UNIT 0*: Management Accounting:

Costing and Budgeting

Acknowledgement

Apart from the efforts of me, the success of any project depends largely on the encouragement and guidelines of many others. I take this opportunity to express my gratitude to the people who have been instrumental in the successful completion of this project.

I would like to show my greatest appreciation to …….. I can't say thank you enough for his tremendous support and help. I feel motivated and encouraged every time I attend his meeting. Without his encouragement and guidance this project would not have materialized.

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Thank you.

………………

Executive summary

The team of management of any organization needs accurate and timely information about various matters to make managerial decisions. Cost accounting is the business function that generates important information to the internal parties or the management for decision making purposes.

Budgets are an important concept in Finance and Accounting which links the planning stage and the controlling stage of the management process. Budgets are a futuristic approach to the operations of an organization. They formulate an estimate of the costs and incomes with relevant to a future period. Variance analysis is related with budgets where the deviations of actual figures from the budgeted or estimated figures are identified and then reasons are analyzed. This report elaborates on the basic costing concepts that could be practiced by an organization for ensuring effectiveness of reporting to the internal parties for better decision making.

Table of Contents

List of Figures & Table

Introduction

The functions of the Finance department of any organization comprises the determining the price of products and services, initiating cost reduction initiatives, approving budgets for future periods etc. These are related with the corporate strategy and hence require a great deal of internal information. Therefore, it is necessary to develop the internal body of knowledge on cost and management accounting concepts. In order to have a future direction to the proceeding of operations, budgets would be a helpful device. Variance analysis would help to identify the differences between the estimates and actual figures and aid in finding the responsible parties and to take corrective actions in a timely manner. Hence effective functioning of the cost and management accounting function would ensure the strategy accomplishment as a whole.

Learning outcome 1

Question 1

Different types of costs according to behavior

The selected organization is a manufacturing plant.

Fixed costs- Fixed costs do not vary with the changes in the amount of production or the level of activity.

When considering a certain capacity level, fixed costs would be constant. Within a specific level of activity, the total fixed cost would be the same. But the average fixed cost or the fixed cost per unit will decline when the activity level increases.

Ex: Building rent and rates for the plant, fixed rental of electricity bill.

Variable costs- This means the costs that change with the activity level. There is a direct relationship between the level of production and the variable cost. Total variable cost for a given activity level would increase if the activity level is increased and the average variable cost would be the same in any activity level. (Clinton, Merwe, Anton, 2006)

Ex: The cost of inputs like direct labor, direct material.

Step fixed costs- These costs would be constant over a certain activity level and when the level of production differs by equal intervals of units; the level of fixed cost would also change accordingly.

Ex: The electricity bill is a good example where the rate per unit is Rs.7.85 for a range of 0-62 units and the rate per unit is Rs.10 for a range of 63-93 units and the cost is Rs.27.75 for a range of 94-106 units.

Methods of Costing

Job Costing- Job costing is used to calculate the total cost of customized orders or unique products. In this approach, a job cost sheet would be used to calculate the total cost and profit or loss of the job with assuming the product or service delivered to be one job.

Ex: calculating the total cost of a onetime order of garments in a garment factory.

Contract Costing- This method of costing is used by construction companies to assess the total cost of construction works which are taken on contract basis. Here, each and every contract would be considered as a separate cost unit. (Clinton, Merwe, Anton, 2006)

Ex: construction of a new plant by a contractor.

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