginal Cost.	3.8
Pricing in Oligopoly Market	1. Characterised by the presence of a few large sellers occupying a major share of the market. 2. Decision of each Seller will necessarily be in tune with the industry. 3. Firms tend to charge the same price as is being charged by their competitors. 4. One Firm assumes the role of Price Leader and the others follow any change in price by the Leader.	3.8
Optimal prices for New Products	Procedure: 1. Market Survey 2. Price Volume Relationship 3. Incremental Contribution Approach	3.8
Pricing Strategies	1. Meaning: Broad plan of action by which an organisation intends to reach its goal. 2. Types: (a) Market Entry Strategies, (b) Discount Strategies, (c) Price Discrimination Strategies, and (d) Geographic Pricing Strategies.	3.9
Skimming Pricing	1. Meaning: Policy of charging high prices during the early period of a product's existence and in the later years the prices are gradually reduced. 2. Reasons: (a) Inelastic Demand, (b) Sales Boost, (c) Assured Profit, (d) Cost-Revenue Matching.	3.9
Penetration Pricing	1. Meaning: Policy of using a low price as the principal instrument for penetrating mass markets early. This method is used for pricing a new product and to popularise it initially. 2. Circumstances: (a) Elastic demand, (b) Mass Production and, (c) Frighten off competition.	3.10
Distributor's Discount	1. Meaning: Price deductions that systematically make the Net Price vary according to Buyer's position in the chain of distribution. These discounts are given to various Distributors in the trade channel. 2. Forms: (a) Different Net Prices for different Distributor Level, (b) Uniform List Price subject to a discount structure, differing for various Distributors, (c) Single discount combined with differing supplementary discounts.	3.10
Price Discrimination	• Meaning: Charging different prices and it takes various forms according to whether the basis is customer, product, place or time. • Conditions: 1. Segmentable Market, 2. No resale, 3.No competition • Forms: Based on – 1. Customers, 2. Product Version, 3. Place, 4. Time.	3.10

Price Discrimination

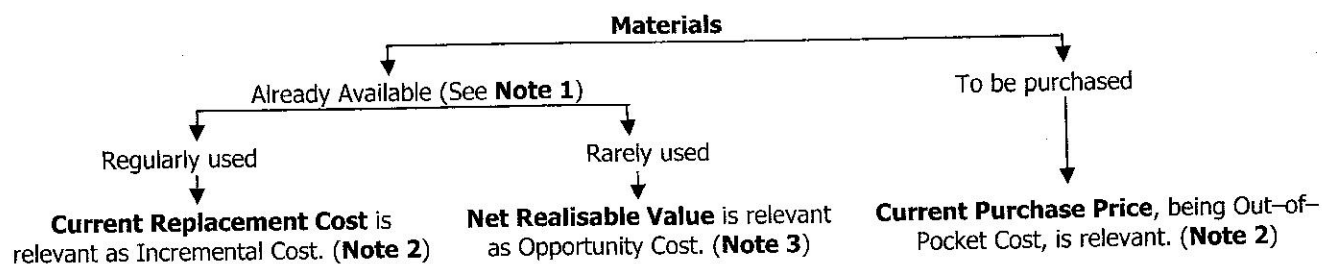
Issue	Points to remember	Page
Time Differentials	Meaning: Charging different prices on the basis of time is a kind of price discrimination called Time differentials. Classification: 1. Clock-Time Differentials, 2. Calendar-Time Differentials, 3. Geographical Price Differentials, and 4. Consumer Category Price Differentials.	3.11
Geographic Pricing	1. Point-of-Production Pricing 2. Uniform Delivered Pricing 3. Zone-Delivered Pricing 4. Freight-Absorption Pricing	3.12
Pareto Analysis	1. Focus on the most important aspects of decision making, in order to simplify the DM process. 2. Management can use 80:20 relationship in a number of business situations to direct its attention to key control mechanism or planning aspects, It helps to clearly establish top priorities and to identify both profitable and unprofitable target.	3.13
Pareto Analysis – Applications	1. Product Pricing 2. Customer Profitability Analysis 3. ABC Analysis – Stock Control 4. Activity Based Costing 5. Quality Control	3.13

FTR 4 Relevant Cost Analysis

Cost Classification (Page 4.1)



Relevance of Material Cost (Page 4.5)

