

**MOCK TEST PAPER – II**  
**INTERMEDIATE (NEW): GROUP – I**  
**PAPER – 3: COST AND MANAGEMENT ACCOUNTING**  
**SUGGESTED ANSWERS/HINTS**

**1. (a) Employee turnover rate using:**

**(i) Separation Method:**

$$= \frac{\text{No. of workers left} + \text{No. of workers discharged}}{\text{Average number of workers}} \times 100$$

$$= \frac{(40+160)}{(3,800+4,200) \div 2} \times 100 = \frac{200}{4,000} \times 100 = 5\%$$

**(ii) Replacement Method:**

$$= \frac{\text{No. of workers replaced}}{\text{Average number of workers}} \times 100 = \frac{150}{4,000} \times 100 = 3.75\%$$

**(iii) New Recruitment Method:**

$$= \frac{\text{No. of workers newly recruited}}{\text{Average number of workers}} \times 100$$

$$= \frac{\text{No. of Recruitments} - \text{No. of Replacements}}{\text{Average number of workers}} \times 100$$

$$= \frac{600-150}{4,000} \times 100 = \frac{450}{4,000} \times 100 = 11.25\%$$

**(iv) Flux Method:**

$$= \frac{\text{No. of separations} + \text{No. of accessions}}{\text{Average number of workers}} \times 100$$

$$= \frac{(200+600)}{(3,800+4,200) \div 2} \times 100 = \frac{800}{4,000} \times 100 = 20\%$$

**(b) (i) Minimum stock of Pi**

$$\begin{aligned} &\text{Re-order level} - (\text{Average consumption} \times \text{Average time required to obtain delivery}) \\ &= 8,000 \text{ kg.} - (400 \text{ units} \times 5 \text{ kg.} \times 2 \text{ weeks}) = 4,000 \text{ kg.} \end{aligned}$$

**(ii) Maximum stock of Qu**

$$\begin{aligned} &\text{Re-order level} - (\text{Min. Consumption} \times \text{Min. delivery period}) + \text{Re-order quantity} \\ &= 4,750 \text{ kg.} - (350 \text{ units} \times 2 \text{ kg.} \times 3 \text{ weeks}) + 5,000 \text{ kg.} \\ &= 9,750 - 2,100 = 7,650 \text{ kg.} \end{aligned}$$

**(iii) Re-order level of Ar**

$$\begin{aligned} &\text{Maximum delivery period} \times \text{Maximum Usage} \\ &= 4 \text{ weeks} \times (450 \text{ units} \times 3 \text{ kg.}) = 5,400 \text{ kg.} \end{aligned}$$

OR

$$\begin{aligned} &= \text{Minimum stock of Ar} + (\text{Average consumption} \times \text{Average delivery time}) \\ &= 2,000 \text{ kg.} + [(400 \text{ units} \times 3 \text{ kg.}) \times 3 \text{ weeks}] = 5,600 \text{ kg.} \end{aligned}$$

(iv) Average stock level of Pi

$$= \text{Minimum stock level of Pi} + \frac{1}{2} \text{ Re-order quantity}$$

$$= 4,000 \text{ kg.} + \frac{1}{2} 10,000 \text{ kg.} = 4,000 + 5,000 = 9,000 \text{ kg.}$$

OR

$$= \frac{\text{Minimum stock} + \text{Maximum stock}}{2} \quad (\text{Refer to Working Note})$$

$$= \frac{4,000 + 16,250}{2} = 10,125 \text{ kg.}$$

#### Working note

Maximum stock of Pi = ROL + ROQ – (Minimum consumption × Minimum delivery period)

$$= 8,000 \text{ kg.} + 10,000 \text{ kg.} - [(350 \text{ units} \times 5 \text{ kg.}) \times 1 \text{ week}] = 16,250 \text{ kg.}$$

