Cost Accounting (462-1st) B.Com
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Q No 1:"Financial accounting procedures are generally designed to ascertain the periodic profit or loss, but there are important limitations and deficiencies in the system".

Answer: LIMITATIONS

Financial accounting suffers from the following limitations which have been responsible forthe emergence of cost and management accounting:

1. Financial accounting does not provide detailed cost information for different departments, processes, products, jobs in the production divisions. Similarly, separate cost data are not available for different services and functions in the administration division. Management may need information about different products, sales territories and sales activities which are also not available in financial accounting.
2. Financial accounting does not set up a proper system of controlling materials and supplies. Undoubtedly, if material and supplies are not controlled in a manufacturing concern, they will lead to losses on account of misappropriation, mis-utilisation, scrap, defectives, etc. They may, in turn, influence the reported net income of a business enterprise.
3. Recording and accounting for wages and labour is not carried out for different jobs, processes, products, departments. This creates problems in analyzing the cost associated with different activities. This also does not provide a basis for rewarding workers and employees for the above-average performance.
4. It is difficult to know the behaviour of costs in financial accounting as expenses are not assigned to the product at each stage of production. Expenses are not classified into direct and indirect, and therefore, cannot be classified as controllable and uncontrollable. Control of cost which is the most important objective of all business enterprise cannot be achieved with the aid of financial accounting alone.
5. Financial accounting does not possess an adequate system of standards to evaluate the performance of departments and employees working in the departments. Standardisation is now applied to all elements of business. Standards need to be developed for materials, labour and overheads so that a firm can compare the work of labourers, workers, supervisors and executives with what should have been done in an allotted period of time.
6. Financial accounting contains historical cost information which is accumulated at the end of the accounting period. This accounting does not provide day-to-day information about costs and expenses. This is the reason why much dissatisfaction has been shown with external financial reporting. Historical cost is not a reliable basis for predicting future earnings, solvency, or overall managerial effectiveness. Historical cost information is relevant but not adequate for all purposes. It is now rightly contended that current cost information should be reported along with historical cost information.
7. Financial accounting does not provide information to analyze the losses due to various factors, such as idle plant and equipment, seasonal fluctuations in volume of business, etc. It does not help management in taking important decisions about expansion of business, dropping a product line, starting with a new product, alternative methods of production, improvement in product, etc. Managerial decisions about these

business matters have now become vital for the survival and growth of business enterprises.

DEFICIENCIES

Financial accounting is the only branch of accounting and it is not perfect. There are large numbers of limitations which open new way to use other tools of accounting. To know what are the main limitations of financial accounting. It is very necessary for accountants. Accountants are often blind to these limitations. So, I am covering its limitation a lot of ground.

1. Financial accounting is of historical nature

Net effect of transactions are recorded in financial accounting which has happened in past. These accounts is just postmortem of all events of business in past .These record does not help for future planning and other managerial decisions. Financial accounting shows the profitability of business but it is failure to tell that is it good or bad. Financial accounting is also failure to know the reasons of low profitability position.

2. Financial accounting deals with overall profitability

Accounts of business are made by a way which shows only overall profitability .It does not shows net profit per product , or per department or according to job . Thus to find difficult to all activities which do not give profit. So, it creates inefficiency in business activities.

3. Absence of full disclosure of facts

In financial accounting we record only those activities and transactions which we can show or describe in money. There are many other facts of business which are non-financial and non-monetary like efficient management, demand of products of firm, good relations in industry, good working environments which cannot be known by financial accounting.

4. Financial reports are interim report of business

Financial statements made by financial accounting is the interim report of firm's all business work but financial position and profitability which are shown in it is not fully true . Due to adopting cost concept, all transactions are recorded on it real cost but by changing in the time; it is the need of time to adjust cost of assets and liabilities according to inflation of market. Because, financial accounting does not records according to inflation so its result does not show true position of business.