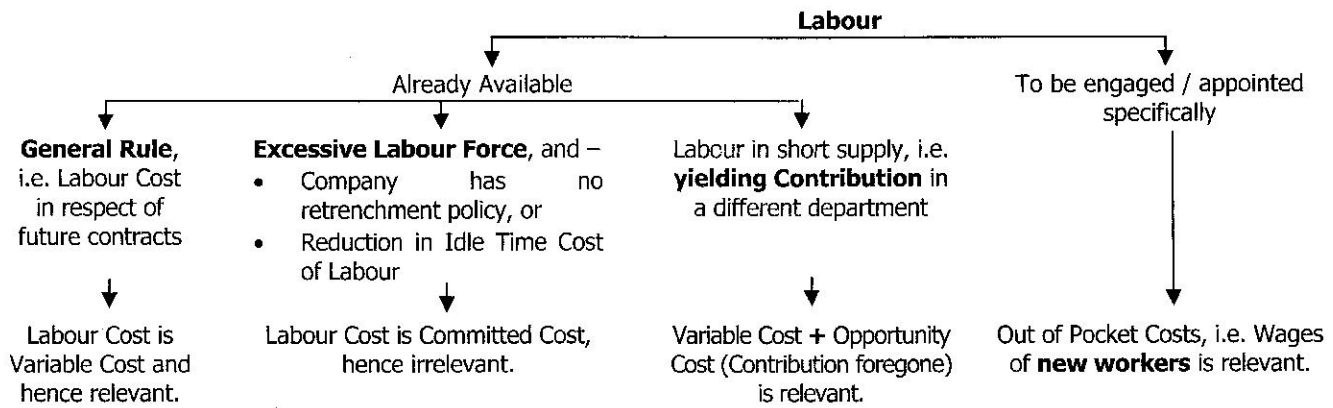


Notes:

- Materials already available includes – (a) Materials under Firm Purchase Orders, (b) Materials in Transit, where the risk / property in materials is already with the Buyer Company.
- Generally, Current Replacement Cost = Current Purchase Price = Current Market Price of the Material.
- If there are alternatives for disposal of rarely used material, e.g. substitution or re-use or scrap, the highest Opportunity Costs shall be considered relevant.
- If a regularly used material is restricted in supply, the Total Relevant Cost = Current Purchase Price **Plus Indirect** Opportunity Cost.

Indirect

Relevance of Labour Cost (Page 4.6)



Note: If acceptance of special contract necessitates replacement / transfer of workers, i.e. existing jobs carried out with new workers, and existing workers are transferred to the special contract, the Wages of New Workers is relevant for the special contract.

Relevance of Other Costs (Page 4.6)

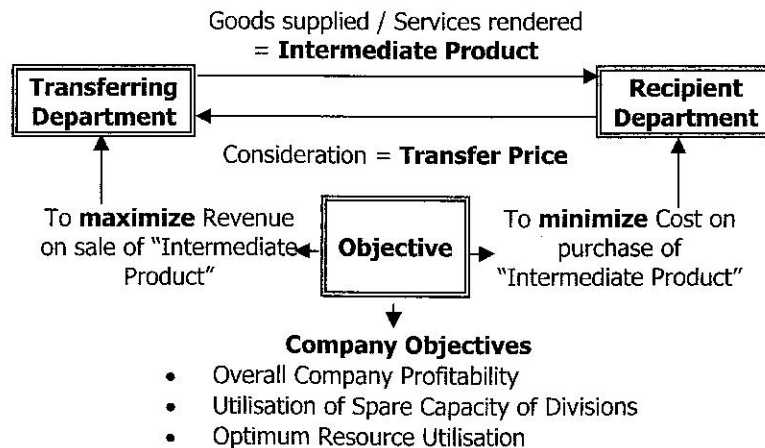
Nature of Cost	Relevant Cost
Variable Overheads	- Irrelevant if already incurred. - Relevant, only if such costs are to be incurred in future.
Fixed Overheads	Relevant, only under specific situations described in Question above.
Depreciation	Irrelevant , as it is an apportionment of Historical Cost. However, fall in Asset Disposal Value due to delay in disposal, becomes relevant.
Other Department Costs	- Irrelevant if already incurred or apportioned. - Relevant if they are to be incurred specifically for any contract / work.
Intra-Company Transfer Price Charges for services	(Incremental Costs upto the point of transfer + Opportunity Costs) are relevant.

Other Points

Issue	Points to remember	Page
Fixed Costs become relevant for decision making	- Fixed Costs are specifically incurred for any contract, - Fixed Costs are incremental in nature, - Fixed portion of Semi-Variable Cost increases due to change in level of activity consequent to acceptance of a contract, - Fixed Costs are avoidable or discretionary, - Fixed Costs are such that one cost is incurred in lieu of another (the difference in costs will be relevant for decision-making.)	4.4
Opportunity Cost – Principles	- Opportunity Cost is a Relevant Cost where alternatives are available. It involves choice and decision-making out of many alternatives. - Opportunity Cost is generally evaluated for short-term purposes. - Opportunity Cost is not useful for accounting, reporting and cost control. It does not find any place in formal accounts and is computed only for comparison purposes. - Opportunity Cost arises only in case of restriction of resources, i.e. Key Factor situation. If resources are abundantly available, they can be used for pursuing all available alternatives / courses of action. - When a number of alternatives are available, the highest of the Opportunity Costs will be considered relevant for decision-making.	4.5
Opportunity Gain	Opportunity Gain = incidental, indirect benefit derived out of choosing a particular course of action, from among various options, and comprises – (a) Savings in Costs , or (b) Additional Indirect benefits derived by accepting / choosing a certain option.	4.6