#### (c) Working Notes:

$$\begin{aligned} \text{(i) Total Productive hours} &= \text{Estimated Working hours} - \text{Machine Maintenance hours} \\ &= 2,200 \text{ hours} - 200 \text{ hours} = 2,000 \text{ hours} \end{aligned}$$

$$\text{(ii) Depreciation per annum} = \frac{\text{Rs. } 1,00,000 - \text{Rs. } 10,000}{10 \text{ years}} = \text{Rs. } 9,000$$

$$\text{(iii) Chemical solution cost per annum} = \text{Rs. } 200 \times 50 \text{ weeks} = \text{Rs. } 10,000$$

$$\text{(iv) Wages of attendants (per annum)} = \frac{\text{Rs. } 1,200 \times 50 \text{ weeks}}{6 \text{ machines}} = \text{Rs. } 10,000$$

#### Calculation of Machine hour rate

Particulars	Amount (Rs.) (per annum)	Amount (Rs.) (per hour)
A. Standing Charge		
(i) Wages of attendants	10,000	
(ii) Departmental and general works overheads	20,000	
Total Standing Charge	30,000	
Standing Charges per hour $\left(\frac{30,000}{2,000}\right)$		15.00
B. Machine Expense		
(iii) Depreciation	9,000	4.50
(iv) Electricity $\left(\frac{\text{Rs. } 0.9 \times 16 \text{ units} \times 1,900 \text{ hours}}{2,000 \text{ hours}}\right)$	-	13.68
(v) Chemical solution	10,000	5.00
(vi) Maintenance cost	12,000	6.00
<b>Machine operating cost per hour (A + B)</b>		<b>44.18</b>

#### (d) Statement of production

Operation	Input	Rejections		Output
		Total	% of output	
1	1,80,000	60,000	50	1,20,000

2	1,98,000	18,000	10	1,80,000
3	1,44,000	24,000	20	1,20,000

(i) **Determination of input required to obtain 500 pieces of finished output:**

Particulars	No. of pieces
Output required after operation 3	500
Add: Rejection in operation 3 (20%)	100
Output required after operation 2	600
Add: Rejection in operation 2 (10%)	60
Output required after operation 1	660
Add: Rejection in operation 1 (50%)	330
<b>Input required in operation 1</b>	<b>990</b>

(ii) **Calculation of cost of raw material:**

To produce 500 pieces of final output, 990 pieces of inputs are required at operation 1. Thus, to get a finished piece of 0.5 kg. of output, the weight of input required is:

$$= \frac{0.5}{500} \times 990 = 0.99 \text{ kg.}$$

The cost of raw material would be Rs. 80 × 0.99 kg. = Rs.79.20

2. (a) **Computation showing Rates for each Activity**

Activity	Activity Cost (Rs.) (A)	Activity driver	Activity Capacity (B)	Activity Rate (A/B)
Marketing Expenses	2,25,000	Number of Customer Contacts	7,50,000	0.30
Website Maintenance Expenses	1,50,000	Number of Customer Online orders	6,00,000	0.25
Credit Card Processing Fees	1,35,000	Number of Credit card transactions	2,70,000	0.50
Cleaning Equipment Cost	3,15,000	Number of Square Feet	10,500	30.00
Inspecting and Testing Cost	2,62,500	Number of Tests	52,500	5.00
Setting up machine's cost	4,50,000	Number of set-ups	900	500.00

