



CA INTERMEDIATE • PAPER 4 • COST AND MANAGEMENT
ACCOUNTING

Scanner Notes 2.0

Topic by Topic • October 2026 Edition



15 Chapters • 15 Units • 120 Topics • 533 Classified Questions

Based on the ICAI Study Material and the Scanner, Cost and Management Accounting 2026 October Edition (V1)

How this book works

For each topic, first read the Study Material paragraphs named in the “Read first” line. Then work down the skill bands — each band names the skill the examiner has actually used on that topic, and lists the exact Scanner questions to practise at it.

The section that follows the Contents — **How to Use These Notes** — explains the question lines, ICAI’s Manner of Assessment, and what the skill mix should change about your preparation. Read it once before you begin.

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BEFORE YOU START

How to Use These Notes

Every question in the Scanner has been read and classified — **533 of them in this paper** — against the skill framework ICAI itself publishes. These notes are built around that classification rather than around the syllabus order. Ten minutes spent on this page will change how you use the rest of the book.

1. How a topic is laid out

Read it like this	
Read first	The exact Study Material paragraphs the topic rests on. Open the Study Material and read them before the notes — the notes assume you have.
Notes	What the topic actually turns on, written for the examination rather than for coverage. Short, and meant to be re-read the night before.
Skill bands	One band for each skill the examiner has actually used on that topic, each with a few lines of guidance and the exact Scanner questions to practise. Work down the bands in the order printed: they run from the least demanding skill to the most.
Concept base	A topic the examiner has not yet reached. It is not optional — it has simply not been asked, and it is examinable.

2. Reading a question line

PQ 1.2 · PYQ 2024-Sep [1] (b) {C} · 5M · Pg 347 **LEVEL II Application** **Easy**

Part of the line	What it tells you
PQ 1.2	The Scanner's own question number. PQ is a practical question, TQ a theory question.
PYQ 2024-Sep [1] (b)	Where it was asked — PYQ past examination, MTP mock test paper, RTP revision test paper — then the sitting, and its number in that paper.
{C}	A case-scenario question.
5M	Marks, as printed in the Scanner. Blank where the source does not print them — RTPs do not.
Pg 347	The page of the Scanner where the question and its answer are printed.
LEVEL II Application	ICAI's skill level, and the sub-skill within it. Section 3 explains these.

Part of the line	What it tells you
Easy	How demanding the question is — judged on the marks it carries and the number of separate things it asks for.

3. The Manner of Assessment — what each skill asks of you

ICAI publishes a **Skill Assessment Specification Grid**. It states three skill levels, and in its **Manner of Assessment of Skills** column it describes each level as two distinct skills. Those six skills are the band headings that run through this book.

Skill	Rolls up to	What the examiner is asking you to do	Directive verbs to watch for
Remembering	Level I	Reproduce what you have learnt, as you learnt it.	Define · List · State · Name · Enumerate · Recognise
Understanding	Level I	Explain it, and place it in context — show you have grasped why the rule is what it is.	Describe · Explain · Distinguish · Identify · Illustrate · Outline
Application	Level II	Use or demonstrate the knowledge, concept or technique. Work the problem.	Apply · Calculate · Determine · Prepare · Reconcile · Record · Perform · Use · Conduct · Demonstrate
Analysis	Level II	Examine the interrelationships between distinct areas to identify root causes and find evidence that supports a judgement.	Analyse · Discuss · Compare and Contrast · Examine · Develop · Monitor · Prioritise · Produce · Align · Communicate
Evaluation	Level III	Assess the problem and use judgement to reach a conclusion.	Advise · Evaluate · Recommend · Review · Select · Assess
Synthesis	Level III	Integrate data and information, separating the relevant facts from the irrelevant.	ICAI lists no verb for synthesis.

ICAI prints the verbs for **Application** and **Analysis** as two separate lists, so that division is the Institute's own. For Level I and for Level III it prints one combined list each — so the line between **Remembering and Understanding**, and between **Evaluation and Synthesis**, follows ICAI's description of the manner of assessment rather than a published list of verbs.

CA Intermediate is assessed at **Levels I and II only** — Evaluation & Synthesis begins at Final. Where a question in this paper is worded as an evaluation, the skill is shown as the question reads and the level tag shows **Level II**, the level the paper is actually assessed at.

4. What the skill mix should change about your preparation

ICAI grades this paper **Level I 20–30%** and **Level II 70–80%** of marks, and CA Intermediate carries **no Level III at all** — Evaluation and Synthesis begin at Final. Measured on the classified Scanner questions in this book, Level I comes to **14.8% of the marks**. Two things follow that are easy to miss.

- **Do not read "Analysis & Application" as an even split.** Inside Level II this paper puts about **94%** of the marks on Application and about **6%** on Analysis. The work is overwhelmingly working the problem, not writing about it.
- **The paper's balance is not each chapter's balance.** Every chapter opens with its own **ICAI Skill Profile** panel, showing how that chapter's marks actually divide and what that means for preparing it. Some chapters are a third theory; others carry almost none. Read the panel before you start the chapter.

5. Two guides at the front of the book

	What it is for
Study Priority Guide	Every examined topic ranked by its share of the classified Scanner questions, and graded A, B or C on cumulative coverage. Category A carries the first 60% of all questions — secure those to full command first.
Importance grade	The A–D grade printed against each chapter in the Contents. This is ICAI's syllabus weightage signal, and it is separate from the question-frequency ranking. Where the two disagree, prepare the chapter to the higher of the two.

STUDY PRIORITY GUIDE

Topic Ranking — Exam Weightage

Read first: Every topic in this booklet that the examiner has actually asked is ranked below by its share of the 533 classified Scanner questions (2026 October Edition, V2), aggregated across all 15 Units — and graded A, B or C on cumulative coverage. **Category A (ranks 1–19)** covers the first 60% of all classified questions: with the passing standard at 50%, a student who prepares the A-topics to full command holds a clear margin above it. **Category B (ranks 20–31)** adds the next 15%, taking coverage to about 75% — work through these as time allows. **Category C (ranks 32–100)** is the remaining 25%: a long tail that is slower to mine for marks, much of which gets covered automatically while preparing A and B. The **Pg.** column cross-references the page on which that topic's study notes begin.

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
1	A	Activity Based Costing	Practical Applications of ABC	6.6%	6.6%	85
2	A	Cost Sheet	Cost Sheet/Statement	5.8%	12.4%	92
3	A	Cost Accounting Systems	Reconciliation of Cost and Financial Accounts	5.1%	17.4%	100
4	A	Marginal Costing	Application of CVP Analysis in Decision Making	5.1%	22.5%	173
5	A	Budgets and Budgetary Control	Classification on the Basis of Capacity or Flexibility	4.3%	26.8%	184
6	A	Material Cost	Inventory Control by Setting Quantitative Levels	3.6%	30.4%	37
7	A	Employee Cost and Direct Expenses	Systems of Wage Payment and Incentives (Premium Bonus Method)	3.6%	34.0%	58
8	A	Process and Operation Costing	Valuation of Work-in-Progress	3.4%	37.3%	122
9	A	Joint Products and By Products	Methods of Apportionment of Joint Cost to Joint Products	3.2%	40.5%	128
10	A	Process and Operation Costing	Treatment of Normal, Abnormal Loss and Abnormal Gain	2.6%	43.2%	120
11	A	Service Costing	Costing of Transport Services	2.6%	45.8%	138
12	A	Marginal Costing	Methods of Break-Even Analysis	2.6%	48.4%	168
13	A	Employee Cost and Direct Expenses	Employee (Labour) Turnover	2.3%	50.7%	62
14	A	Overheads — Absorption Costing Method	Steps for Distribution of Overheads	1.9%	52.5%	68

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
15	A	Overheads — Absorption Costing Method	Types of Overhead Rates	1.9%	54.4%	71
16	A	Unit and Batch Costing	Costing Procedure in Batch Costing	1.7%	56.1%	108
17	A	Job Costing	Job Costing	1.7%	57.8%	114
18	A	Standard Costing	Material Variance	1.7%	59.5%	154
19	A	Introduction to Cost and Management Accounting	Classification of Costs	1.5%	61.0%	26
20	B	Joint Products and By Products	Methods of Apportionment of Joint Cost to By Products	1.5%	62.5%	131
21	B	Standard Costing	Overhead Variance	1.5%	64.0%	158
22	B	Standard Costing	Comprehensive Questions	1.5%	65.5%	160
23	B	Introduction to Cost and Management Accounting	Responsibility Centres	1.3%	66.8%	23
24	B	Overheads — Absorption Costing Method	Comprehensive Questions	1.3%	68.1%	79
25	B	Unit and Batch Costing	Economic Batch Quantity (EBQ)	1.1%	69.2%	110
26	B	Service Costing	Costing of Toll Roads	1.1%	70.4%	143
27	B	Budgets and Budgetary Control	Preparation of Budget	1.1%	71.5%	182
28	B	Introduction to Cost and Management Accounting	Methods of Costing	0.9%	72.4%	29
29	B	Overheads — Absorption Costing Method	Treatment of Under-Absorbed and Over-Absorbed Overheads in Cost Accounting	0.9%	73.4%	73
30	B	Cost Accounting Systems	Non Integrated Accounting System	0.9%	74.3%	96
31	B	Cost Accounting Systems	Integrated (Or Integral) Accounting System	0.9%	75.2%	98
32	C	Marginal Costing	Margin of Safety	0.9%	76.2%	171
33	C	Introduction to Cost and Management Accounting	Objectives of Cost Accounting	0.8%	76.9%	14
34	C	Material Cost	Inventory Control on the basis of Relative Classifications	0.8%	77.7%	41
35	C	Material Cost	Treatment of Normal and Abnormal Loss of Materials	0.8%	78.4%	47
36	C	Employee Cost and Direct Expenses	Idle Time	0.8%	79.2%	53
37	C	Employee Cost and Direct Expenses	Overtime	0.8%	79.9%	55

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
38	C	Standard Costing	Labour Variance	0.8%	80.7%	156
39	C	Budgets and Budgetary Control	Budgetary Control	0.8%	81.4%	181
40	C	Budgets and Budgetary Control	Budget Ratio	0.8%	82.2%	191
41	C	Material Cost	Using Ratio Analysis	0.6%	82.7%	43
42	C	Material Cost	Valuation of Material Issues	0.6%	83.3%	45
43	C	Overheads — Absorption Costing Method	Concepts Related to Capacity	0.6%	83.9%	77
44	C	Joint Products and By Products	Treatment of By Products Cost in Cost Accounting	0.6%	84.4%	132
45	C	Service Costing	Costing of Hotels and Lodges	0.6%	85.0%	140
46	C	Budgets and Budgetary Control	Zero Based Budgeting (ZBB)	0.6%	85.6%	189
47	C	Introduction to Cost and Management Accounting	Users of Cost and Management Accounting	0.4%	85.9%	18
48	C	Introduction to Cost and Management Accounting	Cost Accounting with the use of Information Technology (IT)	0.4%	86.3%	21
49	C	Introduction to Cost and Management Accounting	Cost Objects	0.4%	86.7%	22
50	C	Material Cost	Materials Procurement Procedure	0.4%	87.1%	33
51	C	Material Cost	Valuation of Materials Receipt	0.4%	87.4%	34
52	C	Material Cost	Just in Time (JIT) Inventory Management	0.4%	87.8%	40
53	C	Employee Cost and Direct Expenses	Attendance and Payroll Procedures	0.4%	88.2%	52
54	C	Employee Cost and Direct Expenses	Efficiency Rating Procedures	0.4%	88.6%	61
55	C	Overheads — Absorption Costing Method	Methods of Absorbing Overheads to Various Products or Jobs	0.4%	88.9%	70
56	C	Overheads — Absorption Costing Method	Accounting and Control of Selling and Distribution Overheads	0.4%	89.3%	76
57	C	Activity Based Costing	Stages in ABC	0.4%	89.7%	89
58	C	Unit and Batch Costing	Difference between Job and Batch Costing	0.4%	90.1%	112
59	C	Process and Operation Costing	Inter Process Profit	0.4%	90.4%	124
60	C	Joint Products and By Products	Meaning of Joint and By Products	0.4%	90.8%	127
61	C	Service Costing	Costing of Hospitals	0.4%	91.2%	142
62	C	Service Costing	Costing of Educational Institutions	0.4%	91.6%	145

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
63	C	Service Costing	Costing in Financial Institutions	0.4%	91.9%	147
64	C	Service Costing	Costing For Power Houses	0.4%	92.3%	149
65	C	Standard Costing	Advantages and Criticism of Standard Costing	0.4%	92.7%	162
66	C	Marginal Costing	Advantages and Limitations of Marginal Costing	0.4%	93.1%	166
67	C	Marginal Costing	Cost-Volume-Profit (CVP) Analysis	0.4%	93.4%	167
68	C	Marginal Costing	Distinction Between Marginal and Absorption Costing	0.4%	93.8%	176
69	C	Budgets and Budgetary Control	Performance Budgeting (PB)	0.4%	94.2%	190
70	C	Introduction to Cost and Management Accounting	Scope of Cost Accounting	0.2%	94.4%	15
71	C	Introduction to Cost and Management Accounting	Relationship of Cost and Management Accounting with other related disciplines	0.2%	94.6%	16
72	C	Introduction to Cost and Management Accounting	Essentials of a Good Cost Accounting System	0.2%	94.7%	19
73	C	Introduction to Cost and Management Accounting	Installation of Costing System	0.2%	94.9%	20
74	C	Introduction to Cost and Management Accounting	Techniques of Costing	0.2%	95.1%	30
75	C	Material Cost	Material Storage & Records	0.2%	95.3%	35
76	C	Material Cost	Inventory Control	0.2%	95.5%	36
77	C	Material Cost	Consumption of Materials	0.2%	95.7%	49
78	C	Employee Cost and Direct Expenses	Employee (Labour) Cost Control	0.2%	95.9%	52
79	C	Employee Cost and Direct Expenses	Systems of Wage Payment and Incentives (Time Based)	0.2%	96.1%	57
80	C	Employee Cost and Direct Expenses	Absorption of Wages	0.2%	96.2%	61
81	C	Overheads — Absorption Costing Method	Classification of Overheads	0.2%	96.4%	66
82	C	Overheads — Absorption Costing Method	Treatment of Certain Items in Costing	0.2%	96.6%	78
83	C	Activity Based Costing	Factors Prompting the Development of ABC	0.2%	96.8%	82
84	C	Activity Based Costing	Meaning of Terms used in ABC	0.2%	97.0%	83
85	C	Activity Based Costing	Traditional Absorption Costing vs ABC	0.2%	97.2%	84

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
86	C	Cost Sheet	Functional Classification of Elements of Cost	0.2%	97.4%	91
87	C	Unit and Batch Costing	Unit Costing	0.2%	97.6%	105
88	C	Unit and Batch Costing	Batch Costing	0.2%	97.7%	107
89	C	Process and Operation Costing	Meaning of Process Costing	0.2%	97.9%	118
90	C	Process and Operation Costing	Operation Costing	0.2%	98.1%	126
91	C	Service Costing	Introduction	0.2%	98.3%	135
92	C	Service Costing	Service Cost Unit and KPI	0.2%	98.5%	136
93	C	Service Costing	Statement of Cost for Service Sector	0.2%	98.7%	137
94	C	Service Costing	Costing of Insurance Company	0.2%	98.9%	146
95	C	Service Costing	Costing of other Services	0.2%	99.1%	150
96	C	Standard Costing	Setting Up of Standard Cost	0.2%	99.2%	152
97	C	Standard Costing	Types of Variance	0.2%	99.4%	153
98	C	Standard Costing	Miscellaneous	0.2%	99.6%	163
99	C	Marginal Costing	Angle of Incidence	0.2%	99.8%	172
100	C	Budgets and Budgetary Control	Essential Steps for Preparing Budget	0.2%	100.0%	180

Share % is a question-frequency signal drawn from the Scanner — what has actually been asked. The **Importance** grade (A–D) printed against each Chapter and Unit heading is ICAI's own weightage signal, taken from the Chapter Priority Table, Front Matter — ICAI marks over the papers set under the 2023 scheme, including September 2026. The two measure different things, and where they diverge, prepare to the higher of the two standards. A further **20 topics** are declared in the Scanner's frequency tables but carry no question yet; they are badged **CONCEPT BASE** in the notes and are not ranked here.

CHAPTER 1

Introduction to Cost and Management Accounting

15 Topics · 35 Classified Questions · Importance: B

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge

76.9%

130 of 169 marks

Level II — Analysis & Application

23.1%

39 of 169 marks

Above the paper's Level I ceiling: 77% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for the paper. Reading carries more of the preparation here than it does elsewhere; do not prepare this chapter by working sums alone.

Topic 1: Meaning and Definition

L2P4-C1-T01

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — the meaning and definitions of cost, costing, cost accounting and the basic cost vocabulary.

NOTES

No question has been printed on this topic, but its vocabulary is what every other answer in the chapter is built from, and the definition is marked wherever it turns up. Learn three of them in the printed words: **a cost object is anything for which a separate measurement of cost is required**; a cost unit is a unit of product, service or time (or combination of these) in relation to which cost is ascertained or expressed; a cost centre is a location, person or an item of equipment (or group of these) for which cost is ascertained and used for the purpose of cost control.

What cost accounting itself does, in the words the answers use: it **records the quantitative aspect only**; it records the cost of producing a product and providing a service; it **deals only with cost ascertainment**; it **uses both past and present figures**; and it follows certain principles and procedures for recording costs of different products. Those five limbs are exactly the cost accounting column of the cost accounting versus management accounting table, so learning them here saves learning them twice.

The printed answers date the subject for you: **the development of cost accounting is related to the industrial revolution**, while management accounting develops in accordance with the need of the modern business world. That is a sourced opening line for any question that asks you to introduce the subject.

Keep **cost unit** and **cost centre** apart. The unit is a **measurement** — cost of carrying a passenger per km, cost of a hotel room per day. The centre is a **location, person or item of equipment**, and the printed answer adds the purpose: to control the cost and to fix responsibility of the person in charge of a cost centre. Swapping the two is the commonest way this definition is lost.

Topic 2: Objectives of Cost Accounting

L2P4-C1-T02

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — the objectives of cost accounting and the distinction between cost control and cost reduction.

NOTES

The five objectives, in the order the printed answer gives them: **Ascertainment of cost** — to arrive at a complete and accurate cost figure for cost objects, whether post completion or continuous; **Determination of selling price** — adding the expected profit margin to the cost of goods manufactured; **Cost control and cost reduction** — to adhere to the cost estimate or budget and to identify areas of reduction; **Ascertainment of profit of each activity** — classifying cost by activity to get activity-wise profitability; **Assisting in managerial decision making** — providing relevant cost information to managers. Number them. The examiner marks one line per objective.

Cost control versus cost reduction — the five bases the printed table uses: **Meaning** (control is the guidance and regulation by executive action of the cost of operating an undertaking; reduction is the achievement of real and permanent reduction in the unit cost of goods and services **without impairing their suitability**); **Emphasis** (control on past performance and variance analysis; reduction on present and future performance without considering past performance); **Approach** (control is conservative and stresses conformity to set norms; reduction is dynamic, every function analysed in view of its contribution); **Focus** (control is a short term review of a particular period; reduction seeks a permanent reduction in unit cost on a systematic basis); **Nature of function** (control is preventive, reduction is corrective).

The further differences the 2023-Nov and 2026-May answers add: cost control seeks the lowest possible cost under existing conditions, whereas **cost reduction recognises no condition as permanent** and challenges all standards and endeavours to improvise them continuously; and **cost control ends when the targets are achieved**, whereas cost reduction has no visible end and is a continuous process, operating even when an efficient cost control system already exists.