FTR 5 Transfer Pricing

Transfer Pricing Concept (Page 5.1)



Methods of Transfer Pricing (Page 5.2 & 5.3)

Point	Category 1	Category 2	Category 3
	Cost Based Transfer Pricing , using Cost or any variant of cost, with or without markup, e.g.	Market Price based Transfer Pricing	Bargained or Negotiated Transfer Pricing.
Description	(a) Variable Manufacturing Cost, (b) Full Manufacturing Cost, (c) Total Cost (Actual), (d) Standard Cost.	(a) Market Price of Intermediate Product (as quoted by Outside Supplier) (b) Market Price of substitute, if any.	Combination of Category 1 & Category 2 Methods of Pricing.
Merits	(a) Simple to understand (b) Easy to operate (c) Guarantees cost recovery	(a) Maximum Prices (b) Demand & Supply (c) Opportunity Cost Recovery (d) Objective	(a) Proper Decisions (b) Autonomy & Motivation Value (c) Optimality
Demerits	(a) Not suitable for Performance Evaluation (b) Ignores Opportunity Costs (c) Does not reward cost efficiency.	(a) Availability of Market Prices (b) Impact of S & D Costs (c) Unjust Enrichment	(a) Sub-Optimal (b) Conflicts (c) No scope for Performance Evaluation (d) Time and Cost

Criteria for Setting Transfer Prices (Page 5.4)

Criteria	Cost Based	Market Price Based	Negotiated
1. Achieves Goal Congruence	Often, but not always.	Yes, if markets are competitive.	Yes.
2. Motivates Management Effort	Yes, if based on budgeted costs. There is less incentive to control costs, if transfers are based on actual costs.	Yes.	Yes.
3. Useful for evaluating Sub-Unit performance	Difficult, unless Transfer Price exceeds full costs.	Yes, if markets are competitive.	Yes, but Transfer Prices are affected by bargaining strengths.
4. Preserves Sub-Unit Autonomy	No, since it is rule-based.	Yes, if markets are competitive.	Yes, because it is based on negotiations between sub-units.
5. Other factors	Useful for determining full cost of products and services.	No market may exist or markets may be imperfect or in distress.	Bargaining and negotiations take time, and may need to be reviewed repeatedly as conditions change.

Negotiated / Bargained Transfer Pricing (Page 5.4)

Minimum Transfer Price (from Transferring Division's viewpoint)	Maximum Transfer Price (from Recipient Division's viewpoint)
Minimum TP = Relevant Cost , computed as under –	Maximum TP = Least of the following items –
(a) Variable Costs upto the point of internal transfer. (b) Fixed Costs, if specific to such transfer. (c) Opportunity Costs, i.e. Contribution foregone by the Transferring Division on its External Sales. Note: - Selling and Distribution Costs, not incurred for Internal Transfers are not included. - Opportunity Costs arises only if – (i) Transferring Division produces and sells marketable products, and (ii) Transferring Division operates at full capacity.	(a) Market Price , since this represents the Fair Value in exchange, based on market forces. (b) Effective Purchase Cost , i.e. Market Price + Buying Costs, since the Recipient Division would have to incur this cost if the products are procured externally. (c) Recipient's Ability to Pay , e.g. if Recipient Division sells the Final Product at ₹ 100 after incurring incremental costs of ₹ 15 in its own division, it will be prepared to pay a maximum of ₹ 85 for the Intermediate Product. Note: If the Intermediate Product as such is not available for purchase in the market, the price of its substitute may be considered, in determining the above items.

Negotiation: The Actual Transfer Price may be determined by negotiations between Divisional Managers, subject to the range of minimum to maximum prices. Any price within the given range (i.e. Minimum to Maximum) will be acceptable to both the Managers since –

- Transferring Division has no incentive to transfer at any price **below the minimum**, as its incremental costs and opportunity costs may not be fully recovered.
- Recipient Division has no incentive for internal purchase, at any price **above the maximum**, as external procurement may be beneficial to such division.