**Activity based Cost for each Department**

Activity	Premium Hall (Rs.)	Recliner Hall (Rs.)	7D Hall (Rs.)	Cafeteria (Rs.)
Marketing Expenses	78,750 (2,62,500 x 0.3)	90,000 (3,00,000 x 0.3)	45,000 (1,50,000 x 0.3)	11,250 (37,500 x 0.3)
Website Maintenance Expenses	52,500 (2,10,000 x 0.25)	61,875 (2,47,500 x 0.25)	30,000 (1,20,000 x 0.25)	5,625 (22,500 x 0.25)
Credit Card Processing Fees	37,500 (75,000 x 0.5)	45,000 (90,000 x 0.5)	30,000 (60,000 x 0.5)	22,500 (45,000 x 0.5)
Cleaning Equipment Cost	90,000 (3,000 x 30)	1,35,000 (4,500 x 30)	67,500 (2,250 x 30)	22,500 (750 x 30)
Inspecting and Testing Cost	60,000 (12,000 x 5)	90,000 (18,000 x 5)	75,000 (15,000 x 5)	37,500 (7,500 x 5)
Setting up machine's cost	1,12,500 (225 x 500)	2,25,000 (450 x 500)	75,000 (150 x 500)	37,500 (75 x 500)
Total	4,31,250	6,46,875	3,22,500	1,36,875

**(i) Statement of Operating Income and Operating Income percentage for each Department**

Particulars	Premium Hall (Rs.)	Recliner Hall (Rs.)	7D Hall (Rs.)	Cafeteria (Rs.)
Revenues (Given) (A)	11,55,000	18,75,000	9,30,000	5,25,000
Cost of Goods Sold (given) (B1)	-	-	-	4,51,125
Digital Media Cost (given) (B2)	6,19,800	9,46,875	4,02,900	-
Activity Based Cost (as per Workings) (B3)	4,31,250	6,46,875	3,22,500	1,36,875
Operating Cost (B) (B1+ B2 + B3)	10,51,050	15,93,750	7,25,400	5,88,000
<b>Operating Income/(Loss) (C = A – B)</b>	1,03,950	2,81,250	2,04,600	(63,000)
<b>Percentage of profit/(loss) on sales</b>	<b>9%</b>	<b>15%</b>	<b>22%</b>	<b>(12%)</b>

**(ii) Contention of Supervisor is valid as operating income of Cafeteria is negative i.e. (Rs. 63,000) or percentage of profit/loss is (12%).**

(b) **Contract No. 1551 Account for the year ended 31<sup>st</sup> March, 2021**

Dr.		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Work in progress b/d:		By Material returned to stores	90,000
- Work certified	36,00,000	By Material returned to suppliers	60,000
- Work uncertified	60,000	By Stock (Materials) c/d	90,000
To Stock (Materials) b/d	45,000	By Work in progress c/d:	
To Material purchased	4,80,000	- Work certified	1,05,00,000
To Material issued	15,00,000	- Work uncertified	1,20,000
To Wages paid	21,00,000		
Less: Opening O/s	(30,000)		
Add: Closing O/s	60,000		
	21,30,000		
To Drawing and maps	1,80,000		
To Sundry expenses	45,000		
To Electricity charges	75,000		
To Plant hire expenses	1,80,000		
To Sub-contract cost	60,000		
To Notional profit c/d (balancing figure)	25,05,000		
	1,08,60,000		1,08,60,000

Dr.		Contractee's Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)		
To Balance c/d (Rs. 1,05,00,000 × 70%)	73,50,000	By Balance b/d (70% of Rs. 36,00,000)	25,20,000		
		By Bank A/c	48,30,000		
	73,50,000		73,50,000		

3. (a) **Costing Profit and Loss Account**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Direct Material consumed	22,40,000	By Sales	48,00,000
To Direct Wages	12,00,000	By Closing Work-in-process	96,000
Prime Cost	34,40,000	By Closing Finished stock	3,10,154
		$\left( \frac{\text{Rs. 41,28,000} - \text{Rs. 96,000}}{52,000 \text{ units}} \times 4,000 \right)$	
To Factory overheads (20% of prime cost)	6,88,000		
	41,28,000		

To Administrative overheads (Rs. 4.80 × 52,000* units)	2,49,600		
To Selling & distribution overheads (Rs.6.40 × 48,000 units)	3,07,200		
To Net profit (balancing figure)	5,21,354		
	52,06,154		52,06,154

\* Units produced = Units sold + Closing stock - Opening stock  
= 48,000 + 4,000 - 0 = 52,000 units

