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A WORD ABOUT STUDY MATERIAL

The Study Material has been divided into two parts, namely, Study Material dealing with conceptual theoretical framework; and Practice Manual. The Study Material has been designed having regard to the needs of home study and distance learning students in mind. The students are expected to cover the entire syllabus and also do practice on their own while going through the Practice Manual.

The Study Material deals with the specific conceptual theoretical framework of cost accounting in detail. The main features of Study Material are as under:

- The entire syllabus has been divided into thirteen chapters.
- The chapters have been grouped into two modules
  - Module- 1 consisting of four chapters namely :
    - Chapter- 1: Basic Concepts
    - Chapter- 2: Material
    - Chapter- 3: Labour
    - Chapter- 4: Overheads
  - Module- 2 consisting of nine chapters namely:
    - Chapter- 5: Non-integrated Accounts
    - Chapter- 6: Job Costing and Batch Costing
    - Chapter- 7: Contract Costing
    - Chapter- 8: Operating Costing
    - Chapter- 9: Process & Operation Costing
    - Chapter- 10: Joint Products & By Products
    - Chapter- 11: Standard Costing
    - Chapter- 12: Marginal Costing
    - Chapter- 13: Budgets and Budgetary Control
- In each chapter, learning objectives have been stated. The learning objectives would enable you to understand the sequence of various aspects dealt within the chapter before going into the details so that you know the direction of your studies.
In each chapter, the topic has been covered in step by step approach. The text has been explained, where appropriate, through illustrations and practical problems. You should go through the chapter carefully ensuring that you understand the topic and then can tackle the exercises.

Main features of Practice Manual are as under:

- Questions bunch with compilation of questions appearing during last examinations also.
- Important definitions, equations and formulae have been given before each topic for quick recapitulation. Students are expected to attempt the questions and then compare it with the actual answers.
- Aims to provide guidance as to the manner of writing an answer in the examination.
- Feedback form is given in the Module-1 of the Study Material wherein students are encouraged to give their feedback/ suggestions.

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).

Every effort has been made to make the 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 at sanjitsharma@icai.in; deepak.gupta@icai.in and nnsengupta@icai.in.
SYLLABUS

PAPER – 3 : COST ACCOUNTING AND FINANCIAL MANAGEMENT

(One paper— Three hours— 100 Marks)

Level of Knowledge: Working knowledge

PART – I : COST ACCOUNTING (50 MARKS)

Objectives:
(a) To understand the basic concepts and processes used to determine product costs,
(b) To be able to interpret cost accounting statements,
(c) To be able to analyse and evaluate information for cost ascertainment, planning, control and decision making, and
(d) To be able to solve simple cases.

Contents
1. Introduction to Cost Accounting
   (a) Objectives and scope of Cost Accounting
   (b) Cost centres and Cost units
   (c) Cost classification for stock valuation, Profit measurement, Decision making and control
   (d) Coding systems
   (e) Elements of Cost
   (f) Cost behaviour pattern, Separating the components of semi-variable costs
   (g) Installation of a Costing system
   (h) Relationship of Cost Accounting, Financial Accounting, Management Accounting and Financial Management.

2. Cost Ascertainment
   (a) Material Cost
      (i) Procurement procedures— Store procedures and documentation in respect of receipts and issue of stock, Stock verification (ii)Inventory control —
Techniques of fixing of minimum, maximum and reorder levels, Economic Order Quantity, ABC classification; Stocktaking and perpetual inventory

(iii) Inventory accounting

(iv) Consumption — Identification with products of cost centres, Basis for consumption entries in financial accounts, Monitoring consumption.

(b) Employee Cost

(i) Attendance and payroll procedures, Overview of statutory requirements, Overtime, Idle time and Incentives

(ii) Labour turnover

(iii) Utilisation of labour, Direct and indirect labour, Charging of labour cost, Identifying labour hours with work orders or batches or capital jobs

(iv) Efficiency rating procedures

(v) Remuneration systems and incentive schemes.

(c) Direct Expenses

Sub-contracting — Control on material movements, Identification with the main product or service.

(d) Overheads

(i) Functional analysis — Factory, Administration, Selling, Distribution, Research and Development Behavioural analysis — Fixed, Variable, Semi variable and Step cost

(ii) Factory Overheads — Primary distribution and secondary distribution, Criteria for choosing suitable basis for allotment, Capacity cost adjustments, Fixed absorption rates for absorbing overheads to products or services

(iii) Administration overheads — Method of allocation to cost centres or products

(iv) Selling and distribution overheads — Analysis and absorption of the expenses in products/customers, impact of marketing strategies, Cost effectiveness of various methods of sales promotion.