5. Incomplete knowledge of costs

From cost point of view, financial accounting is incomplete. In financial accounting, accountant does not calculate each and every product's total cost. So, financial accounting does not help to determine the price of product of business.

6. No provision of cost control

Financial accounting does not help business organization for controlling the cost. Because, there is no provision of controlling cost in it. In financial accounting, we write cost, if we paid any expenses. Thus there is no provision of improvement in financial accounting. Except this, there is no any other way to inspect all expenses.

7. Financial statements are affected from personal judgment

Many events of financial statements are affected from personal judgement of accountant. Method of calculating depreciation, rate of provision of doubtful debts and stock valuation method are decided by accountant. Thus, financial statements do not show true and fair view of business.

8.No clear idea of operating efficiency

Financial accounting gives complete information related to increase and fall in prices. It doesn't portrays the clear image of operating efficiency whenever there is increase or fall out on prices during the image or dispersion.

9. Weakness not spotted out by collective result

Businesses prepare account in financialyear at the end of year and consider the business as a one whole unit. Rather thandisclosing results one by one of particular job departments it just gives the joint result ofwhole business. So at times when there is inflation or depression it doesn't give properresult due to in efficiency and at that time companies weaknesses are less likely to be spot.

10. Not helpful in the price fixation

Financial accounting doesn't play any role regarding in the price fixation.

Q No 2: Tennessee Tack manufactures horse blankets. In 2015, fixed overhead was applied to products at the rate of Rs. 8 per unit. Variable cost per unit remained constant throughout the year. In July 2015, income under variable costing was Rs. 188,000. July's beginning and ending inventories were 20,000 and 10,400 units, respectively.

- i. **Calculate income under absorption costing assuming no variances.**
- ii. **Assume instead that the company's July beginning and ending inventories were 9,000 and 12,000 units, respectively. Calculate income under absorption costing.**

Solution:

(i) Income under absorption costing assuming no variances

Income under Variable Costing		Rs. 188,000	
(+) Ending Inventories	10,400 x 8 = 83,200		271,200
(-) Beginning Inventories	20,000 x 8 = 160,000		111,200

=Rs. 111,200

(ii) Income under absorption costing

Income under Variable Costing		Rs. 188,000	
(+) Ending Inventories	12,000 x 8 = 96,000		200,000
(-) Beginning Inventories	9,000 x 8 = 72,000		72,000

= **Rs. 128,000**

Q No 3: Wasik Company had the following inventory balances at the beginning and end of August 2015:

	August 1	August 31
Raw Material inventory	**Rs. 58,000**	**Rs. 84,000**
Work in Process Inventory	**372,000**	**436,000**
Finished Goods inventory	**224,000**	**196,000**

All raw materials are direct to the production process. The following information is also available about August manufacturing costs:

Cost of raw material used	**Rs. 612,000**
Direct labour cost	**748,000**
Manufacturing overhead	**564,000**

a) Calculate the cost of goods manufactured for August.

b) Determine the cost of goods sold for August

Solution:Wasik Company

Cost of Goods Manufactured and Sold Statement

For the year ended August, 31, 2015

Direct Materials:	**Rs.**	
Material (opening)	58,000	
Add: Purchases	612,000	
Material available for use	670,000	
Less: Material (closing)	84,000	
Total material used		586,000
Add: Direct Labour		748,000
		1,334,000
Add: Factory overhead		564,000
Total Manufacturing Cost		1,898,000
Add: Work in process (opening)		372,000
Cost of goods available for manufacturing		2,270,000
Less: Work in process (closing)		436,000
Cost of goods manufactured		**1,834,000**
Add: Finished goods (opening)		224,000
Cost of goods available for sale		**2,058,000**
Less: Finished goods (closing)		196,000
Cost of goods sold		**1,862,000**

Q No 4: Explain the terms minimum level, maximum level and ordering level with regard to maintenance of stocks. What are the factors to be taken into account in fixing these levels?