#### Financial Profit and Loss Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Direct Material consumed	20,00,000	By Sales	48,00,000
To Direct Wages	12,00,000	By Dividend received	40,000
To Factory overheads	6,40,000	By Interest on fixed deposit	8,000
To Administrative overheads	2,80,000	By Closing Work-in-process	96,000
To Selling & distribution overheads	3,84,000	By Closing Finished stock	3,20,000
To Bad debts	32,000		
To Preliminary expenses	16,000		
To Legal charges	4,000		
To Net profit (balancing figure)	7,08,000		
	52,64,000		52,64,000

#### Reconciliation Statement

Particulars	Amount (Rs.)	Amount (Rs.)
Net profit as per Financial Profit & Loss A/c		7,08,000
Add: Administrative overheads (2,80,000 - 2,49,600)	30,400	
Selling & Distribution overheads (3,84,000 - 3,07,200)	76,800	
Bad debts	32,000	
Preliminary expenses	16,000	
Legal charges	4,000	1,59,200
		8,67,200
Less: Difference in value of materials consumed (22,40,000 - 20,00,000)	2,40,000	
Factory overheads (6,88,000 - 6,40,000)	48,000	
Dividend received	40,000	
Interest on fixed deposit	8,000	
Closing stock (3,20,000 - 3,10,154)	9,846	(3,45,846)
Profit as per Costing Profit & Loss A/c		5,21,354

**(b) (i) Calculation of Factory overhead rate.**

If the single brand production was in operation, then

1 unit of Luxury = 3 units of Herbal = 6 units of Beauty. Therefore, the factory overhead ratio in the reverse order would be 5,000:15,000:30,000 or 1:3:6.

The overhead rate will be lowest in case of brand which will be produced in high number. Therefore, in case of Beauty soap brand, the overhead rate will be:

$$= \frac{80,000}{6 \times 6,750 + 3 \times 14,000 + 1 \times 77,500}$$

$$= \frac{80,000}{40,500 + 42,000 + 77,500}$$

$$= \frac{80,000}{1,60,000} = 0.5$$

So, the overhead rate will be:

$$\text{Luxury} = 0.5 \times 6 = \text{Rs. } 3$$

$$\text{Herbal} = 0.5 \times 3 = \text{Rs. } 1.5$$

$$\text{Beauty} = 0.5 \times 1 = \text{Rs. } 0.5$$

**(ii) Statement of Cost of Mix Soap Pvt. Ltd. for the month of June 2021:**

	Luxury (Rs.)	Herbal (Rs.)	Beauty (Rs.)	Total (Rs.)
Raw material consumed	20,000	47,000	2,40,000	3,07,000
Add: Wages paid	7,500	18,750	1,15,000	1,41,250
<b>Prime cost</b>	27,500	65,750	3,55,000	4,48,250
Add: Factory overheads	20,250 (Rs.3 x 6,750)	21,000 (Rs.1.5 x 14,000)	38,750 (Rs.0.5 x 77,500)	80,000
<b>Works cost</b>	47,750	86,750	3,93,750	5,28,250
Add: General & administration overheads (1:1:1)	16,000	16,000	16,000	48,000
Add: Selling expenses	9,550 (Rs.47,750 x 0.20)	17,350 (Rs.86,750 x 0.20)	78,750 (Rs. 3,93,750 x 0.20)	1,05,650
<b>Cost of sales</b>	73,300	1,20,100	4,88,500	6,81,900
Profit (Balancing figure)	95,450	89,900	1,31,500	3,16,850
<b>Sales</b>	1,68,750 (Rs.25 x 6,750)	2,10,000 (Rs.15 x 14,000)	6,20,000 (Rs.8 x 77,500)	9,98,750

**4. (a) (i) Calculation of Absolute Ton-km for the next month:**

Journey	Distance (in km)	Weight-Up (in MT)	Ton-km	Weight-Down (in MT)	Ton-km	Total
	(a)	(b)	(c) = (a)×(b)	(d)	(e) = (a)×(d)	(f) = (c)+(e)
Delhi to Kochi	2,700	15	40,500	7	18,900	59,400

