

STRATEGIC COST ANALYSIS

BBA Semester 3 – Calicut University

DegreeLive

MODULE 1: INTRODUCTION TO COST ACCOUNTING

1. Cost – Meaning, Definition and Scope

- Cost refers to the amount of expenditure incurred for producing a product or rendering a service.
- It includes material cost, labour cost and expenses.
- Cost is measured in monetary terms.
- Every business incurs costs to generate revenue.

Scope of Cost

- Cost ascertainment.
- Cost control.
- Cost reduction.
- Cost analysis.
- Cost comparison.
- Decision making.

Exam line: Cost represents the sacrifice made to obtain a product or service.

2. Cost Accounting – Meaning and Definition

- Cost Accounting is the process of recording, classifying, analyzing and controlling costs.
- Helps determine the cost of products and services.
- Provides information for managerial decision-making.
- Focuses on cost control and cost reduction.

Objectives

- Determine cost of production.
- Control costs.
- Assist management decisions.
- Improve efficiency.
- Increase profitability.

Exam line: Cost accounting helps management know where money is spent and how costs can be controlled.

3. Elements of Cost, Cost Unit and Cost Centre

Elements of Cost

- **Material:** Cost of raw materials used in production.
- **Labour:** Wages paid to workers.
- **Expenses:** Other costs incurred during production.

Cost Unit

Unit used to measure cost.

Example: Per unit, Per tonne, Per kilometre, Per passenger.

Cost Centre

Location, department or person for which costs are collected. Helps in cost control.

Examples: Production department, Maintenance department.

Exam line: Material, labour and expenses are the three basic elements of cost.

4. Cost Classification

According to Nature

- Material Cost.
- Labour Cost.
- Expenses.

According to Function

- Production Cost.
- Administration Cost.
- Selling Cost.
- Distribution Cost.

According to Behaviour

- Fixed Cost.
- Variable Cost.
- Semi-variable Cost.

According to Controllability

- Controllable Cost.
- Uncontrollable Cost.

According to Normality

- Normal Cost.
- Abnormal Cost.

Exam line: Cost classification helps management understand and control different types of costs.

5. Cost Sheet

Meaning

Statement showing detailed cost of production. Helps determine total cost and profit.

Components

Prime Cost, Factory Cost, Cost of Production, Cost of Sales, Profit.

Format

Raw Materials Consumed
Direct Labour
Direct Expenses
= Prime Cost
Factory Overheads
= Factory Cost
Office Overheads
= Cost of Production
Selling & Distribution Overheads
= Cost of Sales
Profit
= Sales

Exam line: A cost sheet provides detailed information regarding the cost structure of a product.

6. Cost Accounting vs Financial Accounting vs Management Accounting

Cost Accounting	Financial Accounting	Management Accounting
Determines cost	Records financial transactions	Assists managerial decisions
Internal use	External reporting	Internal use
Cost control	Profit determination	Planning and control
Detailed cost data	Overall financial position	Future-oriented

Cost Accounting

Focuses on cost determination and control.

Financial Accounting

Records business transactions. Prepares financial statements.

Management Accounting

Provides information for planning and decision-making.

Exam line: Cost accounting determines cost, financial accounting reports performance and management accounting supports decisions.

MODULE 2: MATERIAL, LABOUR AND OVERHEAD ACCOUNTING

7. Material Control Techniques

Meaning

Techniques used to ensure efficient use of materials.

Objectives

- Avoid wastage.
- Prevent theft.

- Maintain optimum stock.
- Reduce material cost.

Techniques

- Stock Levels.
- EOQ (Economic Order Quantity).
- ABC Analysis.
- Perpetual Inventory System.
- Stock Verification.

Exam line: Material control ensures availability of materials at minimum cost.

8. Issue of Material, Stock Verification and Pricing of Material

Issue of Material

Materials released from store to production department. Proper records must be maintained.

Stock Verification

Physical checking of inventory. Ensures accuracy of stock records. Detects shortages and excesses.

Pricing of Material

Methods used to determine issue price of materials: FIFO, LIFO, Simple Average, Weighted Average.

Exam line: Stock verification helps compare physical stock with recorded stock.

9. FIFO, LIFO, Simple Average and Weighted Average

FIFO (First In First Out)

- First purchased materials are issued first.
- Closing stock consists of latest purchases.
- **Advantages:** Simple, Suitable during stable prices.

LIFO (Last In First Out)

- Latest purchased materials are issued first.
- Closing stock consists of oldest materials.
- **Advantages:** Useful during inflation.

Simple Average Method

Issue Price = Total Prices ÷ Number of Purchases

Weighted Average Method

Issue Price = Total Cost ÷ Total Quantity

Exam line: FIFO issues oldest stock first while LIFO issues newest stock first.

10. Labour, Time Wage System, Piece Wage System, Halsey Plan and Rowan Plan

Labour

Human effort used in production.

Time Wage System

Wages based on time worked.

Formula: Wages = Hours Worked × Rate per Hour

Advantages: Simple, Easy to calculate.

Piece Wage System

Wages based on units produced.

Formula: Wages = Units Produced × Rate per Unit

Advantages: Encourages productivity.

Bonus Plans

- **Halsey Plan:** Worker receives a share of time saved.
- **Rowan Plan:** Bonus based on proportion of time saved.

Exam line: Time wages depend on time worked while piece wages depend on output produced.

11. Overhead – Meaning and Definition

Meaning

Indirect costs incurred in business operations. Cannot be directly traced to a product.

Examples

Factory rent, Electricity, Supervisor salary, Insurance.

Types

Factory Overheads, Administration Overheads, Selling Overheads, Distribution Overheads.

Exam line: Overheads are indirect costs necessary for business operations.