Other Points

Issue	Points to remember	Page
Resolving TP Conflicts	1. Dual Rate System: Under this system – - Revenue for Transferring Dept = Full Cost + Mark up - Cost for Recipient Dept = Relevant Costs (Variable Cost + Opportunity Cost) - Company Profits = Total of Divisional Profits Less Interdivisional mark-up 2. Two Part Transfer Pricing: Here, Transfer Price = Marginal Costs + Lumpsum Fixed Fees.	5.6 & 5.7
PAT Maximisation by MNC	1. Income Tax Rates 2. Import Duty 3. Inflation 4. Income Repatriation 5. Penetrating a new market	5.7
Tfr Pricing – Merits	1. Goal Congruence 2. Wholistic Decisions 3. Performance Evaluation 4. Balance between Autonomy & Company's Goals	5.8
Tfr Pricing – Demerits	1. Identity 2. Short Term Focus 3. Reduction in Profits 4. Disharmony 5. Duplication 6. Loss of Control 7. Transfer Pricing Problems 8. Ineffective Control	5.8

FTR 6 Costing of Service Sector

Issue	Points to remember	Page
Operating Costing	Meaning: Ascertainment of the cost of rendering services or intangible products. Aspects: 1. Labour-Intensive Activities, 2. Deemed Cost-Unit and 3. Costs in Service Sector.	6.1
Methods of Costing	1. Cost Accumulation 2. Cost Classification 3. Cost Expression 4. Costing Methods – (a) Job Costing, (b) Process Costing Method, (c) Hybrid Costing, and (d) Activity Based Costing Method.	6.2

Job Costing in Service Sector	1. Identify the Job that is chosen as Cost Object. 2. Identify the Direct Cost categories for the Job. 3. Identify Indirect Costs (Overheads) associated with the Job. 4. Select the Cost Allocation Base for assigning each Indirect Cost to the Job. 5. Identify the rate per unit of the Cost Allocation Base used to allocate cost to the Job.	6.2
Special Features of Service Sector	1. Production and consumption of many services are inseparable. 2. Most services are intangible. 3. Service outputs vary from day to day. 4. Pricing strategies depend on customer.	6.3
Customer Costing	Cost Classification is as under – 1. Customer Specific Costs, 2. Customer-line Category Costs, and 3. Company Costs.	6.3
Pricing methods	1. Supply and Labour Billing 2. Pure Labour Billing 3. Cost Plus Pricing 4. Service Overhead Based Billing	6.4

FTR 7 Budgetary Control

Issue	Points to remember	Page
Planning Aspects	1. Strategic Planning = preparing long-term action plans to attain the Firm's objectives by considering the changes in external environment. 2. Budgetary Planning = preparing the short to medium term plans of the Firm, within the framework of Strategic Plans, e.g. Annual Budget. 3. Operational Planning = short-term or day-to-day planning process. It plans the utilisation of resources and will be carried out within the framework of the Budget. Each step in the Operational Planning Process is an interim step towards achieving the Budget.	7.1
Budget	1. Meaning: 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. 2. Features: (a) Financial and/or Quantitative, (b) Futuristic, (c) Goal Oriented, (d) Components – Income, Expenditure and Employment of Capital.	7.1
Steps in preparation of Budget	1. Definition of Objectives 2. Identification of Key (or Budget) Factor 3. Budget Committee and Controller 4. Budget Manual 5. Budget Period 6. Standard of Activity or Output	7.1
Budget Manual	1. Brief explanation of principles of Budgetary Control System, its objectives and benefits . 2. Procedure to be adopted in operating the system – in the form of instructions and steps. 3. Organisation Chart , and definition of duties and responsibilities of – (i) Operational Executives, (ii) Budget Committee, and (iii) Budget Controller. 4. Nature, type and specimen forms of various reports, persons responsible for preparation of the Reports and the programme of distribution of these reports to the various Officers. 5. Account Codes & Chart of Accounts used by the Company, with explanations to use them. 6. Budget Calendar showing the dates of completion, i.e. "Time Table". 7. Key assumptions to be made by Managers in budgets, e.g. inflation rates, forex rates. 8. Budget Periods and Control Periods. 9. Follow-up procedures.	7.2
Participative Budgeting	1. Participative Budgeting is a budgeting system in which all Budget Committee Members are given the opportunity to apply their own budgets in practice. 2. Participative Budgeting (using Budget Committees) is also called "bottom-up budgeting". It is different from imposed or "top-down budgets" where the ultimate budget holder does not have any say / participation in the budgeting process. 3. Advantages: (a) improved quality of forecasts to use as the basis for the budget, (b) higher levels of motivation for the participating Managers, (c) better results since the applicant and executor of the Budget are the same person.	7.2
Fixed /Flexible Budgets	Points of Differentiation – (1) Definition, (2) Rigidity, (3) Level of Activity, (4) Effect of Variance Analysis, (5) Use for Decision making, (6) Performance Evaluation.	7.2