Delhi to Guwahati	1,890	13	24,570	0	0	24,570
Delhi to Vijayawada	1,840	16	29,440	0	0	29,440
Delhi to Varanasi	815	11	8,965	0	0	8,965
Delhi to Asansol	1,280	13	16,640	5	6,400	23,040
Delhi to Chennai	2,185	11	24,035	9	19,665	43,700
Total	10,710	79	1,44,150	21	44,965	1,89,115

Total absolute Ton-Km = 1,89,115 ton-km

(ii) **Calculation of cost per ton-km:**

Particulars	Amount (Rs.)	Amount (Rs.)
A. Running cost:		
- Diesel Cost {Rs.15 × (10,710 × 2)}	3,21,300	
- Engine oil cost $\left(\frac{\text{Rs. } 4,200}{14,000 \text{ km}} \times 21,420 \text{ km}\right)$	6,426	
- Cost of loading of goods {Rs.200 × (79 + 21)}	20,000	
- Depreciation $\left(\frac{\text{Rs. } 20,00,000}{7,20,000 \text{ km}} \times 21,420 \text{ km}\right)$	59,500	4,07,226
B. Repair & Maintenance Cost $\left(\frac{\text{Rs. } 12,000}{10,000 \text{ km}} \times 21,420 \text{ km}\right)$		25,704
C. Standing Charges		
- Drivers' salary (Rs.20,000 × 5 trucks)	1,00,000	
- Cleaners' salary (Rs.7,000 × 5 trucks)	35,000	
- Supervision and other general expenses	15,000	1,50,000
Total Cost (A + B + C)		5,82,930
Total absolute ton-km		1,89,115
Cost per ton-km		3.08

(b) (i) **Statement of Equivalent Production (FIFO Method)**

Input		Output		Equivalent Production			
Particulars	Units	Particulars	Units	Material		Labour & Overhead	
				(%)	Units	(%)	Units
Opening WIP	16,000	Transfer to next Process:					
Introduced	3,64,000	Opening WIP completed	16,000	--	--	40	6,400
		Introduced & completed	3,00,000	100	3,00,000	100	3,00,000
		Normal loss 5% (16,000 + 3,64,000)	19,000	--	--	--	--
		Abnormal loss	9,000	100	9,000	80	7,200
		Closing WIP	36,000	100	36,000	70	25,200
	3,80,000		3,80,000		3,45,000		3,38,800



(ii) **Computation of Cost per unit**

Particulars	Material (Rs.)	Labour (Rs.)	Overhead (Rs.)
Input of Materials	14,75,000	--	--
Expenses	--	6,81,200	3,40,600
Total	14,75,000	6,81,200	3,40,600
Less: Sale of Scrap (19,000 units x Rs. 5)	(95,000)	--	--
Net cost (A)	13,80,000	6,81,200	3,40,600
Equivalent Units (B)	3,45,000	3,38,800	3,38,800
Cost Per Unit (A/B)	4.0000	2.0106	1.0053

Total cost per unit = Rs. (4.0000 + 2.0106 + 1.0053) = Rs. 7.0159

(iii) **Value of units transferred to next process:**

	Amount (Rs.)	Amount (Rs.)
Opening W-I-P	1,50,000	
Add: Labour (6,400 units × Rs. 2.0106)	12,868	
Overhead (6,400 units × Rs. 1.0053)	6,434	1,69,302
New introduced (3,00,000 units × Rs. 7.0159)		21,04,770
		22,74,072

5. (a) **Workings:**

**Statement Showing Profit on Sale of 90,000 units**

	(Rs.)	(Rs.)
Selling Price per unit		80
Less: Variable Cost per unit		
Material	32	
Conversion Cost	24	
Dealers' Margin	8	64
Contribution per unit		16
Total Contribution (90,000 units × Rs. 16)		14,40,000
Less: Fixed Cost		10,00,000
Profit		4,40,000

In both the proposed suggestions, the fixed costs remain unchanged. Therefore, the present profit of Rs. 4,40,000 can be maintained by maintaining the total contribution at the present level i.e. Rs. 14,40,000.