The trap: every one of the printed answers repeats the same two lines — **control is preventive, reduction is corrective**, and **control ends at the target, reduction never ends**. If time is short, those two lines plus the meaning row will carry most of the marks. The classic wrong answer says cost reduction is about cutting cost anyhow; the printed meaning is a **permanent** reduction in **unit** cost **without impairing suitability**, and all three qualifiers carry marks.

Format: answer in a table with a **Basis of Difference** column and one column each for cost control and cost reduction, numbered rows. The printed answers never run it as prose. Where the question asks for 'some more differences', still put a basis against each row — an unlabelled list of contrasts reads as padding.

Understanding explain it, and place it in context · 3 questions

- Tabulate. Give the basis, then both sides of it on the same row, so the examiner can tick the pair.

TQ 2.1 · PYQ 2016-May [5] (a) · 4M · Pg 3

LEVEL I
Understanding

Medium

TQ 2.2 · RTP 2023-Nov [14] (b) · Pg 4

LEVEL I
Understanding

Medium

TQ 2.4 · PYQ 2026-May [6] (b) · 5M · Pg 5

LEVEL I
Understanding

Medium

Analysis break it down and examine the interrelationships · 1 question

- Where the question quotes one difference and asks for more, do not repeat the quoted one. Start from the next basis and give four or five fresh rows.

TQ 2.3 · RTP 2026-Jan [19] (d) · Pg 4

LEVEL II
Analysis

Medium

Topic 3: Scope of Cost Accounting

L2P4-C1-T03

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — the scope of cost accounting.

NOTES

The scope heads named in the printed answer are four: **Cost Control**, **Cost Report**, **Cost Comparison** and **Cost Analysis**. The one question printed on this topic is an identification question, not an explanation question — you are given a function and asked which head of scope it belongs to.

Reproduce the printed mapping as it stands: 'it involves a detailed examination of each cost' → **Cost Control**; 'helps in planning and control, performance appraisal and managerial decision making' → **Cost Report**; 'cost involved in alternative courses of action' → **Cost Comparison**; 'to find out factors responsible for variance in actual costs from the budgeted costs' → **Cost Analysis**.

Format: two columns, **Function** and **Scope of Cost Accounting**, one line per item, no explanation. The printed answer gives nothing beyond the four labels for 4 marks, so do not spend time

justifying each — a mark per correct label is the whole allocation.

Thin topic warning. Only one question has ever been printed here and its answer is four words. Everything else the examiner wants from the scope of the subject is tested through the objectives topic and the users topic, so revise those two rather than hunting for more material here.

Analysis break it down and examine the interrelationships · 1 question

- The question gives a list of functions and asks you to place each against the right limb of the scope. **Answer item by item, in the question's own numbering**, and give the label before you explain it.
- Match on the operative word in each item — a **detailed examination** of cost, a figure used for **planning and control**, a cost of an **alternative**, a **variance** from budget. One label per item, and do not give two.

TQ 3.1 · PYQ 2025-May [6] (Or) (c) · 4M · Pg 6

LEVEL II
Analysis

Medium

Topic 4: Relationship of Cost and Management Accounting with other related disciplines

L2P4-C1-T04

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — the relationship of cost and management accounting with other related disciplines, and the distinction between cost accounting and management accounting.

NOTES

The six bases of the printed table, in order: Nature — cost accounting **records the quantitative aspect only**, management accounting **records both qualitative and quantitative aspects**;

Objective — cost accounting records the cost of producing a product and providing a service, management accounting provides information to management for planning and co-ordination;

Area — cost accounting **deals only with cost ascertainment**, management accounting is wider in scope as it includes financial accounting, budgeting, tax and planning.

And the remaining three: Recording of data — cost accounting **uses both past and present figures**, management accounting is focused on the projection of figures for the future;

Development — cost accounting's development **is related to the industrial revolution**, management accounting develops in accordance with the need of the modern business world;

Rules and regulation — cost accounting follows certain principles and procedures for recording costs of different products, management accounting **does not follow any specific rules and regulations**.

Format: Sr. No. | Basis | Cost Accounting | Management Accounting, six numbered rows. Write the basis word in the left column — an answer that lists six contrasts without naming the basis

loses the structure marks the table is built to give.

The trap: candidates write that management accounting is a part of cost accounting. The printed answer runs the other way — management accounting is the **wider** discipline; cost accounting is confined to **cost ascertainment**. The second recurring error is saying cost accounting is future-oriented; it uses **past and present** figures, and it is management accounting that projects the future.

Understanding explain it, and place it in context · 1 question

- Give both sides of every basis. A row that describes only cost accounting and leaves management accounting blank scores nothing for that basis.

TQ 4.1 · PYQ 2017-May [7] (b) · 4M · Pg 7

LEVEL I
Understanding

Medium

Topic 5: Role and Functions of Cost and Management Accounting

L2P4-C1-T05

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — the role and functions of cost and management accounting.

NOTES

No question has been printed on this topic, and the pack carries no answer written to it directly. What the examiner has actually asked is the same ground from two other angles — **what the system is for** (the objectives topic) and **who uses what it produces** (the users topic) — so answer a role-and-functions question out of those two printed answers rather than inventing a new list.

The functions, taken from the printed objectives answer: **ascertainment of cost** for cost objects, complete and accurate, post completion or continuous; **determination of selling price** by adding the expected profit margin to the cost of goods manufactured; **cost control and cost reduction**, adhering to the estimate or budget and identifying areas for reduction; **ascertainment of activity-wise profit**; and **assisting managerial decision making** with relevant cost information.

The role, taken from the printed users answer: the system serves **policy makers** formulating strategy and organisational structure, **managers** pricing, measuring responsibility centres and evaluating strategic options, **operational level staff** working to performance goals and parameters, and **employees** on time, attendance and incentives — and outside the entity, **regulatory authorities, auditors, shareholders, and creditors and lenders**.

Thin topic warning. Do not manufacture a separate list of 'functions' for this topic. Everything the pack supports is already above; a question here is best answered by the objectives list with the users list as its second half.

Topic 6: Users of Cost and Management Accounting

L2P4-C1-T06

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — the users of cost and management accounting information, internal and external.

NOTES

The split the answer always makes first: users are **internal** or **external** to the entity. Internal are **policy makers, managers, operational level staff and employees**. External are **regulatory authorities, auditors, shareholders, and creditors and lenders**. Make the split your first line — the question is usually phrased as 'give two internal and three external', and the mark follows the classification as much as the explanation.

Internal users and what each of them wants: **policy makers** — to formulate strategies to achieve short and long term goals, to position the organisation in the competitive market, and to design the organisational structure to get the strategies implemented; **managers** — to know the cost of a cost object and cost centre, to know the price for the product or service, to measure and evaluate the performance of responsibility centres, to know profitability product-wise, department-wise and customer-wise, and to evaluate strategic options and make decisions; **employees** — information on **time and attendance, incentives for work and performance standards**.

Operational level staff have been asked on their own for 5 marks, so learn the four points verbatim: the **supervisors, foreman and team leaders** need the information **to know the objectives and performance goals for them**; to know product and service specifications like volume, quality and process; to know the performance parameters against which their performance is measured and evaluated; and **to know divisional (responsibility centre) profitability**.

External users and what each of them wants: **regulatory authorities** — for **tariff determination, providing subsidies and rate fixation**, and they require the information on the basis of **some standards and format**; **auditors** — for the audit of financial accounts or a special purpose audit such as **cost audit**; **shareholders** — information affecting their investment, communicated through **periodic communiques and annual reports** on new orders received, product expansion and market share; **creditors and lenders** — information affecting the entity's ability to serve them, for example a financial institution lending against **book debts and inventories** wanting regular reporting on **net debt position and stock balances**.

Format and the trap: name the user, then say what they use the information **for**. The classic wrong

answer lists eight user names and stops — the explanation half of the answer is where the marks are. Where the question caps the number, obey the cap: giving five internal users when two were asked earns nothing extra and costs time.

Understanding explain it, and place it in context · 1 question

- Under each user, write the purposes as numbered sub-points exactly as the printed answer does, not as a paragraph.

TQ 6.1 · PYQ 2018-May [6] (a) · 5M · Pg 8

LEVEL I
Understanding

Medium

Analysis break it down and examine the interrelationships · 1 question

- Two things are asked and both carry marks: **name the users** on each side, and **say what each one uses the information for**. A list of names with no use attached earns half.
- Give the number the question asks for — two internal, three external — and no more. Keep the two groups under separate headings so the split is visible at a glance.

TQ 6.2 · MTP 2024-Nov [6] (a) · 5M · Pg 8

LEVEL II
Analysis

Medium

Topic 7: Essentials of a Good Cost Accounting System

L2P4-C1-T07

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — the essential features of a good cost accounting system.

NOTES

The six features, in the printed order, each with its paired adjectives — the pair is the mark: **Informative and simple; Accurate and authentic; Uniformity and consistency; Integrated and inclusive; Flexible and adaptive; Trust on the system**. Write the heading first and the explanation after it, because the heading alone can carry the mark if your explanation runs thin.

What each heading means, in the answer's own terms: **informative and simple** — the system should be tailor-made, practical, simple and capable of meeting the requirements of a business concern, and should not sacrifice utility by introducing meticulous and unnecessary details; **accurate and authentic** — inaccurate data distorts the output of the system and a wrong decision may be taken; **uniformity and consistency** — in **classification, treatment and reporting** of cost data, needed for **benchmarking and comparability** on both **horizontal and vertical** analysis.

And the last three: **integrated and inclusive** — integrated with financial accounting, taxation, statistics and operational research to give a complete overview; **flexible and adaptive** — able to

take amendments for changes in **technological, reporting, regulatory and other requirements**; **trust on the system** — management must trust the output, which needs **an active role of management** in developing a system it is convinced enough to use for decision making.

The trap: this topic is regularly confused with the factors for **installing** a costing system, which is a separate topic with nine factors. Features answer 'what must the system be'; installation factors answer 'what must you study before you build it'. If the question says **features** or **essentials**, give the six adjectives; if it says **factors, installing** or **designing**, give the nine factors.

Understanding explain it, and place it in context · 1 question

- Do not merge uniformity with integration. They are separate features and separate marks: one is about consistent treatment inside the system, the other about linking it to other systems.

TQ 7.1 · PYQ 2022-May [6] (a) · 5M · Pg 10

LEVEL I
Understanding

Medium

Topic 8: Installation of Costing System

L2P4-C1-T08

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — the factors to be considered in installing a cost accounting system.

NOTES

The nine factors, in the printed order: **Objective** — decide before installation whether the system is to fix selling prices, control costs, or both; **Nature of the business** — introduce the costing system suitable to that organisation; **Organisational hierarchy** — the system must meet the requirement of **different levels of management**, so the organisation structure is studied to decide the manner of introduction; **Knowing the product** — the nature of the product determines the type of system, and a product which has by-products requires a system which accounts for by-products as well.

And the remaining five: **Knowing the production process** — no good system can be established without complete knowledge of the production process; **Method of maintenance of cost records** — how cost and financial accounts could be inter-locked into a single integral accounting system and how separate sets of accounts **could be reconciled by means of control accounts**; **Information synchronisation** — the system must be synchronised with other systems and departments so information is collected, processed and made available at the appropriate time; **Statutory compliances and approvals** — all applicable requirements, rules, regulations and approvals for maintaining and reporting cost information; **Attributes and reliability of information** — information must be **accurate, reliable and useful**, which needs **appropriately trained and competent staff** and **proper records**.

The case-scenario version: the same nine factors are set as 'you are a consultant hired by a manufacturing company — how would you assess the critical factors'. Answer it as a checklist in the same order, converting each factor into a question you would put to the client: what is the objective, what is the nature of the business, what does the hierarchy need, and so on. The content does not change; only the framing does.

The trap: the factor students drop is **method of maintenance of cost records**, because it is long. It is the one factor that connects this chapter to the reconciliation chapter — **integral accounts or separate sets reconciled through control accounts** — and it is worth a full mark on its own.

Understanding explain it, and place it in context · 1 question

- The ask has two halves: the **factors** themselves, and **how you would go about assessing them**. Answer both; candidates who give only the list lose the second half.
- Group the factors rather than listing them flat — the objectives of the system, the nature of the business, the organisation's own structure, cost and benefit. Grouping is what makes a long list readable.

TQ 8.1 · PYQ 2017-May [5] (b) · 4M · Pg 11

LEVEL I
Understanding

Easy

Topic 9: Cost Accounting with the use of Information Technology (IT)

L2P4-C1-T09

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — cost accounting with the use of information technology, and the digital costing system.

NOTES

The impact of IT on cost accounting — the printed answer gives seven, and the question usually asks for five: **ERP integrates the functional activities**, so a **single entry provides custom made reports for every purpose** and the reconciliation of cost and financial results becomes simpler and less sophisticated; a **paperless environment**, where the Bill of Material, Material Requisition Note, Goods Received Note and labour utilisation report no longer need multiple copies and the department takes an e-copy; the **internet, intranet and extranet** help resource procurement — production draws material without a physical requisition note and purchase orders go out over the extranet — which **enables a shift towards the Just-in-Time approach**.

And the remaining four: cost information for a cost centre or cost object is ascertained accurately and on time because each is **codified** and costs are assigned by code, which **automates cost accumulation and ascertainment** and lets the information be customised **job-wise, batch-wise, process-wise, cost centre wise**; **uniformity** in reports, budgets and standards **irrespective of location, currency, language and regulations**; **cost and revenue variance reports generated on a**

real time basis so control measures can be taken immediately; and close monitoring of each process to eliminate non value added activities.

Digital costing system — define it before you list its benefits: it links different business functions such as production, procurement and inventory management with the digital costing systems of its suppliers, customers and the market through data sharing and network interaction. That definition line is the first mark in every 'describe five benefits' question.

The five benefits, in the printed order: ascertainment of cost with certainty on a cost object, which helps analyse activities for **allocation and apportionment**; **analysis of data on time spent on each activity**, used to **formulate incentive plans**; material requirement planning and scheduling of material procurement; identifying and eliminating non-value-added activities; and **data on resource consumption** used in setting standards and measuring variances on a real time basis.

The trap: these are two separate questions, not one. 'Impact of IT in cost accounting' wants the ERP and paperless points; 'benefits of a digital costing system' wants the five above and, crucially, the linking definition. Two points do overlap — **eliminating non-value-added activities** and **real time variance information** — so if you are stuck, those two are safe in either answer.

Understanding explain it, and place it in context · 2 questions

- Open the digital costing answer with the linking definition. An answer that starts straight at benefit one has skipped a mark.

TQ 9.1 · PYQ 2021-Jan [6] (e) · 5M · Pg 13

LEVEL I
Understanding

Medium

TQ 9.2 · PYQ 2024-Sep [6] (a) · 5M · Pg 14

LEVEL I
Understanding

Medium

Topic 10: Cost Objects

L2P4-C1-T10

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — cost objects and cost units.

NOTES

The definition, in eleven words: a cost object is anything for which a separate measurement of cost is required. Then the categories, which the printed answer lists before the examples: a product, a service, a project, a customer, a brand category, an activity or a programme.

The printed examples, by category — give one per category, not four of the same kind: **Product** — smart phone, SUV car, book; **Service** — an airline flight from Delhi to Mumbai, a utility bill payment facility; **Project** — metro rail project, road project; **Activity** — quality inspection of materials,

placing of orders; **Process** — refinement of crude in oil refineries. The classic wrong answer gives four products and loses the marks for showing the spread of the concept.

The cost unit table is asked almost every attempt. The printed answers: Automobile — Number; Brewing — Barrel; Brick works — 1,000 bricks; Cement — Ton or per bag; Chemical — Litre, gallon, kilogram, tonne; Coal mining — Tonne; Education — Per course, per student, per batch, per lecture; Electricity — Kilowatt-hour (kWh); Engineering — Contract or job; Gas — Cubic feet.

And the rest of the printed list: Hospitals — Patient day; Hotel or catering — Guest day or room day, per item, per meal; Oil — Cost per barrel, cost per gallon or litre; Power — Kilowatt-hour (kWh); Professional services — Chargeable hour, job, contract; Steel — Ton; Transport by road — Passenger-kilometre, tonne-kilometre; Construction — Square metre, cubic metre; Technology — Software licence, hardware components.

The two traps in the cost unit table: first, transport takes a composite unit — passenger-kilometre or tonne-kilometre, not kilometre alone, and the same composite logic gives patient day and guest day. Second, electricity and power both take kWh, and oil and gas take different units — gas is cubic feet, oil is per barrel or per litre. These are one mark each and are lost to carelessness rather than ignorance.

Remembering reproduce what you have learnt · 2 questions

- Answer the cost unit question as a two-column list and nothing else. No definition is asked for and none is given in the printed answer.

TQ 10.1 · PYQ 2023-May [6] (a) · DESC · 5M · Pg 15

LEVEL I
Remembering

Medium

TQ 10.2 · PYQ 2025-Jan [6] (b) · DESC · 5M · Pg 15

LEVEL I
Remembering

Medium

Topic 11: Responsibility Centres

L2P4-C1-T11

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — responsibility centres, cost centres, profit centres and investment centres.

NOTES

Why responsibility centres exist, and the definition: as an organisation grows its operations and structure become larger and more complex, so management delegates authority and responsibility to different departments, divisions or individuals, and those units or persons are **responsibility centres**. Each is held accountable for its performance in relation to one or more of cost, revenue, profit and return on investment. Start with that accountability line — every classification question

is decided by it.

The four types, and the test that identifies each: **Cost Centre** — the manager is accountable for the costs incurred and controllable within the centre, and performance is evaluated on **cost control**; **Revenue Centre** — primarily accountable for the generation of revenue, measured in **terms of revenue generated**; **Profit Centre** — responsible for **both generating revenue and incurring expenditure**, evaluated on **profitability**; **Investment Centre** — responsible for profitability and has the authority to make capital investment decisions, evaluated on **profit as well as Return on Investment (ROI)**.

The classification answers, which recur almost verbatim: purchase of bonds, stocks or real estate property → **Investment Centre**; a Maharatna, Navratna or Miniratna public sector undertaking of the Central Government → **Investment Centre**; decentralised branches of an organisation → **Profit Centre**; a restaurant unit in a hotel → **Profit Centre**; a ticket counter at a railway station → **Revenue Centre**; the sales department → **Revenue Centre**; the reservation department of an airline → **Revenue Centre**; the customer support department of an e-commerce company → **Cost Centre**.

The two sub-types of cost centre the scenario questions turn on: a **Standard Cost Centre** where **fixed input-output norms exist**, standard quantities of material and labour are set per unit and deviations are analysed as variance into controllable and uncontrollable cost — output is measurable and the input-output relationship is defined; and a **Discretionary Cost Centre** where **output cannot be measured in financial terms** and performance is evaluated **only against the budget allocated**, because **the input-output ratio cannot be defined**. Research and development is the printed example of the second.

Cost centre, the older definition and its classifications: a location, person, or an item of equipment (or group of these) for which cost may be ascertained and used for the purpose of cost control; it is a part of an organisation that does not produce direct profits and adds to the cost of running a company, such as R&D, marketing, the help desk. Cost centres are **personal** (a person) or **impersonal** (a location or item of equipment); in a manufacturing concern they are **production cost centres** (where raw material is handled for conversion into finished product, with both direct and indirect expenses — machine shops, welding shops, assembly shops) or **service cost centres** (ancillary to a production cost centre — power house, gas production shop, material service centres, plant maintenance).

Profit centre, in the printed words: a centre whose performance is measured in terms of income earned and cost incurred, whose **main responsibility is to generate and maximise profit**; it is a branch or division accounted for on a standalone basis for the purpose of profit calculation, and its managers generally have decision making authority related to product pricing and operating expenses.