3. Cost Book-keeping

Cost Ledgers—Non-integrated accounts, Integrated accounts, Reconciliation of cost and financial accounts.
4. Costing Systems
   (a) Job Costing
       Job cost cards and databases, Collecting direct costs of each job, Attributing overhead costs to jobs, Applications of job costing.
   (b) Batch Costing
   (c) Contract Costing
       Progress payments, Retention money, Escalation clause, Contract accounts, Accounting for material, Accounting for plant used in a contract, Contract profit and Balance sheet entries.
   (d) Process Costing
       Double entry book keeping, Process loss, Abnormal gains and losses, Equivalent units, Inter-process profit, Joint products and by products.
   (e) Operating Costing System

5. Introduction to Marginal Costing
   Marginal costing compared with absorption costing, Contribution, Breakeven analysis and profit volume graph.

6. Introduction to Standard Costing
   Various types of standards, Setting of standards, Basic concepts of material and Labour standards and variance analysis.

7. Budget and Budgetary Control
   The budget manual, preparation and monitoring procedures, budget variances, flexible budget, preparation of functional budget for operating and non operating functions, cash budget, master budget, principal budget factors.
Introduction

Cost Accounting and Financial Management is a subject which consists of two parts i.e. Cost accounting and Financial Management. The Cost Accounting part deals with basic concepts of Cost Accounting, elements of Cost, various methods of Costing and application of costing techniques. The basic objective of Cost Accounting part is as follows:

(a) To understand the basic concepts and processes used to determine product costs,
(b) To be able to interpret cost accounting statements,
(c) To be able to analyse and evaluate information for cost ascertainment, planning, control and decision making, and
(d) To be able to solve simple cases.

Outline of the Syllabus

The entire syllabus of the Cost Accounting part has been divided into thirteen chapters. The topics covered under these chapters are


Chapter Specific

- In the first chapter ‘Basic Concepts’, overview of all the concepts of Cost Accounting needs to be understood. The major parts which need to understand are definitions and different terminologies used in Cost Accounting and the context in which these are normally used. You are required to understand the objectives and importance of Cost Accounting system and its installation in industry, relation between Cost Accounting with other fields of study and its synchronisation with other related department/ stake holders to assist the management of the Organisation. Classification of cost, various elements and components of cost and various costing methods used in different industries need to be studied carefully. Theoretical questions are generally asked from this chapter almost in every examination. To answer these questions conceptual clarity and visualisation of practical life examples are necessary.

- The second chapter ‘Material’ is very important for the students. Students shall understand the concept, need and importance of materials in production system, various procedures involved in procuring, storing and issuing of material. You must know the
treatment of excess/ shortage of stores and valuation of store to be received, issued & stock at hand. Components which should form part of value of material should be understood; you may refer illustrations given in the Study Material. Generally problems on EOQ are solved using formula but some time instead of using formula answers to the questions is required to be done in tabular format as shown in the Study Material. You should also learn to draft format of Store Ledger under different valuation methods and accounting treatment. Treatment of normal and abnormal loss of materials, waste, scrap, spoilage and defectives in the Store ledger to be understood to arrive at correct stock position and its respective value. You should clearly know the differences between Simple average method and weighted average method of stock valuation. To avoid any confusion you should read the question carefully and understand the calculation under two methods of Valuation.

➢ In the third chapter ‘Labour’ students shall learn and understand the need of labour cost control, methods of attendance and payroll preparation procedures. Treatment of idle time and overtime both as normal and abnormal should be clearly understood by you. Students may also refer various illustrations given in the Study material for better and clear understanding. Labour Turnover is a term which can be heard in almost every industry; you should understand what exactly, labour turnover is, reasons for labour turnover and its impact on an organisation’s productivity directly and on image indirectly. Be conversed with various methods of computing labour turnover and Incentive plans to the workers. Students should be acquaintance with of different systems of wage payment and Incentives through practicing different types of problems. In examination generally questions are asked to compute Incentives based on a particular incentive plan or make comparison between two given plans. Students are advised to avoid selective study like only Rowan or Halsey method of bonus plan.