(i) **Reducing Selling Price by 5%**

New Selling Price (Rs. 80 – 5% of Rs. 80)	=	Rs. 76
New Dealer's Margin (10% of Rs. 76)	=	Rs. 7.60
New Variable Cost (Rs. 32 + Rs. 24 + Rs. 7.60)	=	Rs. 63.60
New Contribution per unit (Rs. 76 – Rs. 63.60)	=	Rs. 12.40

$$\begin{aligned}
 \text{Level of sales required for present level of Profits} &= \frac{\text{Total Contribution Required}}{\text{New Contribution per unit}} \\
 &= \frac{\text{Rs. } 14,40,000}{\text{Rs. } 12.40} \\
 &= 1,16,129 \text{ units}
 \end{aligned}$$

**(ii) Increasing Dealer's Margin by 20%**

$$\begin{aligned}
 \text{New Dealer's Margin after increasing it by 20\%} &= \text{Rs. } 8 + (20\% \text{ of Rs. } 8) \\
 &= \text{Rs. } 9.60
 \end{aligned}$$

$$\text{New Variable Cost (Rs. } 32 + \text{Rs. } 24 + \text{Rs. } 9.60) = \text{Rs. } 65.60$$

$$\text{Contribution (Rs. } 80 - \text{Rs. } 65.60) = \text{Rs. } 14.40$$

$$\begin{aligned}
 \text{Level of sales required for present level of Profits} &= \frac{\text{Total Contribution Required}}{\text{New Contribution per unit}} \\
 &= \frac{\text{Rs. } 14,40,000}{\text{Rs. } 14.40} \\
 &= 1,00,000 \text{ units}
 \end{aligned}$$

**Conclusion:**

The second proposal, i.e., increasing the Dealer's Margin is recommended because:

1. The contribution per unit is higher which is Rs. 14.40 in comparison to Rs. 12.40 in the first proposal; and
2. The sales (in units) required to earn the same level of profit are lower. They are at 1,00,000 units as against 1,16,129 units in the first proposal. This means a lower sales effort and less finance would be required for implementing proposal (ii) as against proposal (i). Of course, under proposal (ii) the company can earn higher profits than at present level if it can increase its sales beyond 1,00,000 units.

**(b) (i) Statement Showing "Flexible Budget for 3,200 units Activity Level"**

Particulars	Amount (Rs.)	Amount (Rs.)
Sales $\left( \frac{\text{Rs. } 12,00,000}{4,000 \text{ units}} \times 3,200 \text{ units} \right)$		9,60,000
Less: Variable Cost		
Direct Material (3,200 units × 3 kg. p.u. × Rs. 30 per kg.)	2,88,000	
Direct Labour (3,200 units × 1 hr. p.u. × Rs. 72 per hr.)	2,30,400	
Variable Overhead (3,200 units × 1 hr. p.u. × Rs. 44 per hr.)	1,40,800	(6,59,200)
Contribution		3,00,800
Less: Fixed Overhead		1,80,000
Profit		1,20,800

**(ii) Computation of Variances**

$$\begin{aligned}
 \text{Material Usage Variance} &= \text{Standard Cost of Standard Quantity for Actual Production} - \text{Standard Cost of Actual Quantity} \\
 &= (\text{SQ} \times \text{SP}) - (\text{AQ} \times \text{SP}) \\
 &\quad \text{Or} \\
 &= (\text{SQ} - \text{AQ}) \times \text{SP}
 \end{aligned}$$

$$= [(3,200 \text{ units} \times 3 \text{ kg.}) - 10,000 \text{ kg.}] \times \text{Rs. } 30.00$$