The trap, and it is the whole chapter's commonest: candidates call a sales department a profit centre. The printed answers make it a **Revenue Centre** — it controls revenue and its own selling expenses such as commission, but **not production costs**. Similarly a PSU or any unit deciding on

capital investment is an **Investment Centre**, not a profit centre; the dividing line is **authority over capital investment and evaluation on ROI**. Where the question says 'show the reason for your classification', give the test before the label.

Remembering reproduce what you have learnt · 2 questions

- Learn the four types with their measure of performance attached — cost, revenue, profit, ROI. The measure is what you use to justify every classification.

TQ 11.1 · PYQ 2015-May [7] (a) · DESC · 4M · Pg 17

LEVEL I
Remembering

Easy

TQ 11.2 · PYQ 2016-May [7] (e) (ii) · DESC · 2M · Pg 18

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context · 4 questions

- For a 'define and discuss the types' question, spend the first two lines on delegation and accountability before you reach the types. That is where the definition mark sits.

TQ 11.3 · PYQ 2017-May [5] (a) · DESC · 4M · Pg 18

LEVEL I
Understanding

Easy

TQ 11.4 · PYQ 2021-Jul [6] (a) · DESC · 5M · Pg 19

LEVEL I
Understanding

Medium

TQ 11.6 · MTP 2025-Dec S2 [3] (b) · DESC · 5M · Pg 20

LEVEL I
Understanding

Medium

TQ 11.7 · MTP 2026-Mar S1 [6] (a) · DESC · 5M · Pg 22

LEVEL I
Understanding

Medium

Analysis break it down and examine the interrelationships · 1 question

- Where the scenario asks you to show the reason, take the departments one at a time and name the deciding feature first — fixed input-output norms, or unmeasurable output, or no control over production cost, or authority over investment — then state the label. An answer that gives labels without the deciding feature loses half the marks.

TQ 11.5 · PYQ 2025-Sep [6] (a) · 5M · Pg 20

LEVEL II
Analysis

Medium

Topic 12: Limitations of Cost Accounting

L2P4-C1-T12

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting —

the limitations of cost accounting.

NOTES

No question has been printed on this topic and the pack carries no answer written to it, so treat what follows as the pack's own material assembled from adjacent answers rather than a learned list, and go to the Study Material for the full set of limitations before the exam.

What the printed answers do concede about the system's reach: cost accounting **records the quantitative aspect only**, while management accounting records **both qualitative and quantitative** aspects; cost accounting **only deals with cost ascertainment**, while management accounting is **wider in scope**; and cost accounting **uses both past and present figures**, while the projection of figures for the future belongs to management accounting. Those three lines are the sourced core of any limitations answer.

The second sourced limitation is that important costs never enter the books at all. **Imputed costs do not involve any immediate cash payment** and are **not recorded in the books of account**, yet are important for decisions such as equipment replacement and the relative profitability of two alternatives; **opportunity cost** — the value of sacrifice made or benefit of opportunity foregone in accepting an alternative course of action — likewise **is not recorded in the books of accounts** although it **plays an important role in managerial decision making**. A system that omits both cannot on its own support a decision.

The third is that the system must be built to fit, and can be built badly. The essentials topic warns against sacrificing utility by introducing meticulous and unnecessary details, against data that is not **accurate and authenticated** because it may distort the output of the system and a wrong decision may be taken, and notes that the system fails unless **management has trust in the system and its output**. Read as limitations, those are cost, complexity and non-acceptance.

Topic 13: Classification of Costs

L2P4-C1-T13

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — the classification of costs by element, function, variability, controllability and use in managerial decision making.

NOTES

The one formula in the topic, and it is asked repeatedly: Conversion Cost = Direct Labour Cost + Direct Expenses + Manufacturing Overhead, or equivalently **Conversion Cost = Factory Cost – Direct Materials Cost**. Give both forms; the second is the one that saves you in a cost sheet question. Define it first — the cost incurred to convert raw materials into finished goods.

The decision-making terms, in the printed wording, because the wording is the mark: **Sunk cost** — historical costs incurred in the past; they play no role in decision making in the current period, and the written down value of an existing machine in a replacement decision is the printed example; **Opportunity cost** — the value of sacrifice made or benefit of opportunity foregone in accepting an alternative course of action, illustrated by the interest lost on a bank deposit withdrawn to fund expansion, and **not recorded in the books of accounts**; **Imputed cost** — **does not involve any immediate cash payment, not recorded in the books, also known as economic cost and similar to opportunity cost**; **Out-of-pocket cost** — **that portion of total cost which involves cash outflow, a short-run concept, avoidable if the proposal is not accepted**; **Explicit cost** — out-of-pocket cost, involving **immediate payment of cash**; **Implicit cost** — no immediate cash payment, not recorded.

The predetermined family, which is examined together: **Pre-determined cost** — computed in advance before production or operations start, on the basis of specification of all the factors affecting cost; **Standard cost** — a pre-determined cost calculated from management's expected standard of efficient operation and the relevant necessary expenditure, used **for price fixation and for cost control through variance analysis**; **Estimated cost** — Kohler's definition, the expected cost of manufacture or acquisition, often in terms of a unit of product, computed on the basis of information available in advance of actual production or purchase, and **prospective** because it predicts; **Marginal cost** — the amount at any given volume of output by which aggregate costs increase if the volume of output is increased or decreased by one unit; **Differential cost** — the change, increase or decrease, in total cost (variable as well as fixed) due to a change in activity level, technology, process or method of production, called incremental or decremental cost.

The behaviour and attachment terms: **Discretionary cost** — **not tied to a clear cause and effect relationship between inputs and outputs, arising from periodic decisions regarding the maximum outlay to be incurred** — advertising, public relations, training; **Engineered cost** — the opposite, resulting specifically from a clear cause and effect relationship between inputs and outputs, the relationship **usually personally observable**; **Product cost** — **inventoriable, assigned to the product**, and the definition that carries the mark is that under marginal costing variable manufacturing costs, and under absorption costing total manufacturing costs, constitute product costs; **Period cost** — not assigned to products but charged as expenses against the revenue of the period, and all non-manufacturing costs — general and administrative, selling and distribution — are period costs; **Capitalised cost** — **initially recorded as assets and subsequently treated as expenses**, such as installation expenses added to the cost of a machine; **Shut down cost** — **costs which continue to be incurred even when a plant is temporarily shut down**, such as rent, rates and depreciation, **which cannot be eliminated with the closure**; **Absolute cost** — the cost of a product, process or unit **in its totality**, the base on which further analysis is made; **Controllable cost** — **can be controlled, typically by a cost, profit or investment centre manager**, and can be influenced by the action of the executive heading that responsibility centre, and **uncontrollable costs** are those which cannot.

The relevance question, and the printed mapping you are marked against: owning premises and using them rather than renting a similar office → **opportunity cost, also imputable or notional**

cost → **relevant**; rent paid on a factory shed temporarily closed → **committed cost or shut down cost** → **non-relevant**; money already paid to a market research agency → **sunk cost** → **non-relevant**; sales incentive paid at a percentage of sales → **out of pocket cost** → **relevant**; interest forgone on a fixed deposit by investing in a project → **opportunity cost** → **relevant**. **The rule the mapping runs on:** a cost is relevant if it is **future and differs between alternatives** — anything already spent, or committed whatever you decide, is not.

The three purposes of computing product cost, asked as a set: **preparation of financial statements**, where the focus is on **inventoriable costs**; **product pricing**, for which the cost of the areas along the value chain should be included to make the product available to the customer; and **contracting with government agencies**, where the agency may not allow contractors to recover research and development and marketing costs under cost plus contracts.

Classification by function and by variability is a two-column answer and each column is marked separately. The printed mapping: **consumable store** → factory, production or manufacturing overhead / **variable**; **general manager's salary** → administration / **fixed**; **delivery van expenses** → distribution / **semi-variable or variable**; **compensation of fixed salary plus commission on sales** → selling and distribution / **semi-variable**; **rent of finished goods warehouse** → selling and distribution, or distribution / **fixed**. The trap is answering only one of the two columns, or calling a salary-plus-commission package variable — a fixed component makes it **semi-variable**.

Understanding explain it, and place it in context · 6 questions

- Where a term has a formula, write the formula as well as the definition. Conversion cost without its formula is half an answer.

TQ 13.1 · PYQ 2016-Nov [7] (d) (ii) · DESC · 2M · Pg 23	LEVEL I Understanding	Easy
TQ 13.2 · MTP 2019-Mar [6] (a) · DB · 5M · Pg 24	LEVEL I Understanding	Medium
TQ 13.3 · PYQ 2023-Nov [6] (a) · DESC · 5M · Pg 24	LEVEL I Understanding	Medium
TQ 13.4 · PYQ 2025-May [6] (a) · DESC · 5M · Pg 25	LEVEL I Understanding	Medium
TQ 13.5 · RTP 2025-May [20] (a) · DESC · Pg 26	LEVEL I Understanding	Medium
TQ 13.6 · RTP 2025-May [20] (d) · DESC · Pg 26	LEVEL I Understanding	Medium

Analysis break it down and examine the interrelationships · 2 questions

- Justify a non-relevant verdict by saying the cost is already incurred or committed regardless of the decision. One clause is enough, but it converts a guess into an analysed answer.

TQ 13.7 · PYQ 2026-Jan [6] (a) · DESC · 5M · Pg 27

LEVEL II
Analysis

Medium

TQ 13.8 · RTP 2026-May [17] (a) · DESC · Pg 28

LEVEL II
Analysis

Hard

Topic 14: Methods of Costing

L2P4-C1-T14

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — the methods of costing and the industries in which each is used.

NOTES

The test that decides the method, taken from the printed identification answers: costs charged to a specific job → **Job costing**; costs charged to a group of products or a predetermined lot → **Batch costing**; cost ascertained for a single product → **Single, unit or output costing**; costs charged to operations and averaged over units produced, or the cost of each stage of work → **Process or operation costing**; a combination of two or more methods, where the nature of the product is complex and a single method cannot be ascertained → **Multiple costing**.

The industry-to-method list, exactly as printed: Real estate — **Contract costing**; Motor repairing workshop — **Job costing**; Chemical industry — **Process costing**; Transport service — **Service or operating costing**; Assembly of bicycles — **Multiple output costing**; Biscuit manufacturing — **Batch costing**; Power supply companies — **Service costing**; Car manufacturing — **Multiple costing**; Cement industry — **Process or output costing**; Printing press — **Job costing**.

And the rest of the printed list: Oil refinery — **Process costing**; Interior decoration — **Job costing**; Airlines company — **Operation or service costing**; Advertising — **Job costing**; Car assembly — **Multiple costing**; Paper and pulp — **Process costing**; Bakery — **Batch costing**; Custom furniture workshop — **Job costing**; Packaged snacks on a continuous basis — **Process costing**; Bus transport fleet — **Service or operating costing**.

Unit costing and batch costing, defined together because they are asked together: **unit costing** is the method where the output produced is identical and each unit of output requires identical cost; costs are collected and analysed element-wise and the cost per unit is the total cost divided by the number of units produced — used in paper, cement and steel works. **Batch costing** is a type of specific order costing where articles are manufactured in predetermined lots known as batches, and the cost per unit in a batch is the total cost of the batch divided by the number of units produced in that batch — used in pharmaceutical and drug industries, readymade garments, and electronic parts of televisions and radio sets.

The trap, visible across the printed answers: **assembly is not the same as manufacture**. Assembly of bicycles and car assembly are **multiple costing**, because components are costed separately and then combined, while a single continuous product such as cement or a chemical is **process costing**. The second recurring error is giving job costing for a transport service — a service delivered

repeatedly to a standard unit takes **service or operating costing**.

Format for the scenario version: three columns — **business scenario, costing method, key reason** — and the reason is one phrase, not a paragraph: uniform products and mass production; unique custom jobs per client; production in identifiable batches; continuous and standardised production; costing per service unit such as kilometre or passenger-kilometre. The question says 'explaining your reasoning', so the third column is compulsory.

Remembering reproduce what you have learnt · 1 question

- Two columns and no prose for a pure identification question. Fifteen industries at 5 marks means a third of a mark each — speed is the skill being tested.

TQ 14.1 · PYQ 2021-Jan [6] (d) · DESC · 5M · Pg 30

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 3 questions

- For 'describe unit costing and batch costing', give the definition, then the cost-per-unit rule, then three industries. That is three marks in three lines each.

TQ 14.3 · PYQ 2024-May [6] (c) · DESC · 4M · Pg 32

LEVEL I
Understanding

Easy

TQ 14.2 · PYQ 2022-May [6] (e) · DESC · 5M · Pg 32

LEVEL I
Understanding

Medium

TQ 14.4 · MTP 2024-Nov [6] (Or) (d) · DESC · 4M · Pg 33

LEVEL I
Understanding

Medium

Evaluation judge it against the standard · 1 question

- Each business gets **one named method and one reason**. Write them as a short table or as lettered lines matching the question — a paragraph covering all of them loses the per-business mark.
- The reason must point at the feature of the business that decides it — continuous mass output, a customer's own specification, a batch, a service. Naming the method without that feature is half an answer.

TQ 14.5 · MTP 2025-Nov S1 [6] (a) · DESC · 5M · Pg 33

LEVEL II
Evaluation

Hard

Topic 15: Techniques of Costing

L2P4-C1-T15

Read first Read ICAI Study Material Chapter 1, Introduction to Cost and Management Accounting — the techniques of costing.

NOTES

Techniques are not methods. A method answers how cost is collected for the output — job, batch, process. A technique answers how the collected cost is treated and used, and the printed answer notes that a technique **may be used in conjunction with any method of costing**. Say that line first; it is what separates this topic from the methods topic and it is where the answer is won or lost.

Uniform costing — when a number of firms in an industry agree among themselves to follow the same system of costing in detail, adopting common terminology for various items and processes. Its two printed advantages: the performance of each firm can be compared with another, or with the average performance in the industry; and it is possible to determine the cost of production of goods which is true for the industry as a whole, which is **useful when tax relief or protection is sought from the Government**.

Marginal costing — the ascertainment of marginal cost by differentiating between fixed and variable costs, used **to ascertain the effect of changes in volume or type of output on profit**.

Absorption costing — the practice of charging all costs, both variable and fixed, to operations, processes or products, and the printed answer contrasts it directly: **this differs from marginal costing where fixed costs are excluded**. **Direct costing** — a specialised form of cost analysis that only uses variable costs to make decisions, not considering fixed costs, which are **assumed to be associated with the time periods in which they are incurred**.

Standard costing and variance analysis — the technique whereby standard costs are pre-determined and subsequently compared with the recorded actual costs; it is **a technique of cost ascertainment and cost control**, may be used with **any method of costing**, and is especially suitable where the manufacturing method involves production of standardised goods of a repetitive nature.

Historical costing — the ascertainment of costs after they have been incurred, and the printed answer adds plainly that **this type of costing has limited utility**. It has two sub-forms worth a mark each: **post costing, ascertainment of cost after production is completed**; and **continuous costing**, where cost is ascertained as soon as the job is completed or even when the job is in progress.

Format: a two-column table — **Technique** and **Description** — in the printed order: uniform, marginal, standard costing and variance analysis, historical, absorption, direct. Six techniques for 5 marks, so one or two sentences each and the advantages only under uniform costing, where the printed answer gives them.

Understanding explain it, and place it in context · 1 question

- Pair marginal with absorption in adjacent rows and state the difference in one clause — fixed costs excluded against all costs charged. The contrast is worth more than either description alone.

CHAPTER 2

Material Cost

15 Topics • 42 Classified Questions • Importance: B

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% • Level II 70-80% — this chapter reads **on profile**Level I — Comprehension & Knowledge **27.7%** 64 of 232 marksLevel II — Analysis & Application **72.3%** 168 of 232 marks

This chapter sits inside ICAI's own band for the paper — 28% Level I against 20-30%. Prepare it in those proportions: know the method, then drill it.

Topic 1: Material Control

L2P4-C2-T01

CONCEPT BASE — no exam question asked yet • essential for full preparation**Read first** Read ICAI Study Material Chapter 2, Material Cost — material control and the material control cycle.

NOTES

No question has been printed on this topic, so build an answer out of the documents and records the printed answers do describe, and read the Study Material for the control objectives themselves rather than inventing a list.

The documents the chapter actually names, in the order they arise: the **Bill of Material**, a schedule of standard quantities of materials required for any job or other unit of production, prepared by the **engineering or planning department**; the **material requisition note**, which asks stores for one lot of material as it is needed and is raised by the department that wants it; the **Goods Received Note**; and the two perpetual inventory records, the **bin card** kept by the store keeper and the **stores ledger** kept by the cost accounting department.

The control purpose the pack states directly comes from the inventory control answer: **to make a balance between sufficient stock and over-stock**. Stock must be enough that **uninterrupted production flow can be maintained**, because insufficient stock not only pauses production but also causes a loss of revenue and goodwill; against that, inventory requires funds for purchase, storage and maintenance, with a risk of obsolescence and pilferage. **A trade-off between stock-out and over-stocking is required**.

The four bases of control, which are the rest of this chapter and should be named in any material control answer: **by setting quantitative levels**; on the basis of relative classification; **using ratio analysis**; and **physical control**.

Topic 2: Materials Procurement Procedure

L2P4-C2-T02

Read first Read ICAI Study Material Chapter 2, Material Cost — the materials procurement procedure, the bill of material and the material requisition note.

NOTES

Bill of material, in the printed words: a schedule of standard quantities of materials required for any job or other units of production; **also known as the material specification list or material list;** it contains the code, description and quantity of materials and other stores items required for carrying out a particular work or job order; it acts as an authorisation for issue of the materials and stores items mentioned in it; and its use saves paper work and ensures requisition of the exact quantity of materials. It is prepared by the engineering or planning department in a standard form, in quadruplicate.

The four departmental uses, one line each, which is how the 5 mark question is marked: **Purchase department — materials are procured on the basis of the specifications mentioned in it;** **Production department —** production is planned according to the nature and volume of the materials required to be used, and material requisition lists are prepared accordingly; **Stores department —** it is used as a reference document while issuing materials to the requisitioning department; **Cost or accounting department —** it is used to estimate cost and profit, and any purchase, issue and usage is compared and verified against this document.

The format of the bill itself, if you are asked to draw it: a heading with the **Job or Work Order No., BOM No. and Date**, then columns for Sr. No. | Materials and Parts Description | Quantity | Remarks, then Prepared by — Chief, Drawing Office or Planning Department and **Checked by**.

Bill of material against material requisition note — answer on contents and on utility, in a table, not on definition alone. **On contents:** the bill lists every material needed for a job or product at the outset, with quantities, and is drawn up by the drawing or planning office; the requisition asks stores for one lot of material as it is needed and is drawn up by the department that wants it. **On utility:** the bill serves planning, purchasing and cost estimation before work begins and covers the whole job; the requisition authorises an individual issue and is the document from which the stores ledger and the job are charged.

The line that lifts the answer: one bill of material usually gives rise to several requisition notes. Saying so shows the relationship between the two documents rather than only the contrast, and it is the point the printed guidance singles out.

Understanding explain it, and place it in context · 2 questions

- Where the question names four departments, use four rows and keep the question's order. One line per department is the whole allocation.

TQ 2.1 · PYQ 2021-Dec [4] (c) · DESC · 5M · Pg 40

LEVEL I
Understanding

Medium

TQ 2.2 · PYQ 2026-Sep [6] (Or) (c) · DB · 4M · Pg 41

LEVEL I
Understanding

Medium

Topic 3: Valuation of Materials Receipt

L2P4-C2-T03

Read first Read ICAI Study Material Chapter 2, Material Cost — the valuation of materials received and what enters the cost of purchase.