Answer: Minimum Level

Minimum level or safety stock level is the level of inventory, below which the stock of materials should not be fall. If the stock goes below minimum level, there is a possibility that the production may be interrupted due to shortage of materials. In other words, the minimum level represents the minimum quantity of the stock that should be held at all times.

The minimum level is determined by using the following formula:
Minimum Level = Re-order level - (Normal consumption x Normal Re-order Point)

Maximum Level
Maximum level is that level of stock, which is not normally allowed to be exceeded. Beyond the maximum stock level, a blockage of capital should be exercised to check unnecessary stock. The factory should not keep materials more than the maximum stock level. It increases the carrying cost of holding unnecessary inventory level. It is the opportunity cost of holding inventory.
The maximum stock level can be calculated by using the following formula:
Maximum Level = Re-order Level + Re-order quantity - (Minimum consumption x Minimum Delivery Time)

Ordering Level: Reorder level (or reorder point) is the inventory level at which a company would place a new order or start a new manufacturing run.

Reorder Level = Lead Time in Days × Daily Average Usage
Lead time is the time it takes the supplier or the manufacturing process to provide the ordered units.
Daily average usage is the number of units used each day.
If a business is holding a safety stock to act as buffer if daily usage accelerates the reorder level would increase by the level of safety stock.
Reorder Level = Lead Time in Days × Daily Average Usage + Safety Stock
Determination of various levels of inventory is one of the prime responsibilities of Materials Department. The purpose behind setting of different stock levels is to ensure smooth operation of the enterprise and allocation of appropriate amount of monetary resources to different items in the inventory. A number of factors affect the determination of stock levels for different items. Some of these are:

- Rate of consumption
- Lead time
- Storage /warehousing /carrying costs
- Insurance cost
- Seasonal considerations
- Price fluctuations
- Economic Order Quantity (EOQ)
- Quality of raw material
- Availability of space
- Availability of funds
- Government and other legal and statutory requirements.

A systematic material control results in economy and efficiency in the maintenance of each item of inventory and at the same time ensures that it is available as and when required. It helps in avoiding blocking up of funds in unnecessary stock items. Now, coming back to the topic under discussion, to ensure smooth running of production process, the materials department of an enterprise sets different levels for each item of inventory.

Q No 5: Insides, an interior decorating firm, uses a job order costing system and apply overhead to jobs using a predetermined rate of Rs. 17 per direct labor hour. On June 1, 2015, Job #918 was the only job in process. Its cost included direct material of Rs. 8,250 and direct labor or Rs. 500(25 hours at Rs. 20 per hour). During June, the company began work on Jobs #919, #920 and #921. Direct material used for June totaled Rs. 21,650. June's direct labor cost totaled Rs. 6,300. Job #920 had not been completed at the end of June and its direct material and direct labor charges were Rs. 2,850 and Rs. 800 respectively. All other jobs were completed in June.

   a) What was the cost of Job #920 as of the end of June 2015?
   b) What was the cost of goods manufactured for June 2015?
   c) If actual overhead for June was Rs. 5,054, was the overhead under applied or over applied for the month? By how much?

Solution (a):

a) The cost of Job #920 as of the end of June 2015:

Total cost of Job #920 = Direct material + Direct Labor
Total cost of Job #920 = Rs. 2,850 + Rs. 800
Total cost of Job #920 = **Rs. 3,650**

b) The cost of goods manufactured for June 2015:

Total cost of Direct Material all the Jobs =Rs. 21,650 + Rs. 2,850
Total cost of Direct Material all the Jobs = **Rs. 24,500**
Total cost of Direct Labor all the Jobs = Rs. 6,300 + Rs. 800
Total cost of Direct Labor all the Jobs = **Rs. 7,100**
Cost of goods manufactured = total direct material used + total direct labor
= Rs. 24,500 + Rs. 7,100
= **Rs. 31,600**

c) Under-applied or over-applied for the month:

	Rs.
Actual FOH	5,054
Applied Factory overhead	6,300
Over-applied	**1246**

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