Issue	Points to remember	Page																		
Situations where Flexible Budgets are used	- Seasonal fluctuations in sales and/or production. - Introduction of new products, product designs and versions on a frequent basis. - Industries engaged in make-to-order business like shipbuilding. - An industry which is influenced by changes in fashion. - General changes in Sales. - In case of new business venture, due to its typical nature, it may be difficult to forecast the demand of a product accurately. - In case of labour intensive industry where the production of the Firm is dependent upon the availability of labour. - Where the business is dependent upon the mercy of nature, and environment is uncertain.	7.3																		
Functional Budgets	Physical Budgets, 2. Cost Budgets, 3. Profit Budgets, and 4. Financial Budgets.	7.3																		
Budget Process / Calculations	Sales Budget (in Quantity and in Value) Production Budget (in Qty) = Budgeted Sales + Closing Stock of FG – Opening Stock of FG. Raw Materials Consumption / Usage Budget: (a) RM Usage Quantity = Budgeted Prodn of FG × RM Usage p.u. of FG, (b) Cost of RM Consumed = RM Usage Qty × Price of RM p.u. Raw Materials Purchase Budget: (a) RM Purchase Quantity = RM Usage Quantity + Closing Stock of RM – Opening Stock of RM, (b) Cost of RM Purchased = RM Purchase Quantity × Price of RM p.u. Labour Cost Budget: (a) DLH Requirement = Budgeted Prodn of FG × DLH required pu of FG, (b) Direct Labour Cost = DLH Required × Labour Rate per hour, (c) Manpower required = Total DLH Required ÷ Effective Hours per worker. OH Budgets: (a) Fixed Budget lists Fixed OH, Variable OH and Semi-Variable OH at one level of activity (i.e. one amount column only), (b) Flexible Budget lists Fixed OH, Variable OH and Semi-Variable OH at various levels of activity (i.e. different amount columns) Cost Summary Budgets – Prime Cost Budget, Cost of Production Budget, Ending-inventory Budget, Cost-of-Goods-Sold Budget. Specific Budgets – R&D Cost Budget, Capital Expenditure Budget, Cash Budget. - Budget Summaries/Master Budget – Budgeted Income Statement & Budgeted Balance Sheet.	7.3																		
Principal Budget Factor	- Principal Budget Factor = Limiting Factor, or Key Factor, or Critical Factor, is the factor that limits the activities of the functional budgets of the Firm. Some examples are Sales Demand, Raw Material Availability, Labour Hours or Machine Capacity, etc. - The early identification of this Factor is important since it indicates which budget should be prepared first. If Sales Volume is the Principal Budget Factor, Sales Budget should be prepared first based on available sales forecasts, and all other budgets should then be linked to the Sales Budget. Alternatively, if Machine Capacity is limited, then Production Budget should be prepared first, followed by other Budgets. - If the Principal Budget Factor is not identified properly and at an early stage, there could be problems of – (a) delay in the Budget Process, (b) possibility of infeasible targets, etc.	7.4																		
Budget Ratios	<table><thead><tr><th>Ratio</th><th>Time Based Formula</th><th>Output Based Formula</th></tr></thead><tbody><tr><td>Budgeted Capacity Usage Ratio</td><td>$\frac{\text{Budgeted Hours}}{\text{Practical Plant Cap (in hrs)}}$</td><td>$\frac{\text{Budgeted Output}}{\text{Practical Plant Cap (in output)}}$</td></tr><tr><td>Actual Capacity Usage Ratio</td><td>Actual Hrs ÷ Budgeted Hrs</td><td>Std Output ÷ Budgeted Output</td></tr><tr><td>Efficiency Ratio</td><td>Std Hrs ÷ Actual Hours</td><td>Actual Output ÷ Std Output</td></tr><tr><td>Calendar Ratio</td><td>Actual Days ÷ Budg. Days</td><td>Possible Output ÷ Budg Output</td></tr><tr><td>Volume or Activity Ratio</td><td>Std Hrs ÷ Budgeted Hours</td><td>Actual Output ÷ Budg Output</td></tr></tbody></table> Note: Volume Ratio = Capacity Ratio × Efficiency Ratio × Calendar Ratio.	Ratio	Time Based Formula	Output Based Formula	Budgeted Capacity Usage Ratio	$\frac{\text{Budgeted Hours}}{\text{Practical Plant Cap (in hrs)}}$	$\frac{\text{Budgeted Output}}{\text{Practical Plant Cap (in output)}}$	Actual Capacity Usage Ratio	Actual Hrs ÷ Budgeted Hrs	Std Output ÷ Budgeted Output	Efficiency Ratio	Std Hrs ÷ Actual Hours	Actual Output ÷ Std Output	Calendar Ratio	Actual Days ÷ Budg. Days	Possible Output ÷ Budg Output	Volume or Activity Ratio	Std Hrs ÷ Budgeted Hours	Actual Output ÷ Budg Output	7.4
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Zero Base Budgeting	Meaning: Expenditure Control Device where each divisional head has to justify the requirement of funds for each head of expenditure and prepare the budget accordingly, without reference to the past budget or achievements. Features: 1. Wholistic, 2. Analytical, 3. Priority Based, 4. Review Based, 5. Rational, and 6. Efficiency. Steps: 1. Objectives, 2. Coverage, 3. Decision Areas, 4. Ranking, 5. Budgeting. Merits: 1. Priority Allocation, 2. Maximum Efficiency, 3. Cost Benefit Analysis, 4. Goal Congruence, 5. Management by Objectives. Demerits: 1. Lack of Co-ordination, 2. Old is Gold Attitude, 3. Time Consuming.	7.5, 7.6																		