NOTES

The treatment rules, and each one is a mark: Detention charges or fines — imposed for non-compliance of a rule or law by a statutory authority; an abnormal cost, not included with the cost of purchase. **Demurrage** — a penalty imposed by the transporter for delay in uploading or offloading of materials; an abnormal cost, not included with the cost of purchase. **Shortage due to abnormal reasons** — mishandling, pilferage or any avoidable reason — is not absorbed by the good units; losses due to abnormal reasons are debited to the Costing Profit and Loss Account.

Returnable containers: if the containers are returned and their cost is refunded, the cost of containers should not be considered in the cost of purchase; if the amount of refund on returning the container is less than the amount paid, only the shortfall is added to the cost of purchase. In the printed sum, ₹90,000 deposited against ₹60,000 refunded put **₹30,000** into the cost — not ₹90,000 and not nil.

GST: CGST is excluded from the cost of purchase if the input credit is available for the same, and **unless mentioned specifically CGST is not added to the cost of purchase**. Where credit is **not** available the tax is added — and the trap is the base: GST is payable on the net price, that is the listed price less the trade discount, never on the listed price.

The format of the computation, in the order the printed statement runs: Listed price of materials; less trade discount on the listed price; **add CGST and SGST on the net figure** where credit is not available; add road tax, freight and insurance, and commission and brokerage; add the non-refunded part of the returnable container deposit; subtotal; add other expenses at the stated percentage of total cost; **total cost of material;** then the unit line — less shortage due to normal loss, in quantity only; **total cost of material of good units; cost per unit = total cost ÷ good units.**

The normal loss trap, and the printed answer says it in a note: shortage due to normal reasons should not be deducted from cost to ascertain the total cost of good units. The quantity column falls from 5,000 units to 4,000 units but the value column stays at ₹9,00,000, so the rate rises to **₹225**. Deducting the value of normal shortage as well as the quantity is the single commonest error here, and it understates the unit cost twice over.

Where 'other expenses at a percentage of total cost' appears, apply it to the running total you have built up to that point and show the subtotal line before it, so the examiner can see the base.

In the printed sum 2% was applied to ₹8,82,000 to give ₹18,000.

Remembering reproduce what you have learnt · 1 question

- This is a treatment question: **for each item say whether it is added to, excluded from, or not part of the cost of material**, and then why in one clause.
- Take the items in the question's order and give each its own line. Where a tax is recoverable as input credit, say so expressly — that is the whole of the mark on that item.

TQ 3.1 · PYQ 2021-Jan [6] (a) · DESC · 5M · Pg 42

LEVEL I
Remembering

Medium

Application use the rule - work the problem · 1 question

- Build the statement downwards with a units column beside the amount column from the start. Introducing the units only at the last line is how the normal-loss adjustment gets made to the wrong column.

PQ 3.1 · MTP 2022-Mar [1] (a) {C} · 5M · Pg 43

LEVEL II
Application

Easy

Topic 4: Material Storage & Records

L2P4-C2-T04

Read first Read ICAI Study Material Chapter 2, Material Cost — material storage, bin cards and the stores ledger.

NOTES

Open with the line the printed answer opens with: both bin cards and stores ledgers are perpetual inventory records, and neither is a substitute for the other. That sentence frames the whole distinction and is itself a mark.

The six bases of the printed table: **Maintained by** — the bin card **by the store keeper**, the stores ledger **by the cost accounting department**; **Nature** — the bin card is **the stores recording document**, the stores ledger is **an accounting record**; **Information** — the bin card contains quantities only, that is receipts, issues and balance, the stores ledger contains both quantitative and value information in respect of receipts, issues and balance.

And the remaining three: **Time of recording** — in the bin card entries are made at the time when the transaction takes place, in the stores ledger entries are made only after the transaction has taken place; **Recording** — the bin card **records each transaction**, the stores ledger **records the same information in a summarised form**; **Inter-departmental transfer** — **does not appear** in the

bin card but **appears** in the stores ledger.

The trap: the difference students miss is the **value** column. The bin card is a quantity record only; the moment a question asks you to price an issue you are in the stores ledger. The second miss is **inter-departmental transfers**, which is the last row and the one most often dropped.

Understanding explain it, and place it in context · 1 question

- Do not say one record replaces the other. The printed answer opens by denying exactly that.

TQ 4.1 · PYQ 2017-Nov [7] (a) · DB · 4M · Pg 45

LEVEL I
Understanding

Medium

Topic 5: Inventory Control

L2P4-C2-T05

Read first Read ICAI Study Material Chapter 2, Material Cost — inventory control, its objective and the bases on which it is exercised.

NOTES

The CIMA definition, quote it in full: inventory control is the function of ensuring that sufficient goods are retained in stock to meet all requirements without carrying unnecessarily large stocks. Both halves of that sentence carry marks — sufficiency and the cap on excess.

The objective, stated as a balance: to make a balance between sufficient stock and over-stock.

The stock held should be enough to meet production requirements **so that uninterrupted production flow can be maintained**, because insufficient stock not only pauses production but also causes a loss of revenue and goodwill. On the other side, inventory requires funds for purchase, storage and maintenance of materials, with a risk of obsolescence and pilferage. The closing line is the one to write: **a trade-off between stock-out and over-stocking is required.**

The four bases of inventory control, and they are the map of the rest of the chapter: **by setting quantitative levels** — re-order level, minimum, maximum, danger level and economic order quantity; **on the basis of relative classification** — ABC, VED and FSN analysis; **using ratio analysis** — inventory turnover ratio and holding days; and **physical control** — perpetual inventory and continuous stocktaking.

Format: definition, then objective as the balance, then the four bases as a bulleted list. The printed answer gives the bases as bare labels, so do not spend the 5 marks explaining all four — name them and, if the question says 'list down the basis', stop there.

Remembering reproduce what you have learnt · 1 question

- Attribute the definition to CIMA. The attribution is in the printed answer and costs you four words.

TQ 5.1 · PYQ 2019-Nov [6] (c) · DESC · 5M · Pg 46

LEVEL I
Remembering

Medium

Topic 6: Inventory Control by Setting Quantitative Levels

L2P4-C2-T06

Read first Read ICAI Study Material Chapter 2, Material Cost — inventory control by setting quantitative levels: economic order quantity, re-order level, maximum, minimum, danger and average stock levels.

NOTES

The five formulae, exactly as the answers use them: $EOQ = \sqrt{(2AO \div C)}$, where **A** = annual demand or consumption in units, **O** = ordering cost per order and **C** = carrying cost per unit per annum; Re-order level = Maximum consumption $\times$ Maximum re-order period (lead time); Maximum level = Re-order level + Re-order quantity - (Minimum consumption $\times$ Minimum re-order period); Minimum level = Re-order level - (Average or normal consumption $\times$ Average or normal re-order period); Danger level = Average consumption $\times$ Lead time for emergency purchases. **Average stock level** = $\frac{1}{2}$ (Maximum level + Minimum level), or **Minimum level** + $\frac{1}{2} \times$ **Re-order quantity** — the printed answers give both and they do not agree, so state which you have used.

Choosing the right end of each range is the whole of the working. Re-order level takes **maximum** consumption and **maximum** period. Maximum level takes **minimum** consumption and **minimum** period. Minimum level takes **average** of both. Danger level takes **average** consumption and the **emergency** lead time, which is a separate, shorter figure given specially — not the minimum lead time. Taking the wrong end is the commonest error in the printed answers, and each level is marked separately so a wrong maximum does not cost you the minimum.

Where safety stock is given, the re-order level changes shape: **Re-order level** = **Maximum consumption $\times$ Maximum lead time + Safety stock**, or as one printed answer puts it, **Re-order level** = **Lead time consumption + Safety stock** — 1,000 units a day $\times$ 45 days + 6,500 = **51,500 units**. A third printed route runs it backwards from the minimum level: **Re-order level** = **Minimum stock + (Average consumption $\times$ Average delivery time)**. Use the route the question's data supports and say so.

Building C, the carrying cost per unit per annum, is where most marks are lost before the formula is even reached. Add every annual rate the question gives: **storage plus interest** (2% + 6% = 8% of ₹50 = ₹4); **storage, interest and obsolescence** together; **interest on cash credit plus warehouse rent**; or, where rates come in different periods, convert first — ₹2.5 per kg per month $\times$ 12 months + ₹18 per kg per annum = ₹48 per kg. And two trap items: insurance charges of ₹20 per unit are added to the purchase price of ₹80 to give ₹100 before the percentage is applied, while cash discount is treated as an interest and finance item and is therefore ignored.

Building A, the annual requirement, is the second place marks go. Convert to a year and to the

material: **quarterly output** $\times 4 \times \text{kg per unit}$; **monthly usage** $\times 12$; **annual output** $\times \text{the company's market share}$; and where the material has a yield, **divide by the yield** — 2 kg per unit at an 80% yield is **2.5 kg per unit**. Then, if opening stock is given, **deduct it**: requirement 22,630 kg less opening stock 2,630 kg gives a purchase requirement of **20,000 kg**. Show the working note; the examiner marks the derivation of A separately.

The quantity-discount question always takes the same three-line comparison, and you must run it under both options: **Purchase cost** (annual units $\times$ the price under that option) + **Ordering cost** (annual units $\div$ order size $\times$ cost per order) + **Carrying cost** (order size $\times \frac{1}{2} \times$ price under that option $\times$ carrying rate) = **Total cost**; then **advise the lower total cost and state the saving in rupees**. The trap is the carrying cost line — when the discount is accepted, **the carrying cost must be computed on the discounted price**, not the original, because the value held has fallen. The printed advice also adds a warning worth a mark: a larger order increases average inventory substantially, involving greater risk of shrinkage, pilferage and obsolescence.

Frequency and derived quantities: **Number of orders per annum** = **Annual requirement** $\div$ **EOQ**; **Frequency of orders in days** = **Days in the year** $\div$ **Number of orders**, on the 360-day year the questions specify. At the EOQ, **total ordering cost equals total carrying cost** — ₹9,000 and ₹9,000 in the printed answer — so if your two figures differ materially, your EOQ is wrong and you can catch it before the marks are gone. Where consumption is given only as a maximum and an average, recover the minimum from **Average consumption** = **(Maximum + Minimum)** $\div 2$; and where a perishable material must be used within a set number of days, the maximum stock level is the lower of the formula figure and that many days' consumption.

Application use the rule - work the problem - 19 questions

- Do the levels in the order re-order, maximum, minimum, danger, average, because every later one uses the re-order level. Put the derivation of A and of C in working notes above the computation, not inside it.

PQ 6.3 • PYQ 2019-Nov [1] (a) {C} • 5M • Pg 50	LEVEL II Application	Easy
PQ 6.10 • PYQ 2024-May [1] (a) {C} • 5M • Pg 58	LEVEL II Application	Easy
PQ 6.13 • MTP 2025-Mar S1 [1] (a) • 5M • Pg 63	LEVEL II Application	Easy
PQ 6.1 • PYQ 2018-May [1] (a) {C} • 5M • Pg 47	LEVEL II Application	Medium
PQ 6.5 • MTP 2020-Oct [1] (b) {C} • 5M • Pg 52	LEVEL II Application	Medium
PQ 6.6 • PYQ 2020-Nov [3] (b) • 10M • Pg 53	LEVEL II Application	Medium
PQ 6.12 • RTP 2025-Jan [8] • Pg 62	LEVEL II Application	Medium

PQ 6.14 • RTP 2025-May [8] • Pg 64	LEVEL II Application	Medium
PQ 6.15 • PYQ 2025-Sep [5] (b) • 3M • Pg 66	LEVEL II Application	Medium
PQ 6.16 • RTP 2025-Sep [7] • Pg 67	LEVEL II Application	Medium
PQ 6.19 • PYQ 2026-Sep [1] (b) {C} • 4M • Pg 77	LEVEL II Application	Medium
PQ 6.2 • PYQ 2018-Nov [1] (a) {C} • 5M • Pg 48	LEVEL II Application	Hard
PQ 6.4 • MTP 2020-May [3] (a) • 10M • Pg 51	LEVEL II Application	Hard
PQ 6.7 • PYQ 2022-May [1] (a) {C} • 5M • Pg 55	LEVEL II Application	Hard
PQ 6.8 • PYQ 2022-Nov [1] (c) {C} • 5M • Pg 56	LEVEL II Application	Hard
PQ 6.9 • PYQ 2023-Nov [1] (a) {C} • 5M • Pg 57	LEVEL II Application	Hard
PQ 6.11 • MTP 2024-Nov [3] (b) • 6M • Pg 60	LEVEL II Application	Hard
PQ 6.17 • RTP 2026-Jan [8] • Pg 70	LEVEL II Application	Hard
PQ 6.18 • RTP 2026-May [6] • Pg 75	LEVEL II Application	Hard

Topic 7: Inventory Stock Out

L2P4-C2-T07

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 2, Material Cost — inventory stock out and the cost of running short.

NOTES

No question has been printed on this topic, and the pack carries no answer written to it, so what follows is assembled from the inventory control and stock level answers. Go to the Study Material for the stock-out cost analysis itself rather than inventing figures.

What the pack does say about stock-out. The objective of inventory control is **to make a balance between sufficient stock and over-stock**, and the printed answer states the consequence plainly: insufficient stock not only pauses production but also causes a loss of revenue and goodwill. Against that stand the carrying costs — funds for purchase, storage and maintenance, with a risk of

obsolescence and pilferage. The conclusion the answer draws is the sentence to reproduce: **a trade-off between stock-out and over-stocking is required.**

Safety stock is the device the numerical answers use to buy protection from a stock-out, and it is described in the questions as being maintained **in order to avoid any kind of disruption in the assembly line.** When it exists, it changes the re-order level: **Re-order level = Maximum consumption × Maximum lead time + Safety stock**, or **Lead time consumption + Safety stock.** It does not enter the EOQ formula at all.

The danger level is the second device, and it is the point at which you stop relying on normal replenishment: **Danger level = Average consumption × Lead time for emergency purchases.** The emergency lead time is always given separately and is shorter than the normal minimum — in the printed sum, 8 days against a normal range of 10 to 30.

Topic 8: Just in Time (JIT) Inventory Management

L2P4-C2-T08

Read first Read ICAI Study Material Chapter 2, Material Cost — Just in Time inventory management.

NOTES

The definition, in the printed words: JIT is an inventory management approach under which materials are purchased and goods are produced only when they are actually required, with the objective of keeping inventory at the minimum possible level, ideally close to zero. The phrase **minimum or nearly zero inventory** is the one the examiner looks for.

The two principles, and the question asks for them by name: **produce goods only when they are required**, and deliver products to customers only when they are wanted. Number them. They are two separate marks and an answer that merges them into one sentence collects one.

Why it is called the demand pull system: JIT is also known as a demand pull or pull through system of production because production is initiated by actual customer demand rather than by forecasts. If the question opens 'which system of inventory management is known as demand pull', name JIT in the first line and give that reason in the second.

The sequence, which is the diagram the printed answer draws and is worth reproducing as a chain: demand for the final product → production requirement arises → material requirement is communicated to the purchase department → order is placed with the supplier → supplier provides materials for production. Note the direction: the order to the supplier comes **after** the customer's order, which is the whole of what 'pull' means.

The benefits the answers state: JIT **reduces unnecessary inventory holding, helps reduce storage costs and avoid unnecessary stock**, and ensures that materials flow into production in response to actual demand. The printed answers do not give a list of JIT's limitations, so do not manufacture

one.

Understanding explain it, and place it in context · 2 questions

- Contrast pull with forecast-driven push in one clause. The printed answer makes that contrast and it is what explains the name.

TQ 8.1 · PYQ 2018-May [6] (b) · DESC · 5M · Pg 79

LEVEL I
Understanding

Medium

TQ 8.2 · PYQ 2026-May [6] (a) · DESC · 5M · Pg 79

LEVEL I
Understanding

Medium

Topic 9: Inventory Control on the basis of Relative Classifications

L2P4-C2-T09

Read first Read ICAI Study Material Chapter 2, Material Cost — inventory control on the basis of relative classification: ABC analysis, VED analysis and slow-moving and non-moving items.

NOTES

The format of the ABC statement, in the order the printed answers build it: Item code | Units | Unit cost | Total cost | Percentage of total cost | Rank | Classification. Compute total cost first, then the percentage of total cost, then rank **by value in descending order**, and only then apply the classification basis. Ranking is by value, never by quantity — that is the point of the whole technique and the questions are written to catch it.

The classification basis is given in the question and you must use the one given, not a remembered rule. One printed question sets **15% and above of total inventory cost as A, 6% or less as C, the remainder as B** — and the printed note spells the bands out as **15% and above A, 7% to 14% B, 6% and less C**. Another sets them in rupees: **₹50,000 and above as A, ₹15,000 to ₹50,000 as B, below ₹15,000 as C**. Reproduce the basis as a note above your classification so the examiner can see which rule you applied.

Close the ABC answer with the summary the 8 mark version asks for: group the items by category and show, for each category, the number of items, the percentage of total units and the percentage of total cost. The printed answer's result is the teaching point — **three A items are 9.89% of the units but 69.8% of the value**, while **three C items are 69.71% of the units and 9.8% of the value** — and it answers the store keeper who thought bulk quantity meant importance.

VED analysis, and the basis is criticality, not value: inventories are classified on the basis of their criticality for the production function and the final product, and the classification is **generally done for spare parts used in production**. **Vital** — unavailability can interrupt the production process and cause a production loss, and these are **strictly controlled by setting a re-order level**. **Essential** — essential but not vital; unavailability may cause sub-standardisation and loss of efficiency, and

these are **reviewed periodically and get second priority**. **Desirable** — optional in nature; unavailability does not cause any production or efficiency loss.

The hospital illustration is printed and is worth carrying, because the scenario questions use it: **life saving, rare and critical drugs are vital inventory**, since **their unavailability can interrupt smooth service**; optional drugs or substitutes, not leading to a loss in efficiency, are desirable. **FSN categorisation** is the companion technique — it helps the store keeper keep a check on medicines whose expiry date is close and which need to be disposed of at the earliest, and slow moving drugs are stocked accordingly.

Detecting slow moving and non-moving stores — the four printed methods: preparing and perusing periodic reports showing the status of different items of stores; calculating the inventory turnover period of various items in terms of number of days or months of consumption; computing the inventory turnover ratio periodically, relating the issues as a percentage of average stock held; and **implementing the use of a well-designed information system**.

And the three printed steps to reduce them, which is the second half of the question: lay down proper procedure and guidelines for the disposal of non-moving items before they further deteriorate in value; **diversify production to use up such materials**; and **use these materials as a substitute in place of other materials**. The trap is answering only the detection half — the question always asks for the strategies as well, and they are marked separately.

Remembering reproduce what you have learnt · 1 question

- For VED, give all three grades with the consequence of unavailability attached to each. The consequence is what distinguishes the grades and is the mark.

TQ 9.1 · PYQ 2021-Jul [6] (e) · SN · 5M · Pg 80

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 1 question

- Keep ABC and VED apart in your head: ABC classifies by value, VED by criticality. A question about spare parts is almost always VED.

TQ 9.2 · MTP 2024-Dec S2 [6] (c) · DESC · 4M · Pg 81

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 1 question

- Show the percentage of total cost column even when the question gives the basis in rupees. It costs one column and it is what makes your ranking auditable.

PQ 9.2 · PYQ 2025-Sep [5] (a) · 8M · Pg 83

LEVEL II
Application

Medium

Analysis break it down and examine the interrelationships · 1 question

- Where the question plants an argument, such as a store keeper who guarded the bulky items, answer it explicitly in a closing comment using your own category totals.