$$= \text{Rs. } 12,000 \text{ (A)}$$

**Labour Rate Variance** = Standard Cost of Actual Time – Actual Cost

$$= (\text{SR} \times \text{AH}) - (\text{AR} \times \text{AH})$$

Or

$$= (\text{SR} - \text{AR}) \times \text{AH}$$

$$= \left[ \left( \text{Rs. } 72 - \frac{\text{Rs. } 2,25,600}{3,100 \text{ hrs.}} \right) \times 3,100 \text{ hrs.} \right]$$

$$= \text{Rs. } 2,400 \text{ (A)}$$

6. (a) **Difference between Cost Control and Cost Reduction**

Cost Control	Cost Reduction
1. Cost control aims at maintaining the costs in accordance with the established standards.	1. Cost reduction is concerned with reducing costs. It challenges all standards and endeavours to improve them continuously
2. Cost control seeks to attain lowest possible cost under existing conditions.	2. Cost reduction recognises no condition as permanent, since a change will result in lower cost.
3. In case of cost control, emphasis is on past and present	3. In case of cost reduction, it is on present and future.
4. Cost control is a preventive function	4. Cost reduction is a corrective function. It operates even when an efficient cost control system exists.
5. Cost control ends when targets are achieved.	5. Cost reduction has no visible end and is a continuous process.

(b) **The advantages that would accrue in using the LIFO method of pricing for the valuation of raw material stock are as follows:**

- The cost of materials issued will be either nearer to and or will reflect the current market price. Thus, the cost of goods produced will be related to the trend of the market price of materials. Such a trend in price of materials enables the matching of cost of production with current sales revenues.
- The use of the method during the period of rising prices does not reflect undue high profit in the income statement as it was under the first-in-first-out or average method. In fact, the profit shown here is relatively lower because the cost of production takes into account the rising trend of material prices.
- In the case of falling prices profit tends to rise due to lower material cost, yet the finished products appear to be more competitive and are at market price.
- Over a period, the use of LIFO helps to iron out the fluctuations in profits.
- In the period of inflation LIFO will tend to show the correct profit and thus avoid paying undue taxes to some extent.

(c) **Assumptions of Cost Volume Profit analysis:**

1. **Changes in the levels of revenues and costs arise only because of changes in the number of product (or service) units produced and sold** – for example, the number of television sets produced and sold by Sony Corporation or the number of packages delivered

by Overnight Express. The number of output units is the only revenue driver and the only cost driver. Just as a cost driver is any factor that affects costs, a revenue driver is a variable, such as volume, that causally affects revenues.

2. **Total costs can be separated into two components**; a fixed component that does not vary with output level and a variable component that changes with respect to output level. Furthermore, variable costs include both direct variable costs and indirect variable costs of a product. Similarly, fixed costs include both direct fixed costs and indirect fixed costs of a product
  3. When represented graphically, **the behaviours of total revenues and total costs are linear** (meaning they can be represented as a straight line) in relation to output level within a relevant range (and time period).
  4. **Selling price, variable cost per unit, and total fixed costs (within a relevant range and time period) are known and constant.**
  5. The analysis either covers a single product or assumes that **the proportion of different products when multiple products are sold will remain constant** as the level of total units sold changes.
  6. All revenues and costs can be added, subtracted, and compared **without taking into account the time value of money.**
- (d) **The following steps are necessary for establishing a good budgetary control system:**
1. Determining the objectives to be achieved, over the budget period, and the policy or policies that might be adopted for the achievement of these objectives.
  2. Determining the activities that should be undertaken for the achievement of the objectives.
  3. Drawing up a plan or a scheme of operation in respect of each class of activity, in quantitative as well as monetary terms for the budget period.
  4. Laying out a system of comparison of actual performance by each person, or department with the relevant budget and determination of causes for the variation, if any.
  5. Ensuring that corrective action will be taken where the plan has not been achieved and, if that is not possible, for the revision of the plan.