	Traditional Budgeting	ZBB	
Traditional vs ZBB	1. Accounting-oriented 2. Reference made to the past period levels. 3. Routine and direct approach. 4. Top Mgmt decides on cost allocation. 5. Comparatively rigid. 6. Managers may deliberately inflate their Budget Cost Request.	Decision-oriented. No reference to past period levels. Analytical approach. Manager of each Division should justify his budget. Flexible and responsive to environmental changes. Managers cannot have an adhoc approach for Cost Budgets.	7.6
Performance Budgeting	1. Performance Budget is one which presents – (a) purposes and objectives for which funds are required, (b) costs of the programmes proposed for achieving those objectives, and (c) quantitative data measuring the accomplishments & work performed under each programme. 2. Performance Budgeting is a technique of presenting budgets for costs and revenues, in terms of functions. In this technique, programmes and activities are correlated with the physical and financial aspect of individual items comprising the budget. 3. Steps in Performance Budgeting: (a) Establish a meaningful functional Programme and Activity Classification of operations, (b) Bring the system of Accounting and Financial Management, in accordance with the above classification, (c) Establish suitable norms, yardsticks, work units of performance and unit costs, wherever possible, under each programme and activity, for their reporting and evaluation. (d) Monitor and evaluate performance on the basis of Performance Reports. 4. Pre-requisites: (a) Define objectives, (b) Translate objectives into specific functions, programmes, activities and tasks, for different levels of Management, (c) Quantify realistic and acceptable standards or performance indicators, (d) decentralized responsibility structure and flexible management style, (e) suitable Accounting and Reporting System. 5. Advantages: Performance Budgeting – (a) lays immediate stress on the achievement of specific goals over a period of time. (b) provides a meaningful relationship between estimated inputs and expected outputs, (c) aims at a continuous growth of the Firm,. (d) enables the Firm to be sensitive and adaptive,. (e) requires the preparation of periodic Performance Reports, to find out existing variances. 6. Traditional vs Performance Budgeting: Traditional Budgeting – (a) focusses on financial aspect, and (b) aims at expenditure control. Performance Budgeting – (a) focusses on performance, and (b) aims at functions and not their expenditure.		7.7, 7.8
Performance Reports	1. Considerations: (a) Significance, (b) Timeliness, (c) Accuracy, (d) Appropriateness, (e) Discrimination, and (f) Presentation. 2. Reports given to: (a) Top Management, (b) Sales Management, (c) Production Management, (d) Works Managers, (e) Special Reports.		7.8, 7.9