PQ 9.1 · PYQ 2021-Jul [1] (a) {C} · 5M · Pg 82

LEVEL II
Analysis

Medium

Topic 10: Using Ratio Analysis

L2P4-C2-T10

Read first Read ICAI Study Material Chapter 2, Material Cost — inventory control using ratio analysis, the inventory turnover ratio and the holding period.

NOTES

The four steps, and they are always run in this order: Material consumed = Opening stock + Purchases – Closing stock; **Average inventory = (Opening stock + Closing stock) ÷ 2**; **Inventory turnover ratio = Consumption ÷ Average inventory**; Number of days for which average inventory is held = Number of days in a year ÷ Inventory turnover ratio, on the 360-day year the questions specify. Set it out as a two-column statement with one material per column, so both materials are computed line by line together.

The comment is part of the answer and carries its own mark. A higher turnover ratio, or a shorter holding period, means the material is moving faster — the printed conclusions read **Material N is moving faster than Material M** and Material A is moving faster than Material B, or Material A has a less holding period. Name the faster material and give the reason in figures, as the printed answer does: **45 days against 60 days.**

The reverse working, set when average stock and the ratio are given and the purchases are asked for. Run the same relationships backwards: **Consumption = Inventory turnover ratio × Average stock** ($6 \times 59,400 = 3,56,400$ kg). Then recover the two stocks — let opening stock be A, take the stated difference to write closing stock as A + the difference, put both into **Average stock = (Opening + Closing) ÷ 2** and solve. Finally **Purchases = Material consumed + Closing stock – Opening stock**, which is the consumption identity rearranged.

The trap is the denominator. The ratio is consumption over **average** inventory, not over closing inventory, and consumption is **not** purchases. Two answers are wrong from the first line because purchases were used as consumption; write the consumption statement out in full even when the question looks as though it has given you the figure.

Watch the units. Where the question is in kilograms the whole working stays in kilograms and no value is computed; where it is in rupees the whole working stays in rupees. The turnover ratio is a pure number either way, and the holding period is in days either way.

Application use the rule - work the problem · 3 questions

- Show the consumption statement as its own block before the ratio. It is worth marks on its own and it is where a mistake, if made, is visible and recoverable.

PQ 10.1 · PYQ 2018-May [5] (a) (i) · 5M · Pg 85	LEVEL II Application	Medium
PQ 10.2 · PYQ 2021-Dec [1] (a) {C} · 5M · Pg 86	LEVEL II Application	Hard
PQ 10.3 · MTP 2026-Mar S1 [3] (a) · 5M · Pg 87	LEVEL II Application	Hard

Topic 11: Physical Control

L2P4-C2-T11

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 2, Material Cost — physical control of inventory, perpetual inventory and continuous stocktaking.

NOTES

No question has been printed on this topic, and the pack carries no answer addressed to it, so the notes below are drawn from the records and shortage answers. Read the Study Material for perpetual inventory and continuous stocktaking in full before relying on this alone.

Physical control is one of the four bases of inventory control the printed answer lists, alongside setting quantitative levels, **relative classification** and **ratio analysis**. It is the basis that reconciles the book record to the material actually on the shelf.

The two book records that physical control is checked against are both described in the pack: both bin cards and stores ledgers are perpetual inventory records, and neither is a substitute for the other. The **bin card** is kept **by the store keeper**, carries **quantities only**, and entries are made **at the time the transaction takes place**; the **stores ledger** is kept **by the cost accounting department**, carries **both quantity and value**, and entries are made **only after the transaction has taken place**.

What a physical check finds, and how the printed answers treat it. A discrepancy is a shortage, and the treatment turns on its cause: shortage arising due to abnormal reasons such as material mishandling, pilferage, or any avoidable reason is not absorbed by the good units, and losses due to abnormal reasons are debited to the Costing Profit and Loss Account; **shortage due to normal reasons is not deducted from cost**, so the good units carry it and the unit cost rises. In the stores ledger question, 50 kg **fraudulently misappropriated by the store assistant and never recovered** was written out of the balance at the current rate and left out of the value of material consumed.

Topic 12: Valuation of Material Issues

L2P4-C2-T12

Read first Read ICAI Study Material Chapter 2, Material Cost — the valuation of material issues under FIFO, LIFO and weighted average, and the stores ledger account.

NOTES

FIFO, in the printed words: a method of pricing the issues of materials in the order in which they are purchased, so **the items longest in stock are issued first**, and each issue only recovers the purchase price, which does not reflect the current market price. It is suitable in times of falling prices, because the material cost charged to production will be high while the replacement cost is low; in **rising** prices the charge to production is **low compared to the replacement cost**, so it would be difficult to purchase the same volume of material in future without additional capital resources.

LIFO, in the printed words: based on the assumption that the items of the last batch or lot purchased are the first to be issued, so **the prices of the last lot are used until it is exhausted**, and if the quantity issued exceeds the latest lot, the earlier lot and its price are also taken into consideration. During inflation or a period of rising prices, LIFO helps ensure that the cost of production is approximately the current one, and it is useful where there is a feeling that under FIFO or average methods the profits shown and the tax paid are too high.

The format of the stores ledger account, and the column that does the work: Date | Receipts (Qty, Rate, Amount) | Issues (Qty, Rate, Amount) | Balance (Qty, Amount, Rate for further issue). Under **weighted average** the balance rate is recomputed **after every receipt** as **total balance amount ÷ total balance quantity** — in the printed answer 15.00, then 15.75, then 16.50, then 16.35, then 16.48 — and every issue until the next receipt goes out at that rate. Under **FIFO and LIFO** the balance column is kept **lot by lot**, each lot on its own line with its own rate, which is what lets you price the next issue.

The two non-issue transactions that the printed answer treats specially, and this is the trap. A **return to the supplier** is entered in the **issues** column but priced at **the rate of the lot being returned**, not at the running weighted average — the 300 kg returned out of the 15 April purchase went out at **₹18** under both the weighted average and the LIFO ledgers. A **shortage or misappropriation** is also entered in the issues column, but at **the current rate** — ₹16.48 under weighted average, ₹17 under LIFO.

Neither of those is material consumed. The printed answer adds the issues only: **weighted average**, $15,750 + 19,800 + 16,350 = ₹51,900$; **LIFO**, $16,000 + 21,600 + 16,000 = ₹53,600$. The return to the supplier and the 50 kg shortage are excluded from consumption although both left the ledger. Closing stock is simply the last balance — **₹40,376 under weighted average** and $15,000 + 16,000 + 7,650 = ₹38,650$ under LIFO, the LIFO figure being the sum of the surviving lots.

Where the question gives production and purchase data rather than a ledger, build the quantities

first. The printed FIFO answer computes **total production = working days × production per day**, then **consumption = production × kg per unit**, then **total purchases over the period = consumption + closing stock – opening stock**, then splits the purchase quantity month by month using the given percentages and values each month at that month's price. Only then is the ledger drawn. Each of those three steps is separately marked.

Understanding explain it, and place it in context · 1 question

- When asked to explain FIFO or LIFO, give the pricing rule first and the price-level effect second. The effect under rising and falling prices is half the marks.

TQ 12.1 · PYQ 2018-May [6] (e) (ii) · DESC · 2.5M · Pg 89

LEVEL I
Understanding

Easy

Application use the rule - work the problem · 2 questions

- Rule the balance column lot-wise for FIFO and LIFO from the first line. Collapsing the balance into a single figure makes the next issue impossible to price and the error runs through the whole ledger.

PQ 12.1 · PYQ 2019-May [4] (b) · 10M · Pg 90

LEVEL II
Application

Hard

PQ 12.2 · PYQ 2023-May [2] (a) · 10M · Pg 93

LEVEL II
Application

Hard

Topic 13: Valuation of Returns and Shortages

L2P4-C2-T13

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 2, Material Cost — the valuation of material returns and shortages.

NOTES

No question has been printed on this topic, but its rules are settled inside the printed answers to the stores ledger and the material receipt questions, so the notes below are sourced from those and you should read the Study Material for the return-to-stores case, on which the pack is silent.

Return to the supplier. In the printed stores ledger it is entered in the **issues** column and priced at **the rate of the lot being returned** — ₹18, the 15 April purchase price — under both the **weighted average** and the **LIFO** ledgers. It is not priced at the running average rate, and the balance rate is recomputed afterwards on the reduced balance, falling from 16.50 to **16.35**.

Shortage found in the stores ledger. It too goes in the **issues** column, but at **the current rate** —

₹16.48 under weighted average and ₹17 under LIFO for the 50 kg **fraudulently misappropriated by the store assistant and never recovered**. Neither the return nor the shortage forms part of the **value of material consumed**, which the printed answer computes from the genuine issues alone.

Shortage found on receipt, where the treatment turns on the cause. Shortage arising due to abnormal reasons such as material mishandling, pilferage or any avoidable reason is not absorbed by the good units; losses due to abnormal reasons are debited to the Costing Profit and Loss Account. Shortage due to normal reasons should not be deducted from cost to ascertain the total cost of good units — the quantity of good units falls but the value does not, so the good units carry the loss and the cost per unit rises.

The trap in one line: an abnormal shortage is taken **out of cost** and into the **Costing Profit and Loss Account**; a normal shortage stays **in cost** and is spread over **fewer units**. Deducting the value of a normal shortage is the error the printed working note is written to prevent.

Topic 14: Treatment of Normal and Abnormal Loss of Materials

L2P4-C2-T14

Read first Read ICAI Study Material Chapter 2, Material Cost — the treatment of waste, scrap, spoilage, defectives and obsolescence in cost accounts.

NOTES

Waste against scrap, on the four printed bases: **Meaning** — waste is the portion of raw material which is lost during storage or production and discarded, scrap is the output which is discarded and disposed of without further treatment; **Relation** — waste is connected with raw material or inputs to the production process, scrap is **the loss connected with the output**; **Identification** — waste **may be visible or invisible**, scrap is **generally identifiable and has physical substance**; **Recoverable value** — waste **generally has no recoverable value**, scrap is termed a by-product and has a small recoverable value.

Scrap against defectives, on the four printed bases: scrap is **the loss connected with the output**, defectives are connected with the output as well as the input; both are unintended, but scrap cannot be eliminated due to the nature of the material or the process itself while defectives can be eliminated through a proper control system; **scrap are generally not used or rectified**, whereas **defectives can be used after rectification**; scrap has **insignificant recoverable value**, defectives are sold at a lower value than the good ones.

The treatment of scrap, and learn it as two lines: Normal scrap — the cost is borne by the good units produced, and the income arising from its realisable value is deducted from the cost. Abnormal scrap — the scrap account is charged with the full cost, credit is given to the job or process concerned, and the profit or loss in the scrap account on realisation is transferred to the Costing Profit and Loss Account.

The treatment of defectives: Normal — an amount equal to the cost less the realisable value on sale of the defectives is charged to the material cost of good production. Abnormal — the material cost of abnormal defectives is not included in material cost but treated as a loss after giving credit to the realisable value of such defectives, and the material cost of the abnormal loss is transferred to the Costing Profit and Loss Account.

Spoiled work against defective work, because the case questions turn on this line: spoiled work is production completely rejected because it cannot be repaired or brought up to the required quality, and has no further production value; defective work does not meet the required quality standards but can be corrected by carrying out additional work and incurring extra cost, after which it becomes fit for sale or use. Rectifiability is the whole test.

The three circumstances for defective work, and the printed treatment of each: (i) **where a percentage of defectives is unavoidable in a batch** — if actual defectives are **within the normal or expected limit**, the rectification cost is a normal production cost charged to the entire batch and distributed over all units, but if the defectives much exceed the normal limit, the extra rectification cost on the excess is an abnormal loss transferred to the Costing Profit and Loss Account; (ii) **where the defect is due to bad workmanship** — normally an abnormal cost, because it arises from inefficiency, and written off to the Costing Profit and Loss Account, except that where management expects a level of defects from the nature of the work, the rectification cost of that expected portion is a normal production cost charged to the batch; (iii) **where the defect is due to the Inspection Department wrongly accepting poor-quality material** — charged to the department responsible, that is the Inspection Department, not included in the manufacturing cost of the batch, and transferred to the Costing Profit and Loss Account as it arises from an abnormal mistake.

Obsolescence: the loss in the intrinsic value of an asset due to its supersession. Material becomes obsolete where it is a spare part or component of machinery that has itself become obsolete, **where it is used in the manufacture of a product which has become obsolete**, and where the material itself is replaced by another material due to improvement in quality or a fall in price.

Treatment in all three cases: the value of the obsolete material held in stock should be written off, immediate steps should be taken to dispose of it at the best available price, and the loss should be treated as an abnormal loss and should not form part of the cost of manufacture.

Understanding explain it, and place it in context · 4 questions

- In a distinguish question, name the basis in the left column — meaning, relation, identification, recoverable value — rather than writing four loose contrasts.

TQ 14.4 · PYQ 2026-May [6] (Or) (c) · 4M · Pg 98

LEVEL I
Understanding

Easy

TQ 14.1 · PYQ 2018-Nov [6] (b) · DESC · 5M · Pg 96

LEVEL I
Understanding

Medium

TQ 14.2 · PYQ 2024-May [6] (b) · DESC · 5M · Pg 96

LEVEL I
Understanding

Medium

TQ 14.3 · RTP 2026-May [17] (b) · DESC · Pg 97

LEVEL I
Understanding

Medium

Topic 15: Consumption of Materials

L2P4-C2-T15

Read first Read ICAI Study Material Chapter 2, Material Cost — consumption of materials and working the stock level formulae backwards.

NOTES

This topic is the stock level formulae run in reverse: you are given the levels and asked for the consumption rates or the lead times. The formulae do not change — **Re-order level = Maximum consumption × Maximum lead time**; **Maximum stock level = Re-order level + Re-order quantity – (Minimum consumption × Minimum lead time)**; **Minimum stock level = Re-order level – (Average consumption × Average lead time)** — you simply solve each for the unknown term.

Recover the lead times first, by simultaneous equations. Where the question gives the difference between minimum and maximum lead time is 4 days and **the average lead time is 7 days**, write **B – A = 4** and **(A + B) ÷ 2 = 7**, so **A + B = 14**, giving minimum lead time 5 days and maximum lead time 9 days. Nothing else in the question can be attempted until those two numbers exist.

Then take the levels in the order that unlocks them. Maximum consumption comes from the re-order level: $1,80,000 = 9 \times \text{maximum consumption}$, so **maximum consumption = 20,000 units per day**. Minimum consumption comes from the maximum stock level: $1,90,000 = 1,80,000 + 90,000 - (\text{minimum consumption} \times 5)$, giving **16,000 units per day**.

The printed answer also shows a second route to the minimum consumption, through the minimum stock level, and the two do not agree — say which you used. $1,00,000 = 1,80,000 - (\text{average consumption} \times 7)$ gives **average consumption 11,428.57 units**; then **average consumption = (maximum + minimum) ÷ 2** gives **minimum consumption 2,858 units**. Both workings are printed as acceptable, so state the relationship you are using at the head of each part and carry it through consistently rather than mixing the two.

The trap is pairing the wrong lead time with the wrong consumption. Maximum consumption always pairs with **maximum** lead time in the re-order level; minimum consumption with **minimum** lead time in the maximum stock level; average with **average** in the minimum stock level. Getting the pairing right matters more in a reverse question than in a forward one, because there is no sense-check on the answer to catch you.

Application use the rule - work the problem · 1 question

- Write the formula in its standard forward form, then substitute the knowns, then solve for the unknown as a separate line. Rearranging the formula in your head and writing only the answer forfeits the method mark.

PQ 15.1 · PYQ 2025-Jan [1] (c) (i) (ii) {C} · 4M · Pg 100

LEVEL II
Application

Easy

CHAPTER 3

Employee Cost and Direct Expenses

12 Topics · 46 Classified Questions · Importance: A

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge **17.6%** 43 of 245 marks

Level II — Analysis & Application **82.4%** 202 of 245 marks

Below the paper's Level I floor: only 18% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for the paper. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Employee (Labour) Cost

L2P4-C3-T01

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 3, Employee Cost and Direct Expenses — what employee cost is made up of and how it enters the cost of the product.

NOTES

Employee cost is never just the basic pay. Every printed answer builds it as a statement, and the rows are always the same: **Basic pay or salary, Dearness allowance, Bonus** (a stated percentage of salary and DA), **Employer's contribution to P.F., E.S.I. etc., other allowances,** and a **share of employee welfare cost.** Total those rows to get the **annual cost of each employee.** A figure taken straight from the salary line without the allowances and the employer's contributions loses most of the marks.

The employer's contribution is a cost; the employee's own contribution is not an extra cost. In the printed answers the employer's contribution to P.F. and E.S.I. is **added** to earnings to get gross wages, and then the employee's and employer's contributions together are **deducted** to arrive at net wages paid. Net wages paid is what the worker receives; it is not the figure you charge to cost.

Cost per hour = Annual cost of the employee ÷ Effective working hours. The second line of that fraction is where the marks are: effective hours are the paid hours less leave and less **normal** idle time. Abnormal idle time is never taken out of the denominator — it is costed separately.

Whether the worker is a direct or an indirect worker decides where the cost goes. The answers treat setting-up time of a **direct** worker as part of the **cost of production**, and normal break time of an **indirect** worker as something to be recovered through the **overhead rate.** Read the description

of the worker in the question before you decide the treatment.

Where employee cost sits in the cost sheet: the answers build **Material cost + Labour cost = Prime cost**, then Prime cost + Factory overheads = Factory cost. When a question gives you factory cost and asks you to work backwards to the wage rate, it is this identity you are inverting.

Topic 2: Employee (Labour) Cost Control

L2P4-C3-T02

Read first Read ICAI Study Material Chapter 3, Employee Cost and Direct Expenses — control of employee cost.

NOTES

The eight factors for controlling employee cost, in the order the answer prints them: 1. Assessment of manpower requirements; 2. Control over time-keeping and time-booking; 3. Time & Motion Study; 4. Control over idle time and overtime; 5. Control over employee turnover; 6. Wage and Incentive systems; 7. Job Evaluation and Merit Rating; 8. Employee productivity. This is a four-mark list question — reproduce the list, do not write an essay on one of them.

Each item on that list is a separate examinable topic in this chapter. Time-keeping and time-booking give you idle time; idle time and overtime carry their own treatment rules; employee turnover carries its own rates; incentive systems carry the Halsey and Rowan formulae. Use the list as the map of the chapter.

Write the list with one line of explanation each only if the marks allow. At four marks the printed answer gives the eight headings and nothing more, so headings are what is being marked.

Remembering reproduce what you have learnt · 1 question

- Learn the eight headings in sequence. A list question is marked by counting the correct headings you produce.

TQ 2.1 · PYQ 2025-Sep [6] (c) · DESC · 4M · Pg 108

LEVEL I
Remembering

Easy

Topic 3: Attendance and Payroll Procedures

L2P4-C3-T03

Read first Read ICAI Study Material Chapter 3, Employee Cost and Direct Expenses — attendance and payroll procedures, time-keeping and time-booking.

NOTES

The six objectives of time-keeping, as printed: for the preparation of payrolls; **for calculating overtime**; for ascertaining and controlling employee cost; for ascertaining idle time; **for disciplinary purposes**; and **for overhead distribution**. A question asking for 'any four' still wants four of these six, stated as objectives.

Time-keeping and time-booking are not the same record, and the gap between them is idle time. Time-keeping records the time the worker is present and paid for; time booking records the time booked to jobs. Idle time is defined in the answers as **the difference between the time paid and the time booked**, so the two records exist precisely so that the difference can be found.