➢ The fourth chapter ‘Overheads’ in which students shall understand the meaning and difference between direct cost and indirect cost i.e. overheads. Overheads are generally associated with more than one department or product line. Overheads are distributed amongst the concerned departments/ product lines using a basis. Distribution of overheads is called allocation of overheads or apportionment of overheads or absorption of overheads. Understanding the meaning and differences among the terms such as allocation, apportionment and absorption of overhead is important for conceptual clarity. As stated above overheads are allocated/ apportioned/ absorbed using some basis e.g. primary distributions are done using labour hours, machine hours, floor area, capacity, number of staff etc. Students should be versed with treatment of under absorption and over absorption of overheads through application of supplementary rate while ascertaining the cost of a particular product or department. You should also learn different methods of secondary distribution and calculation involved therein. Students should do thorough practice to avoid computational errors. Some time questions are related with capacity determination, in this regard students should be familiar with terms such as Installed/ Rated capacity, normal capacity, practical capacity, actual capacity etc. Question may be asked to calculate idle capacity and/or cost.
In the Fifth chapter ‘Non-Integrated Accounts’ students shall acquainted with both Integrated and Non-Integrated systems of accounting and different ledgers account to be opened under the two methods of cost accounting. You should know the reasons for the differences between profit as per the financial accounting and the cost accounting and ways to reconcile it. Accounting treatment of over absorption and under absorption of overheads should be understood.

The sixth, seventh and eighth chapters consist of Job Costing and Batch Costing, Contract Costing, Operating Costing and Multiple Costing. Here students should understand the meaning and distinctive features of above mentioned methods of costing and the accounting procedures to be applied in the above mentioned different methods of costing. Students shall be conversed with the adjustment of opening and closing stock of raw material, work in process and finished goods while preparation of Job/ Batch cost sheet. In Contract Costing profit from the contract is recognised using percentage of completion method. To arrive at it various factors such as Value of contract, Cost of Work certified, work uncertified, retention money, cash received should be understood. Computation of notional profit and estimated profit shall be learned. You should understand effects of escalation clause both to contractor and contractee and revision of work certified.

The ninth and tenth chapters consist of Process & Operation Costing and Joint Products and By Products. Area of application of the above costing methods and accounting difference among these should be understood. Process Costing method is followed in an industry where a product passing through various identifiable processes, where output of one process becomes the input of succeeding process and so on till it reaches its final shape. Students should be able to identify each process and related cost. Production being a continuous process where some incomplete (work in process) stock remains a possibility. To find out accurate cost incurred and output for a given period ‘Statement of Equivalent Production’ is prepared. Students should be able to calculate equivalent production for a given period with the use of any methods of inventory valuation. Students may refer illustrations given in the Study material for practice and clarity. One most important area of calculation is the treatment of normal loss, abnormal losses/gains, adjustment for scrap in ascertainment of actual abnormal loss/gain.

Some time more than one final products are obtained from a common process or input. Students shall know the treatment of joint cost to joint products for stock valuation purposes. Joint costs are apportioned using various methods such as based on sales value or based on volume etc. students may refer illustrations given in the Study Material for clear understanding. Some time questions may be asked on selling price at which a particular product can be sold or should be sold after further processing. Various illustrations have been given in the Study materials showing this type of calculations. Similarly all other methods such as operation costing and costing for By Products should be understood.
The eleventh chapter is ‘Standard Costing’. First of all students should understand the meaning of standard cost and what is actual cost. The difference between standard values with actual value is called variance; Variances are calculated using some rational and conventional formulas. Formulas and its logical interlinks for finding out variances should be understood. Mere mugging up of formulas without proper understanding of its relationship will not going to help, as this chapter is just an introduction, clear understanding will definitely help students at Final level where numerical are based on practical situations. Students should also understand the accounting procedures and disposition of variances. Classification of variances and interrelationship could be understood from the chart given in the study material. This chapter requires lots of practice.

‘Marginal Costing’ is the twelfth chapter of Cost Accounting at IPCC level and is one of the most vital chapter. Basic marginal equations and formulas should be understood. Students should be able to extract Profit Volume Ratio (P/V Ratio), Break Even Point/sales, margin of safety, contribution, bifurcation of fixed cost from semi variable cost. Difference between marginal costing and absorption costing should be understood as some time you are required to reconcile figures from one method to another. Specimen Income Statement given in Study material is very helpful for clear understanding of the differences and treatment.

In thirteenth chapter ‘Budgets and Budgetary Control’, objectives and importance of budgets and budgetary control, advantages and disadvantages of budgetary control should be understood. You are also required to learn the difference between various types of budgets and process of preparation of budgets. Generally preparation of flexible budget segregation of fixed cost and variable cost is required, so segregation techniques should be learnt (also discussed in Chapter-1). It is important for the students to understand inter linkage among different functional budget while answering question on functional budget. You may refer illustrations given in the Study Material.

Happy Reading and Best Wishes!
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