FTR 8 Activity Based Cost Management

Issue	Points to remember			Page
Changes in nature of Mfrg Costs	1. Cost Pool Identification, 2. Activity Related Costs, 3. Standard Costing System, 4. Design of Cost Accounting System.			8.1
ABC -- Meaning	Identification of cost with each cost driving activity and making it as the basis for apportionment / assignment of costs over different cost objects / jobs / products / customers / services.			8.1
Cost Object & Cost Driver	1. Cost Object – Item for which cost measurement is required. 2. Cost Driver: Factor that causes a change in the cost of an activity. Cost Drivers are classified as – (a) Resource Cost Driver: Measure of quantity of resources consumed by an activity & used to assign the cost of a resource to an activity/ cost pool. (b) Activity Cost Driver: Measure of frequency and intensity of demand, placed on activities by cost objects & used to assign activity costs to cost objects. Note: Selection of Cost Drivers is dependent upon – (a) Degree of Correlation, (b) Cost of Measurement, and (c) Behavioural Effects.			8.1, 8.5
Stages in ABC	Step	Particulars		8.2
	1	Identify various activities within the Firm into – Primary & Secondary.		
	2	Relate the Overheads to activities using Resource Cost Drivers.		
	3	Apportion costs of Support activities over Primary activities.		
	4	Determine Activity Cost Drivers for each Activity/ Cost Pool.		
	5	Compute ABC Rate = Total Cost of Activity (Cost Pool) ÷ Activity Cost Driver		
	6	Assign Costs to Cost Objects using formula– Resources Consumed × ABC Rate		
Traditional Absorption Costing & ABC	Particulars	Traditional Absorption Costing	Activity Based Costing	8.3
	OH related to	Places / Cost Centres / Departments.	Activities grouped into Cost Pools.	
	Activity Ascertainment	Only – (a) Unit Level Activities (Variable), and (b) Facility Level Activities (Fixed) may be identified.	4 levels of activities, (a) Unit Level, (b) Batch Level, (c) Product Level, and (d) Facility Level, are identified.	
	Cost related to	Costs related to Places / Cost Centres.	Activities and Causal Factors.	
	Cost Drivers	Time (Hours) is assumed as the only “causal factor” governing cost.	Activity–wise Cost Drivers identified.	
	Single & Multiple Cost Drivers	Only Single Cost Driver for each dept.	Multiple Cost Drivers can be identified. Most dominant is chosen.	
	Recovery Rates	Either multiple rates (for each department)/ single rate (for the entire factory) may be used.	Specific activity–wise recovery rates are used. There is no “single” or “overall” ABC Rate.	
	Cost Assignment	Costs are assigned to Cost Units , i.e. to products, or jobs or hours.	Costs are assigned to Cost Objects .	
	Cost Control	Not suitable for cost control.	Suitable for Cost Control.	
Emergence of ABC in Mfring Firms	1. Production Overheads are high in relation to Direct Costs. 2. Products use different amounts of overhead resources. 3. More Support Service Costs. 4. Need for Better Cost Estimate to face competition. 5. Better Tools for Cost Tracing.			8.5
Purposes / Benefits of ABC	1. To link the cost to its causal factor, i.e. the Cost Driver, 2. To identify costs of activities rather than Cost Centres, 3. To ascertain product costs with greater accuracy by relating Overheads to activities, and 4. To overcome inherent limitations of traditional absorption costing & use of blanket OH Rates.			8.5
Steps in installation of ABC System	1. Specification of Objectives, 2. Identification of Costs for ABC, 3. Process Specification, 4. Activity Definition,		5. Activity Driver Selection, 6. Costing, 7. Staff Training, 8. Review & Follow-up	8.5

Issue	Points to remember		Page
Areas of ABC used	1. TQM, 2. Product Profitability Decisions,	3. Facility & Resource Expansion, 4. HR Decision	8.6
Use of ABC in decision Making	1. Pricing, 2. Market Segmentation & Distribution Channels, 3. Make-or-Buy decisions and outsourcing, 4. Transfer Pricing,	5. Plant close down decisions, 6. Evaluation of offshore production, 7. Capital Investment decisions, 8. Product line profitability, etc.	8.6
VA vs NVA Activities	Value-Added Activities (VA)	Non-Value-Added activities (NVA)	8.7
	Activities necessary for the utility or performance of the product.	Additional and extraneous activities , not fully necessary for product performance / utility.	
	Customers perceive as adding usefulness to the product or service that they purchase.	If eliminated, this will not reduce the actual or perceived value that customer obtain by using the product or service.	
	Work that is valued by the external or internal customer.	Work that is not valued by the external or internal customer.	
	They improve or maintain the quality or function of a product. VA activities result in "costs" and not in losses.	NVA activities do not improve the quality or function of a product or service, NVA activities create waste, result in delay of some sort.	
	Making product more versatile for certain other uses.	Expediting due to work delays, cost of re-work of defectives, etc.	
	Management aims to simplify VA Activities and thereby manage "costs".	Management should focus on elimination of NVA Activities and thereby avoid "losses".	
ABM	1. The use of ABC as a costing tool to manage costs at activity level is known as Activity Based Cost Management (ABM). ABM utilises cost information gathered through ABC. 2. Through various analyses, viz. (a) Cost Driver Analysis, (b) Activity Analysis, and (c) Performance Analysis, ABM manages activities rather than resources. It determines what drives the activities of the Firm & how activities can be improved to increase profitability. 3. ABM seeks to satisfy the following customer needs while making fewer demands for resources – (a) Lower Costs, (b) Higher Quality, (c) Faster Response Time, and (d) Greater Innovation. 4. Stages: (a) Identification of the activities that have taken place in the Firm. (b) Assigning Costs to Cost Pool for each activity. (c) Spreading of Support Activities Costs across the Primary Activities. (d) Determining Cost Driver for each activity. (e) Assigning the costs of Activities to Products, according to product demand for Activities.		8.7, 8.8
Business Applications of ABM	1. Cost Reduction, 2. Activity Based Budgeting, 3. Business Process Re-engineering (BPR),	4. Benchmarking, 5. Performance Measurement	8.10
Benefits of ABM	1. Cost Reduction, 2. Budget Implementation, 3. Cost Definition,	4. Management Decision Making & 5. Efficient Resource Utilisation.	8.10
ABC Vs. ABM	ABC	ABM	8.10
	Technique of determining cost of activities & cost of output produced.	Focusses on planning, execution & measurement of activities as the key to competitive advantage.	
	Aims to generate improved cost data for use in managing activities.	Aims to use information given by ABC, for effective business processes and profitability.	
	It is the operational segment of ABM.	It is a conceptual aspect.	
ABB	1. Activity Based Budgeting (ABB) is a process of planning and controlling the expected activities of the Firm, to derive a cost-effective budget, that meets forecast workload and agreed strategic goals. 2. Concept of ABB: ABB focusses on activity / business processes. Resources required are determined on the basis of expected activities and workload. Expenses necessary to perform these activities are estimated, with a focus on overall efficiency. 3. Key Elements are – (a) Type, (b) Quantity, and (c) Cost of work / activity to be performed. 4. Advantages: (a) Better Cost Analysis, (b) Better Cost Control, (c) Management Focus, (d) Resource Management, and (e) Realistic Approach.		8.10