Bio-Metric Attendance System — the four features the answer lists: it records attendance by identifying employees through their **unique physical or behavioural characteristics** instead of manual registers or attendance cards; it **stores biometric details** such as fingerprints, facial features or retina scans in a secure database and **verifies** them at each marking; it uses fingerprint scanning, facial recognition, retina recognition and computerised time and attendance tracking; and because the traits are unique it **prevents proxy attendance** and reduces time manipulation and payroll errors.

Finish the biometric answer with the limitation. The printed answer closes by saying it **may not be economical for small organisations** because of the **high installation and maintenance costs**. Where the question is set as a scenario (a factory of 3,000 workers with proxy attendance), the features must be tied back to the problem stated — proxy attendance and payroll errors — and the cost caveat added.

Analysis break it down and examine the interrelationships · 2 questions

- Give the number asked for — four objectives, or the features of the system — and **name each before explaining it**. Marks follow the named items.
- Where the question sets up a problem (proxy attendance, payroll error), tie at least one feature back to the problem the facts describe. That is what separates a scripted answer from one that has read the question.

TQ 3.1 · PYQ 2020-Nov [4] (c) · DESC · 4M · Pg 108

LEVEL II
Analysis

Easy

TQ 3.2 · PYQ 2026-May [6] (c) · 4M · Pg 109

LEVEL II
Analysis

Easy

Topic 4: Idle Time

L2P4-C3-T04

Read first Read ICAI Study Material Chapter 3, Employee Cost and Direct Expenses — idle time, its causes and its treatment in cost accounts.

NOTES

Definition to quote verbatim: idle time is the time during which no production is carried out because the worker remains idle but is paid; in other words it is **the difference between the time paid and the time booked**. It can be **normal or abnormal**. Both halves of that definition are marked.

Causes of normal idle time: time lost between the factory gate and the place of work; the interval between one job and another; **the setting up time for the machine; normal rest time and break for lunch**. **Causes of abnormal idle time:** **lack of coordination**; power failure and breakdown of machines; non-availability of raw materials, strikes, lockouts, poor supervision, fire, flood.

The three treatments, and what triggers each: normal idle time of a **direct** worker (setting-up time) is **treated as a part of cost of production** and is considered while setting the **standard hours or standard rate**; normal idle time of an **indirect** worker (rest and lunch breaks) is **considered in the computation of the overhead rate**; abnormal idle time (machine breakdown) is shown as a separate item in the Costing Profit and Loss Account. The classic wrong answer charges breakdown time to production.

Effective working hours — the working the examiner marks: start from **working days × hours per day**, deduct the **leave period**, then deduct **normal idle time**. In the printed answer, 310 days of 8 hours with 30 days' leave and 70 hours of normal idle time gives $(310 - 30) \times 8 - 70 = 2,170$ hours. Abnormal idle time is not deducted here — deduct it and the hourly rate and every figure after it is wrong.

Cost of abnormal idle time = abnormal idle hours × employee cost per hour. In the printed answer, 50 hours × ₹234 = ₹11,700, and that amount goes to the Costing Profit and Loss Account, not to the job. Where the question gives annual working hours and a block of non-productive hours treated as normal idle time, effective hours are simply **annual working hours – normal idle time** (2,160 – 360 = 1,800 hours), and effective hourly cost is **total annual earnings ÷ effective hours**.

Remembering reproduce what you have learnt · 1 question

- The question splits into **normal** and **abnormal** idle time. Answer under two headings and give causes under each — mixing them into one list loses the classification mark.
- Two or three causes on each side is enough. Add the treatment in one line at the end if the question leaves room: normal idle time is absorbed in cost, abnormal is charged to Costing Profit and Loss.

TQ 4.2 · MTP 2024-Dec S2 [4] (b) · DESC · 4M · Pg 111

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context · 1 question

- Quote the definition in both its forms — 'no production although paid' and 'time paid less time booked'. The second form is what makes the computation possible.

TQ 4.1 · PYQ 2024-May [6] (Or) (c) · DESC · 4M · Pg 110

LEVEL I
Understanding

Easy

Application use the rule - work the problem · 2 questions

- Set the answer out as a three-column table: Situation, Normal or Abnormal, Treatment. The classification mark and the treatment mark are separate.
- Show effective working hours as a labelled working note. Normal idle time comes out of the denominator; abnormal idle time is costed on its own line.

PQ 4.2 · MTP 2025-Jul S2 [3] (c) · 5M · Pg 112

LEVEL II
Application

Easy

PQ 4.1 · PYQ 2018-Nov [5] (b) (i) · 5M · Pg 111

LEVEL II
Application

Hard

Topic 5: Overtime

L2P4-C3-T05

Read first Read ICAI Study Material Chapter 3, Employee Cost and Direct Expenses — overtime and the treatment of overtime premium.

NOTES

Five situations, five treatments — learn them as a table. (i) **General production programme or urgent orders:** the overtime premium is treated as an overhead cost of the particular department or cost centre which works overtime. (ii) **Overtime in one department due to the fault of another:** the premium is **charged to the department at fault**. (iii) **Overtime worked regularly as a policy, e.g. shortage of workers:** the premium is **treated as part of employee cost** and the job is charged at an **effective average wage rate**. (iv) **Abnormal conditions such as flood or earthquake:** the premium is not charged to cost but to the Costing Profit and Loss Account. (v) **Overtime at the customer's request:** the premium is **charged to that job or customer directly**.

The computational form of those five rules. First build the rate table: **basic rate per hour**, then each overtime rate (a stated percentage of the basic rate), and the hours at each. Then: under the **policy** case use the inflated average wage rate = $\text{Total wages} \div \text{Total hours}$ and charge **total job hours × inflated rate**; under every other case charge the job **total job hours × basic rate** and deal with the **premium** separately. The premium itself is always **(overtime rate – basic rate) × overtime hours**.

The premium is the excess, not the whole overtime payment. In the printed answer the premium on Sunday hours is (₹11.70 – ₹6.50) and on before-and-after hours (₹10.40 – ₹6.50); the basic element of those hours stays in the job at the ordinary rate. Charging the whole overtime wage to overhead or to Costing P&L is the commonest error in this topic.

Ordinary wage rate per hour = (Gross wages excluding overtime + Employer's contribution to

E.P.F. + Employer's contribution to E.S.I.) ÷ Normal working hours. Note two things from the printed answer: the overtime wages are **excluded** from the numerator, and the employer's contributions are **included**. Overtime done on a particular job is then allocated **wholly to that job**, while ordinary wages are split across jobs in the given percentages.

Effect of overtime on productivity — the four printed points: the overtime premium is an extra payment over the normal rate; the efficiency of operators during overtime may fall so output is less than normal; workers may hold back output during normal hours in order to earn overtime; and reduced output plus increased premium raises the cost of production. Open with the line that overtime should be resorted to only when extremely essential.

Understanding explain it, and place it in context · 1 question

- Answer the five-situation question as a two-column table. Each situation carries its own mark, so a wrong first treatment does not contaminate the rest.

PQ 5.2 · PYQ 2022-May [6] (c) · 5M · Pg 116

LEVEL I
Understanding

Easy

Application use the rule - work the problem · 2 questions

- Build the rate-and-hours table before you answer any part. All four situations in a 6-mark question reuse the same basic rate and the same premium figures.
- State for each situation both the amount charged to the job and the amount charged elsewhere (overhead, the other department, the customer, or Costing P&L). Half the marks are for naming the destination.

PQ 5.1 · PYQ 2020-Nov [4] (b) · 6M · Pg 114

LEVEL II
Application

Medium

PQ 5.3 · PYQ 2024-Sep [2] (b) · 6M · Pg 117

LEVEL II
Application

Hard

Analysis break it down and examine the interrelationships · 1 question

- The ask is the **effect** of overtime on productivity, not the definition of overtime premium. Deal with the effect first; bring in the premium only as one of the cost consequences.
- Give both directions — the short-run gain in output and the longer-run fall in efficiency, fatigue and the habit of working slowly in normal hours. A one-sided answer reads as incomplete.

TQ 5.1 · MTP 2025-Mar S1 [2] (b) · DESC · 4M · Pg 113

LEVEL II
Analysis

Easy

Topic 6: Labour Utilisation

L2P4-C3-T06

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 3, Employee Cost and Direct Expenses — utilisation of labour and the records that measure it.

NOTES

Utilisation is measured by comparing the time paid for with the time booked to jobs. Time-keeping gives the first, time-booking gives the second, and the difference is **idle time** — the answers define idle time as exactly that difference. Control over **time-keeping and time-booking** is item 2 on the printed list of factors for controlling employee cost.

The usable measure of utilisation is effective working hours. Paid hours less leave hours less normal idle hours gives the hours actually available for production; every hourly-rate computation in this chapter runs through that figure. Where a worker's hours are given as absenteeism, leave and normal unavoidable idle time separately, deduct them in that order and label each deduction.

Utilisation and efficiency are different questions. Utilisation asks how much of the paid time was booked to work; efficiency asks how that booked time compares with the **standard time** for the work done (see the efficiency rating formula). A question that gives you both standard time and paid time usually wants both figures.

Topic 7: Systems of Wage Payment and Incentives (Time Based)

L2P4-C3-T07

Read first Read ICAI Study Material Chapter 3, Employee Cost and Direct Expenses — systems of wage payment, the time-based system and the choice of an incentive scheme.

NOTES

Time wage system: Earnings = Hours worked × Rate per hour. That is the base on which every premium bonus scheme is built — both Halsey and Rowan start from **time taken × time rate** and add a bonus to it. A guaranteed time wage also sets the floor: where a piece-rate computation gives less than the guaranteed weekly wage, **the worker gets whichever is higher.**

When the question asks you to 'suggest a suitable incentive scheme', the printed answer is the Rowan Scheme of premium bonus, also called a **variable sharing plan**. Do not answer with a list of schemes; name one and justify it against each condition the question sets.

The three justifications, matched to the three conditions the question gives: (i) under Rowan the

entire gains of the time saved do not pass to the worker, so the employer keeps a share; (ii) a worker **cannot increase his bonus merely by increasing speed**, because the bonus is maximised when the time taken is exactly half the time allowed — knowing this, workers work at a speed that maintains **quality**; (iii) the scheme is a **safeguard against loose fixation of standards** by a newly established rate-setting department, because workers cannot take undue advantage of a slack standard.

That middle point is the one students state wrongly. The Rowan bonus is maximised at time taken = half of time allowed — it does not keep rising as the worker gets faster. Say it in those words; it is also the answer to the separate question on why Rowan does not motivate a highly efficient worker.

Understanding explain it, and place it in context · 1 question

- Name the scheme in the first line, then take the question's conditions one at a time in the order given. The marks are allotted condition by condition.

TQ 7.1 · PYQ 2026-Jan [6] (b) · DESC · 5M · Pg 119

LEVEL I
Understanding

Medium

Topic 8: Systems of Wage Payment and Incentives (Premium Bonus Method)

L2P4-C3-T08

Read first Read ICAI Study Material Chapter 3, Employee Cost and Direct Expenses — premium bonus methods, the Halsey and Rowan plans.

NOTES

The two formulae, exactly as the answers write them. Halsey (50%): Total earnings = (Time taken × Time rate) + (50% of Time saved × Time rate). Rowan: Total earnings = (Time taken × Rate per hour) + (Time saved ÷ Time allowed) × Time taken × Rate per hour. In both, **Time saved = Time allowed (standard time) – Time taken**. The Rowan bonus is also written in the answers as **(Time saved ÷ Time allowed) × Basic wages** — the same thing, since basic wages are time taken × rate.

Get the time allowed right first; most lost marks are there, not in the formula. Time allowed for actual output = **units produced × standard time per unit** (200 units × 18/60 = 60 hours; 100 toys at 7.5 hours per ten = 75 hours; 1,800 units at 45 units per hour = 40 hours). Time taken must be read from the facts given — where a job runs from 9:00 a.m. on one day to 12:00 noon on another with a 9-hour working day, the printed answer counts **9 + 9 + 9 + 3 = 30 hours**.

Effective hourly rate = Total earnings ÷ Hours actually worked — divide by **time taken**, never by time allowed. Where a group of workers is involved, the same rule scales up: Effective hourly rate = (Total time wages + Total bonus) ÷ Total hours worked, with total time wages = **days × hours per**

day × rate × number of workers and total hours worked computed the same way.

Which plan pays the worker more is decided by where time taken falls against half the time allowed. Compare the two bonus formulae: Rowan pays more while the worker takes **more than half** the allowed time (6 hours of 9, 30 hours of 40, 48 hours of 75 — Rowan wins in every one of these printed answers), and Halsey overtakes it once time taken falls **below half** the allowed time (78 hours against 168 allowed: Halsey bonus ₹225 against Rowan ₹208.93). For the employer the comparison reverses — where a company is driving cost reduction, the printed advice is to **select Halsey because the cost is lower**.

The Rowan trap the examiner sets directly: Rowan does not reward the highly efficient worker more. With 4 hours allowed and a ₹5 rate, a worker taking 3 hours and a worker taking 1 hour both get a bonus of **₹3.75**. Show both cases and the arithmetic; the conclusion alone earns nothing.

The back-working questions: two workers, one factory cost. Let x = wage rate per hour and y = material cost, express each worker's factory cost as **Material + Wages + Bonus + Overheads** with the Halsey bonus as **50% of $(SH - AH) \times \text{rate}$** and the Rowan bonus as **$(\text{Time taken} \div \text{Time allowed}) \times \text{Time saved} \times \text{rate}$** , set both equal to the given factory cost, and **subtract one equation from the other** — the material term cancels and the rate drops out in one line. Then substitute back for the material. Present the answer as the two equations, the subtraction, and a closing statement of factory cost for both workers.

Where the company has promised an average percentage increase in earnings, answer the advice part by comparison, not by opinion. Compute **present time wages**, add the bonus under each scheme, and test each total against **present wages + the promised percentage**; then compute **labour cost per unit = total wages ÷ units produced** under each scheme and the saving against the time-wage cost per unit (**standard time per unit × rate**). Efficiency is reported separately as **Time allowed ÷ Time taken × 100**, with the increase quoted as the excess over 100%.

Application use the rule - work the problem · 17 questions

- Lay out time allowed, time taken and time saved as three labelled lines before any money appears. Every subsequent figure depends on them.
- When several plans are asked for the same facts, answer them in the order the question lists and keep the basic wages line identical in each — only the bonus line changes.

PQ 8.1 · PYQ 2018-May [1] (b) · 5M · Pg 120	LEVEL II Application	Easy
PQ 8.11 · MTP 2024-Jul [1] (c) {C} · 4M · Pg 134	LEVEL II Application	Easy
PQ 8.13 · PYQ 2025-Jan [2] (b) · 5M · Pg 137	LEVEL II Application	Easy
PQ 8.16 · MTP 2025-Aug S2 [1] (b) · 5M · Pg 142	LEVEL II	Easy

	Application	
PQ 8.18 · PYQ 2026-Jan [1] (c) {C} · 4M · Pg 145	LEVEL II Application	Easy
PQ 8.7 · PYQ 2021-Dec [1] (c) {C} · 5M · Pg 130	LEVEL II Application	Medium
PQ 8.8 · PYQ 2022-Nov [2] (b) · 6M · Pg 131	LEVEL II Application	Medium
PQ 8.10 · PYQ 2023-Nov [1] (b) {C} · 5M · Pg 133	LEVEL II Application	Medium
PQ 8.17 · PYQ 2025-Sep [1] (b) {C} · 5M · Pg 144	LEVEL II Application	Medium
PQ 8.2 · PYQ 2019-May [1] (b) {C} · 5M · Pg 121	LEVEL II Application	Hard
PQ 8.3 · PYQ 2019-Nov [4] (a) · 10M · Pg 122	LEVEL II Application	Hard
PQ 8.4 · MTP 2020-May [1] (c) {C} · 5M · Pg 124	LEVEL II Application	Hard
PQ 8.5 · PYQ 2021-Jan [2] (a) · 10M · Pg 126	LEVEL II Application	Hard
PQ 8.9 · PYQ 2023-May [1] (b) {C} · 5M · Pg 132	LEVEL II Application	Hard
PQ 8.14 · RTP 2025-Jan [9] · Pg 137	LEVEL II Application	Hard
PQ 8.15 · PYQ 2025-May [2] (b) · 7M · Pg 139	LEVEL II Application	Hard
PQ 8.19 · RTP 2026-May [7] · Pg 146	LEVEL II Application	Hard

Analysis break it down and examine the interrelationships · 1 question

- In a two-worker or two-factory problem, set up one equation per worker and subtract. Do not try to solve by trial.

PQ 8.6 · PYQ 2021-Jul [6] (c) · 5M · Pg 129	LEVEL II Analysis	Easy
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Synthesis integrate the material and construct · 1 question

- Where the question asks you to **frame or recommend an incentive plan**, work both schemes on the figures first, then recommend. A recommendation with no comparison behind it earns nothing.
- Set the comparison out per worker: earnings under each scheme, effective rate per hour, and cost per unit to the employer. The recommendation follows from the last of those, so say which figure you are deciding on.

PQ 8.12 · MTP 2024-Nov [1] (c) {C} · 4M · Pg 135

LEVEL II
Synthesis

Easy

Topic 9: Absorption of Wages

L2P4-C3-T09

Read first Read ICAI Study Material Chapter 3, Employee Cost and Direct Expenses — absorption of wages, and the distinction between allocation and absorption.

NOTES

Cost allocation is the allotment of a whole item of cost to a cost centre or a cost unit — the process of identifying, assigning or allowing cost to a cost centre or cost unit. Cost absorption is the process of absorbing all indirect or overhead costs allocated or apportioned over a particular cost centre or production department by the units produced. Both definitions are marked almost word for word in a 'distinguish between' question.

The distinction turns on two words: whole and indirect. Allocation deals with a **whole item** of cost that is identifiable with one centre; absorption deals with the **indirect costs already allocated or apportioned** to a centre, which are then spread **over the units produced**. Allocation puts cost into a department; absorption takes it out of the department and into the product.

Set a distinguish-between answer out in two columns or as two labelled paragraphs. The printed answer defines each in turn and stops — it does not list points of difference. Give the definitions first; any comparison you add should follow them, not replace them.

Understanding explain it, and place it in context · 1 question

- Keep 'whole item of cost' with allocation and 'units produced' with absorption. Swapping those phrases is the standard error.

TQ 9.1 · RTP 2023-Nov [14] (e) · DB · Pg 149

LEVEL I
Understanding

Medium

Topic 10: Efficiency Rating Procedures

L2P4-C3-T10

Read first Read ICAI Study Material Chapter 3, Employee Cost and Direct Expenses — employee productivity and efficiency rating procedures.

NOTES

Productivity is an input/output ratio; for employees the answers compute it as Standard time for doing the actual work ÷ Actual time taken. Efficiency is the same comparison expressed as a

percentage: **Efficiency % = (Standard time ÷ Time taken) × 100**. If the time taken **equals or is less than** the standard time the worker is rated **efficient**; if he takes **more** than standard time he is rated **inefficient**.

The three-step efficiency rating procedure, in order: (1) Determining standard time / performance standards — fixed by Time & Motion study or Work study, taking a **heterogeneous group of workers** and adding **contingency allowances**; (2) **Measuring actual performance** — a recording procedure that captures each worker's **output along with the time taken**; (3) Computation of the efficiency rating by applying the formula to those two figures.

The five factors for increasing employee productivity, as printed: employ only workers with the right type of skill; place the **right person on the right job**; **train young and old workers** by giving them the right opportunities; take measures to **avoid excess or shortage of employees**; and carry out **work study** for fixation of wages and for the simplification and standardisation of work.