12. Allocation of Overheads

Meaning

Charging an entire overhead cost to a specific cost centre.

Characteristics

Direct assignment. No sharing between departments.

Examples

Salary of department supervisor, Rent of exclusive department building.

Exam line: Allocation assigns overhead cost directly to a cost centre.

13. Apportionment and Absorption of Overheads

Apportionment

Distribution of common overheads among departments. Used when overhead benefits multiple departments.

Examples: Electricity, Rent, Insurance.

Absorption

Charging overheads to units produced. Ensures product cost includes overhead expenses.

Exam line: Apportionment distributes overheads among departments while absorption charges overheads to products.

14. Overhead Problems – Key Concepts

- **Allocation:** Direct charging of overheads.
- **Apportionment:** Distribution of common overheads.

- **Re-apportionment:** Redistribution of service department costs.
- **Absorption:** Charging overheads to production.

Bases Used

Floor Area, Number of Employees, Machine Hours, Labour Hours.

Exam line: Overhead distribution is essential for accurate product costing.

MODULE 3: DECISION MAKING WITH MANAGEMENT ACCOUNTING INFORMATION

15. Marginal Costing – Concept and Meaning

Meaning

Technique where only variable costs are charged to products. Fixed costs treated as period costs.

Features

- Focuses on contribution.
- Useful for decision-making.
- Helps profit planning.

Importance

Cost control, Product pricing, Profit analysis, Decision making.

Exam line: Marginal costing considers only variable costs for product costing.

16. Contribution, PV Ratio and Margin of Safety

Contribution

Formula: Contribution = Sales – Variable Cost

Importance: Covers fixed costs, Generates profit.

Profit Volume Ratio (PV Ratio)

Formula: PV Ratio = (Contribution ÷ Sales) × 100

Importance: Measures profitability.

Margin of Safety

Formula: Margin of Safety = Actual Sales – Break Even Sales

Importance: Indicates business safety level.

Exam line: Contribution is the excess of sales over variable cost.

17. Break Even Point (BEP) and Break Even Chart

Break Even Point

Point where total cost equals total revenue. No profit and no loss.

Formula

BEP (Units) = Fixed Cost ÷ Contribution per Unit

Break Even Chart

Graphical presentation of costs and revenue. Shows BEP visually.

Uses

Profit planning, Decision making, Cost control.

Exam line: Break Even Point represents the no-profit no-loss position.

18. Cost Volume Profit Analysis (CVP)

Meaning

Study of relationship among cost, volume and profit.

Assumptions

- Selling price remains constant.
- Costs can be classified into fixed and variable.
- Production equals sales.

Importance

Profit planning, Decision making, Budget preparation, Cost control.

Factors Affecting Profit

Selling Price, Sales Volume, Variable Cost, Fixed Cost.

Exam line: CVP analysis helps managers understand how changes in cost and sales affect profit.

MODULE 4: BUDGETING AND CONTROL

19. Budget and Budgetary Control

Budget

Financial plan prepared for a future period. Expressed in monetary or quantitative terms.

Budgetary Control

System of planning and controlling activities through budgets.

Objectives

Planning, Coordination, Cost control, Performance evaluation, Profit maximization.

Advantages

Better resource utilization, Improved efficiency, Better decision making.

Exam line: Budgetary control compares actual performance with budgeted performance.

20. Types of Budgets, Fixed Budget, Flexible Budget and Cash Budget

- **Fixed Budget:** Prepared for a single level of activity. Does not change with output.
- **Flexible Budget:** Prepared for different levels of activity. Adjusts with business volume.
- **Cash Budget:** Forecast of cash receipts and payments. Helps manage liquidity.

Other Budgets

Sales Budget, Production Budget, Purchase Budget, Labour Budget.

Exam line: Flexible budgets are more useful than fixed budgets in changing business conditions.

21. Preparation and Interpretation of Budgets

Cash Budget Shows:

- Expected cash inflows.
- Expected cash outflows.
- Cash surplus or deficit.

Fixed Budget

Prepared for one activity level. Used when activity remains stable.

Flexible Budget

Prepared for multiple activity levels. Suitable for dynamic environments.

Importance

Better planning, Effective control, Improved financial management.

Exam line: Budget interpretation helps management evaluate future financial performance.

22. Zero Base Budgeting (ZBB)

Meaning

Budget prepared from zero base. Every expense must be justified. Previous budgets are not automatically accepted.

Features

Starts from scratch, Cost-benefit evaluation, Resource optimization, Focus on efficiency.

Advantages

Eliminates unnecessary expenses, Improves resource allocation, Increases accountability.

Limitations

Time-consuming, Requires extensive analysis.

Exam line: Zero Base Budgeting requires every activity and expenditure to be justified from the beginning.

LAST-MINUTE EXAM FACTS

- Cost = Expenditure incurred for production.
- Cost Accounting = Cost determination and control.
- Elements of Cost = Material + Labour + Expenses.
- Cost Sheet shows cost structure of a product.
- FIFO = First In First Out.
- LIFO = Last In First Out.
- Time Wage → Based on time worked.
- Piece Wage → Based on output produced.
- Overheads = Indirect costs.
- Allocation = Direct assignment.
- Apportionment = Distribution among departments.
- Absorption = Charging overheads to products.
- Contribution = Sales – Variable Cost.
- PV Ratio = $(\text{Contribution} \div \text{Sales}) \times 100$.

- Margin of Safety = Actual Sales – BEP Sales.
- BEP = No Profit No Loss Point.
- CVP = Relationship between Cost, Volume and Profit.
- Fixed Budget = Single activity level.
- Flexible Budget = Multiple activity levels.
- Cash Budget = Cash receipts and payments.
- ZBB = Budget starts from zero.

DegreeeLive