Issue	Points to remember	Page
DPP	Benefits: (a) Better Cost Analysis, (b) Better Pricing Decisions, (c) Better Management of Stores and Warehouse Space, and (d) Rationalisation of Product Ranges. DPP Indicators: (a) DPP as % of Sales, (b) DPP per unit of Time, (c) DPP per unit of Space.	8.11
Customer Profitability Analysis	Using ABC, profitability can be analysed customer group-wise, since ABC creates cost pools for activities. Customers use some activities but not all, and different groups of customers have different 'Activity Profiles'. Hence analysis of relative profitability based on customer category and related decision-making is called Customer Profitability Analysis.	8.12

Format of DPP Statement

Particulars / Product	A	B	C	D	Total
Selling Price per unit	XX	XX	XX	XX	XX
Less: Bought-in-Price per unit	XX	XX	XX	XX	XX
Gross Margin per unit	XX	XX	XX	XX	XX
Less: Directly Attributable Product Costs	XX	XX	XX	XX	XX
1. Warehousing and Storage Costs – e.g. space, insurance	XX	XX	XX	XX	XX
2. Transport Costs – e.g. fuel, vehicle maintenance, labour	XX	XX	XX	XX	XX
3. Product Batch Costs	XX	XX	XX	XX	XX
4. Inventory Financing Costs	XX	XX	XX	XX	XX
Direct Product Profit per unit	XX	XX	XX	XX	XX
Less: Indirect Costs and Common Overheads					XX
Net Profit					XX

FTR 9 Target Costing and Cost Reduction Aspects

Issue	Points to remember		Page
Steps in Target Costing	Step	Particulars	9.1
	1	Identify market requirements and product qualities / attributes.	
	2	Set Target Selling Price = customers' willingness to pay.	
	3	Set Target Production and Sales Volumes .	
	4	Establish Target Profit Margin for each product.	
	5	Set Target Cost (or Allowable Cost) per unit, for each product. Target Cost = Target Selling Price Less Target Profit Margin.	
	6	Determine Current Cost of producing the new product.	
	7	Set Cost Reduction Target in order to reduce Current Cost to Target Cost.	
	8	Analyse Cost Reduction Target into various components and identify cost reduction opportunities using VE & VA (for Direct Costs), and ABC (for Indirect Costs).	
	9	Achieve Cost Reduction & Target Profit by Effective Implementation of cost reduction strategies and decisions.	
10	Focus on further possibilities of cost reduction and maintaining the quality of product, i.e. Continuous Improvement program.		
Kaizen Costing	1. Ongoing continuous improvement program that focusses on waste reduction in the production process, thereby further lowering costs below the initial targets specified during design phase. 2. Small but significant cost reductions achieved during implementation stage, on account of workers' involvement. 3. Kaizen Costing is intended to repeat many of the Value Engineering steps, continuously and constantly refining the process, thereby eliminating out extra costs at each stage.		9.3
Steps in implementing Target Costing	1. Customer – Product Design Specification 2. Market – Target Selling Price and Production Volume 3. Profitability – Target Profit Margin	4. Setting Target Costs 5. Computing Current Costs 6. Setting Cost Reduction Targets 7. Identifying Cost Reduction Opportunities	9.2