Do not answer the productivity question with the efficiency procedure, or the reverse. 'What do you mean by employee productivity' wants the input/output ratio and the five factors; 'explain the efficiency rating procedures' wants the formula and the three steps. The formula is common to both, and mentioning the two mentions of **Time & Motion study** links this topic to the control list in the chapter's opening topic.

Understanding explain it, and place it in context · 2 questions

- Give the three procedural steps as numbered headings with one sentence each. The headings are the marks; the sentences protect them.

TQ 10.1 · PYQ 2023-Nov [6] (c) · DESC · 5M · Pg 150

LEVEL I
Understanding

Medium

TQ 10.2 · MTP 2024-Jul [6] (b) · DESC · 5M · Pg 151

LEVEL I
Understanding

Medium

Topic 11: Employee (Labour) Turnover

L2P4-C3-T11

Read first Read ICAI Study Material Chapter 3, Employee Cost and Direct Expenses — employee (labour) turnover, its measurement, its costs and its remedies.

NOTES

The three rates, all on the same denominator — Average number of workers on roll during the period. Separation Method = $(\text{No. of separations} \div \text{Average number of workers on roll}) \times 100$, separations being those who **left and were discharged**. Replacement Method = $(\text{No. of replacements} \div \text{Average number of workers on roll}) \times 100$. Flux Method = $((\text{No. of separations} + \text{No. of accessions}) \div \text{Average number of workers on roll}) \times 100$, where accessions are the workers

recruited and joined; where the question gives replacements rather than accessions the answers use **(Separations + Replacements) ÷ Average × 100**.

Replacements exclude recruitment for expansion. Where 300 employees were recruited and 225 of them were for an **expansion project**, only the remainder — those recruited **due to the exit of employees** — are replacements. Putting the expansion recruits into the replacement rate is the single commonest error in this topic. They do, however, count as **accessions** in the flux method.

Equivalent annual turnover rate = (Turnover rate for the period ÷ Number of days in the period) × 365. The answers also accept the equivalent scaling for other period lengths: a quarterly rate is × **4 quarters**, a two-month rate is × **6** (or ÷ 60 days × 365, or ÷ 60 × 360, all three of which are printed as acceptable). Read what the period actually is — for an organisation **newly set up** part-way through the year, the period runs from the date of setting up, not from 1 April.

The rates are examined backwards as often as forwards. Given any rate and the matching count, invert the formula: from the replacement rate and the number of replacements get the **average number of workers on roll** ($72 \div 8\% = 900$); from that and the separation rate get the **number separated** ($5\% \text{ of } 900 = 45$); then from the flux rate get the **accessions** ($16\% \text{ of } 900 = 144$ less 45 separations = 99 recruited and joined). Always solve in that order — average on roll first, separations next, accessions last.

Two types of cost, and the examiner wants them named: Preventive costs are incurred to **prevent or minimise turnover** — medical benefits, welfare such as pension, and other retention benefits. **Replacement costs arise because of turnover** — recruitment, training and induction, **abnormal breakage and scrap**, and **extra wages and overheads due to the inefficiency of new workers**. High turnover raises the cost of production through exactly those three channels: cost of new workers and their unproductive hours, loss of material and breakages, and extra wages and overheads from inefficiency.

Profit forgone due to turnover — build it in this order. First the **hours lost**: potential productive hours lost through delay in recruitment + unproductive training hours (of 60,000 training hours with 40% unproductive, the unproductive figure is 24,000). Then the **contribution lost** on those hours — either $(\text{Sales} \div \text{Productive hours}) \times \text{Hours lost} \times \text{P/V ratio}$, or via **units lost × contribution per unit** where contribution per unit is the **P/V ratio × selling price**. Then add **cost of rectifying defective units** (defective units × rectification cost), **recruitment and selection cost, training and induction cost** and **settlement cost of workers leaving**. The total is the **profit forgone**.

Remedial steps to minimise turnover, as printed: **exit interview** with each outgoing employee to ascertain why he is leaving; **job analysis and evaluation** to ascertain the requirement of each job; a scientific system of recruitment, placement and promotion; a healthy atmosphere with education, medical and housing facilities; and a **committee for settling workers' grievances**.

Understanding explain it, and place it in context · 1 question

- The question asks **how turnover increases the cost of production** — so every point must end in a cost. Name the cost, not just the disturbance.

- Use the separation / replacement / preventive structure if it helps you, but make sure the answer covers both the **cost of replacing** a worker and the **loss of output** while the post is empty.

TQ 11.1 · PYQ 2023-May [5] (c) · DESC · 5M · Pg 151

LEVEL I
Understanding**Medium****Application** use the rule - work the problem · 9 questions

- Compute the period rate first and the equivalent annual rate underneath it, showing the scaling factor ($\div$ days $\times$ 365, or $\times$ 4 quarters). Two separate marks.
- Where the question gives rates and asks for numbers, invert the formulae in the fixed order: average on roll, then separations, then accessions.

PQ 11.4 · RTP 2023-May [2] · Pg 157

LEVEL II
Application**Easy**

PQ 11.5 · MTP 2023-Sep [1] (d) {C} · 5M · Pg 159

LEVEL II
Application**Easy**

PQ 11.1 · PYQ 2018-May [3] (a) · 10M · Pg 153

LEVEL II
Application**Medium**

PQ 11.6 · PYQ 2024-May [5] (a) · 6M · Pg 160

LEVEL II
Application**Medium**

PQ 11.7 · RTP 2024-Sep [8] · Pg 161

LEVEL II
Application**Medium**

PQ 11.8 · PYQ 2025-May [1] (c) {C} · 4M · Pg 162

LEVEL II
Application**Medium**

PQ 11.2 · PYQ 2021-Jul [2] (c) · 5M · Pg 155

LEVEL II
Application**Hard**

PQ 11.3 · PYQ 2022-May [1] (b) {C} · 5M · Pg 156

LEVEL II
Application**Hard**

PQ 11.9 · PYQ 2026-May [4] (b) · 5M · Pg 163

LEVEL II
Application**Hard****Analysis** break it down and examine the interrelationships · 2 questions

- In a profit-forgone question, present a single statement headed 'Profit forgone due to employee turnover' with the contribution loss first and the four cost items under it. Working notes for hours lost and contribution per unit go above it.

TQ 11.2 · MTP 2025-Aug S2 [6] (Or) (c) · DESC · 4M · Pg 152

LEVEL II
Analysis**Medium**

TQ 11.3 · MTP 2025-Dec S2 [6] (b) · DESC · 5M · Pg 153

LEVEL II
Analysis**Medium**

Topic 12: Direct Expenses

L2P4-C3-T12

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 3, Employee Cost and Direct Expenses — direct expenses and their place in the cost sheet.

NOTES

Direct expenses are the third element of prime cost. The cost sheets printed throughout this chapter build **Material cost + Labour cost (+ Direct expenses) = Prime cost**, and then **Prime cost + Factory overheads = Factory cost**. An expense qualifies as direct only if it can be identified with the particular job, product or cost unit; anything that has to be spread over several cost centres is an overhead, not a direct expense.

The test is identifiability with the cost unit, and it is the same test the chapter applies to labour. Time booked to a job goes to the job; time that cannot be booked to a job (normal rest time of an indirect worker) is recovered through the **overhead rate**. Apply that reasoning to any expense the question puts in front of you.

Watch the boundary with the Costing Profit and Loss Account. The chapter's treatment rules repeatedly exclude abnormal items from cost altogether — abnormal idle time and overtime worked because of a flood are both **charged to the Costing Profit and Loss Account** rather than to the job. An abnormal expense is never a direct expense, however clearly it attaches to a job.

CHAPTER 4

Overheads — Absorption Costing Method

11 Topics · 41 Classified Questions · Importance: C

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge

12.9%

32 of 249 marks

Level II — Analysis & Application

87.1%

217 of 249 marks

Below the paper's Level I floor: only 13% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for the paper. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Classification of Overheads

L2P4-C4-T01

Read first Read ICAI Study Material Chapter 4, Overheads — Absorption Costing Method, classification of overheads and the bases on which each class is apportioned.

NOTES

The classification question is set as a bases-of-apportionment question, so learn the pairs. **Air-conditioning — floor area, or volume of the department; Time-keeping — number of workers; Depreciation of plant and machinery — capital values; Power / steam consumption — technical estimates;** Electric power (machine operation) — horse power of machines, or number of machine hours, or value of machines, or units consumed.

The basis always follows what drives the cost, and that is how you handle an item you have not memorised. Space-related costs (rent and rates, factory rent, security of factory premises, lighting where it is not metered, building insurance, building depreciation) go on **floor area**; people-related costs (time-keeping, personnel, canteen and welfare, hospital, supervision, meal subsidy) go on **number of employees**; asset-related costs (depreciation, insurance of machinery, fire protection) go on **capital value or book value of machinery**; power goes on **horse power**, or on **horse power × machine hours** where both are given.

Where the answer prints several acceptable bases, you need name only one — but name it. Electric power for machine operation is shown with four alternatives, and lighting appears both as **number of light points** and as **floor area or units consumed** depending on what the question supplies. State the basis you have chosen in the statement itself, in a 'Basis' column, next to the ratio you use.

Classification by function decides the destination before any basis is chosen. The chapter's answers separate **factory or manufacturing overhead** from **administration overhead** and from **selling and distribution overhead**, and an item is placed by what it is for, not by who paid it —

auditors' fees and independent directors' fees are administration; salary of the sales manager and depot storage wages are selling; secondary packing and depreciation on delivery vehicles are distribution.

Application use the rule - work the problem · 1 question

- A bases-of-apportionment question. **Give one basis per item, in the question's order**, and make it a measurable quantity — floor area, number of employees, capital value, horsepower × hours, metered units.
- Do not explain the item. The mark is the basis, so a compact two-column answer scores better than prose.

TQ 1.1 · PYQ 2018-Nov [6] (c) · DESC · 5M · Pg 167

LEVEL II
Application

Medium

Topic 2: Accounting and Control of Manufacturing Overheads

L2P4-C4-T02

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 4, Overheads — Absorption Costing Method, the accounting for and control of manufacturing overheads.

NOTES

Manufacturing overhead reaches the product in three named stages, and every practical answer in this chapter is one of those stages. **Allocation** — the whole item is charged to the department it belongs to; **Apportionment (primary distribution)** — items common to several departments are split on a basis; **Re-apportionment (secondary distribution)** — the service departments' totals are cleared over the production departments; then **Absorption** — each production department's total is divided by its own machine hours or labour hours to give a rate that is charged to the job.

The test that separates allocation from apportionment is identifiability. Where the question already gives the figure department by department — indirect material, indirect labour, direct wages of a service department, consumable stores, depreciation shown against each machine — it is **allocated** and shown as 'Direct' or 'Actual' in the Basis column. Where one total has to serve several departments — factory rent, power, insurance, security, supervision — it is **apportioned** and the Basis column must name the basis and the ratio.

What manufacturing overhead is made of, as the printed statements list it: indirect material, indirect wages, factory rent and rates, general lighting, power, depreciation on machines, insurance of machinery, repairs and maintenance including consumables, consumable stores,

supervision and indirect labour, security expenses for factory premises and **sundries**. Direct wages of a production department never enter this statement; direct wages of a **service** department do, because a service department's own wages are an overhead of the factory.

Two items are kept out of cost altogether, and saying so earns the mark. Interest on capital outlay is a finance cost and is excluded from the cost accounts; and where a company charges **notional rent** on a building it owns, that imputed cost is **not included** — rent is apportioned only over the departments that actually use the rented building.

Topic 3: Steps for Distribution of Overheads

L2P4-C4-T03

Read first Read ICAI Study Material Chapter 4, Overheads — Absorption Costing Method, the steps for distribution of overheads and the re-apportionment of service department costs.

NOTES

The three methods of re-distributing support department costs, as the answer defines them.

Direct re-distribution method: support department costs are apportioned **to the production departments only**, ignoring the service one support department gives another. **Step method:** the support department serving the **maximum number of departments** is apportioned first, to the other support departments and the production departments; then the one serving the **next largest number**; and so on until only production departments remain. **Reciprocal service method:** it **recognises that support departments serve each other**, and the methods available under it are (a) simultaneous equation method, (b) repeated distribution method, (c) trial and error method.

Bases for re-apportioning a service department — learn them as pairs. **Maintenance and repair shop** — machine hours; Hospital and dispensary — number of employees; **Fire protection** — capital value of machines; **Stores department** — material requisitions (or the value of issues); **Transport department** — crane hours (also truck hours, mileage, tonnage, ton-hours); **Computer section** — computer hours; **Power house** — horse power for power cost but floor area, cubic content, number of light points or wattage for electric lighting cost; **Inspection** — inspection hours; **Tool room** — machine hours; Time-keeping, personnel, canteen and welfare — number of direct workers or total number of employees; Planning and progress — direct labour hours, machine hours, direct labour wages, or asset value × hours worked.

Simultaneous equation method — the shape of the answer. Let each service department's total be an unknown, write one equation per service department: its own cost before allocation plus its share of the other's total ($S1 = 1,60,000 + 0.10 S2$; $S2 = 2,40,000 + 0.20 S1$), substitute one into the other, and solve. Then apportion **each solved total** over the production departments at the given percentages. Check your work by confirming that the amounts distributed to the production departments add back to the **original total** of the service departments.

Repeated distribution method — keep going until the balance is nil. Apportion department X in its given ratio (including the share to Y), then Y in its ratio (including the share back to X), then X again, and so on; the amounts shrink each round and the last few rupees are absorbed in the final round. The ratios never change between rounds — write them once at the head of each line, as the printed answers do, and keep the service department columns negative.

Step method: you must justify the order before you use it. The printed answer computes the **percentage of service rendered by each service department to the other** — maintenance to personnel 15.00%, personnel to maintenance 5.88% — and puts **maintenance first because it serves the other more**. Once a service department has been closed in this method it **receives nothing further**, so the second department's cost is spread over the production departments alone.

Read the usage table in the right direction. A row shows how that department's service is **consumed by the others**, so the share a department **receives** from another is found in the **other department's row**, not in its own. Taking the percentage from the wrong axis is the standard error and it corrupts both equations at once.

Single rate against dual rate, where a service department has fixed and variable costs. **Single rate:** one budgeted rate = fixed practical capacity cost per hour + budgeted variable cost per hour ($₹7.50 + ₹5 = ₹12.50$), charged on **actual usage**. **Dual rate: fixed costs on practical capacity of each department and variable costs on actual usage** — this allocates all the fixed cost and leaves **no unused capacity identified**. Where the dual rate is applied with the **fixed rate computed on practical capacity but charged on actual usage**, the user departments bear fixed cost **only for the capacity they used** and the **unused capacity cost is highlighted and not allocated**. That last sentence is the comment the question asks for.

Application use the rule - work the problem · 9 questions

- State the method named in the question and use only that method. A repeated-distribution answer to a simultaneous-equation question earns nothing for the method marks.
- Write the two equations, the substitution and the solved totals as separate lines. Most of the marks are in the setting up, not the arithmetic.

PQ 3.4 · PYQ 2025-Sep [2] (b) · 4M · Pg 178	LEVEL II Application	Easy
PQ 3.7 · PYQ 2026-Sep [1] (c) {C} · 3M · Pg 185	LEVEL II Application	Easy
TQ 3.1 · PYQ 2023-May [6] (d) · DESC · 5M · Pg 168	LEVEL II Application	Medium
TQ 3.3 · PYQ 2025-Jan [6] (Or) (c) · DESC · 4M · Pg 170	LEVEL II Application	Medium
PQ 3.1 · RTP 2019-May [3] · Pg 171	LEVEL II Application	Medium

PQ 3.2 · PYQ 2021-Jul [1] (b) {C} · 5M · Pg 174	LEVEL II Application	Medium
PQ 3.3 · RTP 2023-May [3] · Pg 176	LEVEL II Application	Medium
PQ 3.5 · RTP 2026-Jan [10] · Pg 179	LEVEL II Application	Hard
PQ 3.6 · MTP 2026-Apr S2 [4] (a) · 9M · Pg 183	LEVEL II Application	Hard

Analysis break it down and examine the interrelationships · 1 question

- Name the three methods before describing any of them, then take one paragraph each. **Direct, step (non-reciprocal) and reciprocal** — the names are marks in themselves.
- For the reciprocal method say which techniques carry it out (simultaneous equation, repeated distribution, trial and error). That detail is what lifts a three-line answer.

TQ 3.2 · MTP 2024-Dec S2 [6] · DESC · 4M · Pg 169	LEVEL II Analysis	Easy
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Topic 4: Methods of Absorbing Overheads to Various Products or Jobs

L2P4-C4-T04

Read first Read ICAI Study Material Chapter 4, Overheads — Absorption Costing Method, the methods of absorbing overheads into products and jobs.

NOTES

Absorption is always total overhead of the centre divided by the quantum of the chosen base. The bases the chapter's answers use are the **machine hour rate** (total overhead of the department ÷ machine hours), the **direct labour hour rate** (total overhead ÷ labour hours), and a **percentage of direct wages** (in one question 'other indirect expenses are recovered at 20% of direct wages'). The rate once computed is applied to the **hours the job actually took** in that department.

Choose the base department by department, not for the factory as a whole. Where a department's work is dominated by machines it is treated as **machine oriented** and absorbed on machine hours; where the work is dominated by labour it is **labour oriented** and absorbed on labour hours. Where the question gives both machine and labour hours for every department, say in one line which you have assumed for each and why — the printed answers carry exactly that note.

A single blanket rate misprices a job when the departments differ in character. Where two departments are dominated by machine hours and one by direct labour hours, a rate built on total direct labour hours for the whole factory charges the machine-heavy work far too little. The recommendation the examiner wants is **departmental rates with the basis chosen department by department** — and the recommendation only earns its marks if you then recompute the job's

overhead on the recommended basis and show the difference against the blanket-rate figure.

Back-working questions: the rate is given and one cost is missing. Build the full overhead statement for the period with every item you can compute, total it, then **multiply the given rate by the hours to get the total overhead that must exist** ($₹125 \times 2,400 \text{ hours} = ₹3,00,000$) and take the **missing item as the balancing figure**. Where the statement is for four months and the item asked for is annual, **scale it back up** ($₹16,100 \times 3 = ₹48,300$). Annual figures given for repairs, depreciation, sundry works expenses and management expenses must first be brought down to the period by the same fraction.

Application use the rule - work the problem · 2 questions

- In a balancing-figure question, write the statement first and insert the missing line as 'Balancing figure' in words. The examiner is looking for that label.
- Convert annual items to the period of the question before totalling, and show the fraction ($\times 1/3, \div 12$) in the line itself.

PQ 4.2 · PYQ 2026-Sep [5] (b) (ii) · 3M · Pg 188

LEVEL II
Application

Easy

PQ 4.1 · PYQ 2026-Jan [5] (a) · 6M · Pg 186

LEVEL II
Application

Medium

Topic 5: Types of Overhead Rates

L2P4-C4-T05

Read first Read ICAI Study Material Chapter 4, Overheads — Absorption Costing Method, types of overhead rates and the computation of the machine hour rate.

NOTES

Blanket rate against departmental rate. A **blanket overhead rate** is **one single overhead rate for the whole factory** — total overheads of the factory divided by the total quantum of the base for the factory (in the printed answers, total budgeted overheads $\div$ total budgeted machine hours, or $\div$ total budgeted direct labour hours). A **departmental overhead rate** is **one rate for a particular production unit or department**, computed on that department's own overheads and its own base. It is the budgeted figures that set a pre-determined rate, not the actual ones.

Conditions for applying a blanket rate, as printed: (1) where only one major product is produced; or (2) where several products are produced but (a) all products pass through all departments and (b) all products are processed for the same length of time in each department. Both limbs of the second condition are needed — quote (a) and (b) separately.

The comprehensive machine hour rate has a fixed two-part format; use it and the marks follow the rows. **(A) Standing charges** — the costs that do not vary with the running of the machine: **rent and**

rates, heat and lighting, insurance of plant and building, supervision or foreman's salary, departmental and general works overheads, other general expenses, and, in a comprehensive rate, the wages of the operator or attendant with dearness allowance, production bonus and leave wages. **(B) Machine expenses** — depreciation, power, repairs and maintenance including consumable stores, oil and lubricants, and any consumable specific to the machine. Each group is totalled for the period and divided by the effective machine hours; **Machine hour rate = (A) + (B).**

Effective machine hours is where this topic is won or lost. The printed derivations are: **normal working hours less hours lost on repairs and maintenance** ($4,500 - 300 = 4,200$); **normal hours × capacity percentage** ($200 \times 75\% = 150$); **total working hours less unproductive set-up time** ($192 - 16 = 176$); and, where a calendar is given, working days × hours per day, with half-days at the reduced hours, then × capacity %, then less the breakdown allowance ($2,188 \times 92\%$ less 3% of that = 1,953). **Setting-up time follows the question's own words** — one answer treats it as **productive** and does not deduct it, another treats it as **unproductive** and does. Read that sentence before you compute.

Where the machine cannot run without an operator, the operators' hours are the machine's hours — but wages are paid on a different figure. Build the hours as normal available hours (per month × months × operators) – absenteeism (without pay) = paid hours, then paid hours – leave hours – normal unavoidable idle time = effective working hours. Wages are then **paid hours × rate** ($2,460 \text{ hours} \times ₹75$), while the rate is struck on **effective hours** (2,400). Using the same figure for both is the commonest error in this topic. Production bonus is a stated percentage **of wages**, so it follows the paid-hours figure.

Apportion the machine-shop items before you divide. Where several machines share a shop, the printed bases are: insurance of machinery on depreciation or capital value, **indirect labour on direct labour hours, building maintenance and rent on floor space, power on K.W. rating,** supervisor's and operator's salaries equally where they spend equal time on each machine, and **oil, spare parts, consumable stores as allocated.** Where the question gives a price rise and a consumption rise, apply them **in that order and only to the machines named** — price increase to all, consumption increase to the two named machines.

Interest on capital outlay is excluded — say so explicitly. The printed working note ends with 'interest on capital outlay is a finance cost, therefore it has been excluded from the cost accounts'. It is given in the question precisely so that you will leave it out and write that line.

Understanding explain it, and place it in context · 1 question

- Three asks in one line: **what each rate is, how each is calculated, and when a blanket rate may be used.** Number the answer to match, or the third ask gets lost.
- Give the calculation as a formula, not a sentence. The conditions for a blanket rate are a short list — give them all.

Understanding

Application use the rule - work the problem · 9 questions

- Compute effective machine hours as a numbered working note above the statement, with each deduction labelled. Everything else is arithmetic on that figure.
- Keep standing charges and machine expenses in separate blocks with a sub-total each, then add. Presentation on a monthly, six-monthly or annual basis is accepted as long as it is consistent.

PQ 5.1 · PYQ 2019-May [5] (b) · 5M · Pg 190	LEVEL II Application	Easy
PQ 5.2 · PYQ 2021-Jan [1] (b) {C} · 5M · Pg 191	LEVEL II Application	Easy
PQ 5.9 · PYQ 2026-Sep [5] (b) (i) · 2M · Pg 206	LEVEL II Application	Easy
PQ 5.4 · MTP 2024-Jul [4] (a) · 6M · Pg 195	LEVEL II Application	Medium
PQ 5.5 · PYQ 2024-Sep [5] (a) · 7M · Pg 197	LEVEL II Application	Medium
PQ 5.6 · RTP 2024-Sep [9] · Pg 199	LEVEL II Application	Medium
PQ 5.7 · MTP 2025-Dec S2 [1] (b) {C} · 5M · Pg 201	LEVEL II Application	Medium
PQ 5.8 · RTP 2026-May [8] · Pg 202	LEVEL II Application	Medium
PQ 5.3 · PYQ 2022-Nov [2] (a) · 10M · Pg 193	LEVEL II Application	Hard

Topic 6: Treatment of Under-Absorbed and Over- Absorbed Overheads in Cost Accounting

L2P4-C4-T06

Read first Read ICAI Study Material Chapter 4, Overheads — Absorption Costing Method, the treatment of under-absorbed and over-absorbed overheads.

NOTES

Three treatments, and the rule that picks between them. (i) Writing off to the Costing Profit and Loss Account: a **small** difference between the actual and absorbed amount is simply transferred there; where the difference is **large**, investigate the causes and transfer the resulting **abnormal loss or gain** there. **(ii) Use of a supplementary rate:** the balance is charged to work-in-progress, finished stock and cost of sales proportionately. **(iii) Carry forward to the subsequent year**, in the expectation that the position will correct itself.

Purify the actual overhead before you compare it with the absorbed figure. The printed answers deduct from actual overheads incurred: **amount paid to a worker as per a court's award, wages paid for a strike period, stores written off** (including obsolete stores written off), and expenses of a previous year booked in the current year. What remains is the **net actual overhead**. Then Under-absorption = Net actual overheads – Overheads absorbed, where overheads absorbed = actual hours (or man-days, or units) × the pre-determined rate.

Split the under-absorption by cause, because the two halves go to different places. The portion caused by **defective production planning or factory inefficiency** is **abnormal** and is **debited to the Costing Profit and Loss Account**. The portion caused by an **increase in costs** — of indirect material and indirect labour — is normal and is **distributed by a supplementary rate**. The question always gives the split as a fraction or a percentage; apply it to the under-absorbed total, not to the actual overhead.

Supplementary rate = Amount to be distributed ÷ Equivalent units, where equivalent units are units sold + units in finished stock + equivalent completed units of work-in-progress. Work-in-progress enters at its **percentage of completion** (20,000 units 65% complete count as 13,000; 5,000 units 40% complete count as 2,000). Then apportion: **Cost of sales = units sold × rate**, **Finished goods = closing finished units × rate**, **Work-in-progress = equivalent units × rate**, and the three must add back to the amount distributed.

The journal entry, in the order the answer prints it: Work-in-progress control A/c Dr., Finished goods control A/c Dr., Cost of Sales A/c Dr., Costing Profit & Loss A/c Dr., To Overhead control A/c for the whole under-absorbed amount. The direction reverses for over-absorption: under-absorption is debited to the stock and cost of sales accounts, over-absorption is credited to them, and the amount in each case is units (or equivalent completed units) × supplementary rate per unit.

Where a departmental rate has been recommended, the recovery test is departmental. Recovery is the department's **own actual activity at its own recommended rate**, compared with **that department's own actual overhead** — not with the factory total — and the answer must state in terms whether it is **under-recovered or over-recovered**.

Understanding explain it, and place it in context · 1 question

- Keep the direction straight: under-absorption means too little was charged, so the stock and cost of sales accounts are debited with more.

TQ 6.1 · MTP 2024-Mar [6] (a) · DESC · 5M · Pg 207

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 4 questions

- Show the purification of actual overheads as a deduction column with each excluded item named. Skipping straight to the difference loses those marks.

- Compute equivalent units in a working note before the supplementary rate, and apply the rate to WIP on equivalent units only.

PQ 6.4 · PYQ 2026-Sep [5] (b) (iii) · 2M · Pg 214	LEVEL II Application	Easy
PQ 6.3 · PYQ 2024-May [4] (b) · 6M · Pg 212	LEVEL II Application	Medium
PQ 6.1 · PYQ 2019-Nov [2] (b) · 10M · Pg 208	LEVEL II Application	Hard
PQ 6.2 · PYQ 2021-Dec [5] (b) · 10M · Pg 210	LEVEL II Application	Hard

Topic 7: Accounting and Control of Administrative Overheads

L2P4-C4-T07

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 4, Overheads — Absorption Costing Method, accounting and control of administration overheads.

NOTES

Administration overhead is identified by function — the general direction and control of the undertaking — and the printed classification answer groups these items under it: **salary paid to office staff, fees paid to auditors, fees paid to independent directors, and vehicle hire charges for directors attending a general meeting**. Anything belonging to the factory (factory rent, factory security) is manufacturing overhead, and anything belonging to selling or delivery is selling or distribution overhead.

The boundary is tested by putting near-identical items in the same list. An electricity bill for the **sales office** is a selling cost while the factory's power is a manufacturing cost; a director's vehicle hire for a **general meeting** is administration while depreciation on **goods delivery vehicles** is distribution. Read the qualifying words in the item, not the noun.

Where the chapter apportions administration cost between departments, the printed bases are the ordinary ones: **gross salary** for salaries and group employee insurance, **floor area** for rent, property tax and building depreciation, **number of employees** for meal subsidy, **metered units** for electricity, and **direct expenses** for miscellaneous expenditure allocated on that footing.

In a secondary distribution the administration department is cleared like any other service department, in the ratio the question gives, after any department that serves it has been dealt with first. A general management department serving administration, production and selling is apportioned before the administration department's own total is spread.

Topic 8: Accounting and Control of Selling and Distribution Overheads

L2P4-C4-T08

Read first Read ICAI Study Material Chapter 4, Overheads — Absorption Costing Method, accounting and control of selling and distribution overheads.

NOTES

The three methods of controlling selling and distribution overheads, as printed: (a) **Comparison with past performance** — analyse the current figures against those of previous periods; (b) **Budgetary control** — budget the overheads, compare budget with actual, **identify variances and take corrective action**; (c) **Standard costing** — set standards for each category, such as **salespeople, territories and products**, compare with actual and address the variances. Each method must carry the comparison it makes; the name alone is half the point.

Selling cost and distribution cost are separate heads and the examiner separates them. The printed classification puts **salary of the sales manager**, wages of workers storing goods at the sales depot, **travelling allowance of sales staff**, **electricity for the sales office** and bonus to sales staff for achieving targets under **selling**; and **secondary packing** and **depreciation on goods delivery vehicles** under **distribution**.

Bases for apportioning selling and distribution overheads to products: rent and insurance on square feet of storage area, **depreciation on number of parcels**, salesmen's salaries and expenses on sales volume, administrative wages and salaries on number of invoices. The variable items are charged at their own rates — packing wages and materials per parcel, **commission as a percentage of sales**, **stationery per invoice**.

Build a product profitability statement in the marginal-costing order, because the decision turns on contribution. **Sales – (Cost of sales + Commission + Packing + Stationery) = Contribution**; then deduct the **fixed** selling and distribution costs apportioned on their bases to reach **profit or loss per product**, and express it as a **percentage of sales**.

On a proposal to discontinue a product, answer on the figures, not on the size of its sales. In the printed answer the product with the **smallest sales** earned a **7.13% profit** while the largest-selling product made a **loss**, so the recommendation to discontinue it was held to be **not correct**. State the recommendation, give the product's own profit figure, and conclude.

Understanding explain it, and place it in context · 1 question

- The ask is **methods of control**, not the classification of selling and distribution overheads. Name each method and say in one clause what it controls.
- Comparison with past performance, budgetary control and standard costing are the three the printed answers use. Say which is suited to which kind of business.

TQ 8.1 · PYQ 2025-Jan [6] (c) · DESC · 4M · Pg 215

LEVEL I
Understanding**Easy****Application** use the rule - work the problem · 1 question

- Show the basis and the ratio beside every apportioned fixed cost. The bases are separately marked from the arithmetic.

PQ 8.1 · RTP 2025-Jan [10] · Pg 215

LEVEL II
Application**Medium**

Topic 9: Concepts Related to Capacity

L2P4-C4-T09

Read first Read ICAI Study Material Chapter 4, Overheads — Absorption Costing Method, the concepts related to capacity and the treatment of idle capacity cost.

NOTES

Four capacities, with the definitions the answers use. **Installed (rated or theoretical) capacity:** the maximum capacity of producing goods or providing services. **Practical (operating) capacity: the capacity of a plant that can actually be utilised,** after loss of time due to repairs, maintenance, minor breakdowns, idle time, set-up time, normal delays, Sundays and holidays and stock-taking; it is **generally taken at 80% to 90% of the rated capacity** and is also called **net capacity or available capacity**. **Normal capacity:** the volume of production or services achieved or achievable, on an average, over a period under normal circumstances, after taking into account the reduction in capacity resulting from planned maintenance. **Actual capacity: the capacity actually achieved during a given period.**

Identify them from the facts in that order. In the printed illustration: installed **50,000 units** (the plant's maximum); practical **45,000 units** (after preventive maintenance, set-up time, holidays and training); normal **42,000 units** (the average output over the past year); actual **40,500 units** (reduced by **unexpected** breakdowns). The words that decide it are **planned** versus **unexpected** — planned losses take you to practical capacity, unexpected ones take you to actual.

Normal capacity = Installed capacity – Adjustments for normal or planned capacity losses. The adjustments the answer lists are **time lost due to scheduled preventive or planned maintenance, number of shifts or machine hours or man hours, holidays, normal shut-down days and normal idle time, and normal time lost in batch change over.** Present it as a statement, installed capacity at the top and the adjustments deducted beneath.

Why practical capacity is used to set the overhead rate: it reflects the **available productive capacity after planned downtime**, so overheads are allocated **fairly** to products, and it avoids the over- or under-absorption that would follow from using installed capacity or actual capacity as the divisor.

Idle capacity cost is treated according to the reason for the idleness — four cases. **Unavoidable reasons:** recover it through a **supplementary overhead rate**, charging the cost to the **capacity utilised**. **Avoidable reasons such as faulty planning:** charge it to the **Costing Profit and Loss Account**. **Trade depression:** abnormal in nature, so again to the **Costing Profit and Loss Account**. **Seasonal factors:** charge it to the **cost of production by inflating the overhead rate**. The classic wrong answer sends all idle capacity cost to Costing P&L; two of the four cases stay in cost.

Understanding explain it, and place it in context · 3 questions

- Explain normal capacity through the adjustment statement, not in prose. The list of adjustments is the answer.

TQ 9.1 · PYQ 2015-Nov [5] (b) · DESC · 4M · Pg 217

LEVEL I
Understanding

Easy

TQ 9.2 · PYQ 2023-May [6] (b) · DESC · 5M · Pg 218

LEVEL I
Understanding

Medium

TQ 9.3 · MTP 2025-Dec S2 [6] (a) · DESC · 5M · Pg 219

LEVEL I
Understanding

Medium

Topic 10: Treatment of Certain Items in Costing

L2P4-C4-T10

Read first Read ICAI Study Material Chapter 4, Overheads — Absorption Costing Method, the treatment of certain items in costing, including research and development expenses.

NOTES

Definitions first. **Research expenses** are the expenses of searching for new or improved products, new application of materials, or new or improved methods. **Development expenses** are the expenses of the process which begins with the implementation of the decision to produce a new or improved product. The line between them is the **decision to produce**.

The treatment follows what the research was about. Research into **methods of production** is taken separately while computing the cost of production; research relating to **administration** becomes part of **administration overhead**; **market research** is charged to selling and distribution overhead; and fundamental research not relating to any specific product is treated as part of **administration overhead**.

Development cost incurred for a particular product is charged directly to that product, and is usually treated as **deferred revenue expenditure** and **recovered as a cost per unit when production is fully established**. **General research of a routine nature** on improved methods or existing products goes to **general overhead**, but where the **amount is substantial** it too may be treated as deferred revenue expenditure and spread over the period during which the benefit

accrues.

Where the research proves a failure, the cost is excluded from costs and charged to the Costing Profit and Loss Account. That is the sentence the examiner looks for, and it is the same principle the chapter applies to every abnormal item.

Understanding explain it, and place it in context · 1 question

- Organise the treatment by category — production methods, administration, market research, product development, routine general research, failed research — one line each.

TQ 10.1 · MTP 2025-Jul S1 [6] (Or) (d) · DESC · 4M · Pg 220

LEVEL I
Understanding

Easy

Topic 11: Comprehensive Questions

L2P4-C4-T11

Read first Read ICAI Study Material Chapter 4, Overheads — Absorption Costing Method, comprehensive problems running from primary distribution through to the cost of a product.

NOTES

A full question runs in four movements and each carries its own marks: primary distribution, secondary distribution, absorption rate, product cost. Answer them as four separate statements with headings, even when the question runs the requirements together. The rate per hour is **total overhead of the production department ÷ its working hours**, and the product's overhead is **hours in each department × that department's rate**, added to **direct material + direct labour = prime cost** to give **total cost**.

The primary distribution statement has a fixed layout: a **Basis** column, a **Total** column, then one column per production department and one per service department, and a ratio printed against every apportioned line — **floor area** for rent and rates, **light points** for general lighting, **direct wages** for indirect wages and sundries, **horse power** for power, **value of machines** for depreciation. Items given department-wise, including the **direct wages of the service departments**, are entered as **Actual**.

Power has two printed bases and you must follow the question. Where only horse power is given, apportion on **H.P.**; where both horse power and machine hours are given, the answer also accepts **H.P. × machine hours** ($800 \times 4,000 : 200 \times 1,000 : 80 \times 600 : 120 \times 800 = 3,200 : 200 : 48 : 96$). Similarly, where fixed and variable generation costs are separated, the printed answer apportions **variable cost on horse power hours used** and **fixed cost on horse power for capacity production**. State the basis you have adopted; both routes are marked.

Secondary distribution: use the method named, and if none is named say which you used.

Simultaneous equations for a two-way reciprocal arrangement ($X = 9,750 + 0.10Y$, $Y = 13,400 + 0.10X$); repeated distribution where the ratios are given as percentages and you are told to repeat; step method in the order the question fixes, remembering that once a department is closed **it receives nothing further**. Where the question says to **ignore** the service departments' service to each other, apportion each service department over the production departments in the ratio of the given base — consumable value for stores, machine hours for engineering, labour hours for general service.

Dual-rate comprehensive problems: fixed costs on budgeted hours, variable costs on actual hours. Run the **fixed** block and the **variable** block right through every method — direct, step-down and reciprocal — and total them at the end as **(A) + (B)**. Under the **direct** method use only the operating departments' hours as the ratio; under the **step-down** method the first department's costs go to the other support department as well; under the **reciprocal** method solve one pair of equations for the fixed costs and a **second, separate pair** for the variable costs, because the budgeted and actual percentages differ.

Say which department is machine oriented and which is labour oriented, and absorb accordingly. The printed answers add a note assuming the department with high machine hours is machine oriented and the one with high labour hours is labour oriented, and then strike a **machine hour rate** for the first and a **labour hour rate** for the second. An answer that applies one base to every department is marked down even when the arithmetic is right.

Two items to exclude, and one to remember to include. Exclude **notional rent** on a building the company owns — it is an imputed cost, and rent is apportioned only over the departments using the **rented** building — and exclude **interest on capital outlay** as a finance cost. Include the **service departments' own direct wages** in the primary distribution, because they are overheads of the factory.

Application use the rule - work the problem • 7 questions

- Number your statements to match the question's requirements and carry the totals forward visibly from one to the next. A secondary distribution that does not tie to the primary totals loses the later marks as well.
- Put the ratio in the line itself, e.g. 'Rent — Floor area (4:5:7:2:2)'. It shows the basis, the working and the answer at once.

PQ 11.1 • PYQ 2018-Nov [5] (b) (ii) • 5M • Pg 221

LEVEL II
Application

Medium

PQ 11.5 • MTP 2024-Dec S2 [3] (b) • 6M • Pg 232

LEVEL II
Application

Medium

PQ 11.2 • PYQ 2020-Nov [2] (b) • 10M • Pg 222

LEVEL II
Application

Hard

PQ 11.3 • PYQ 2023-Nov [3] (a) • 10M • Pg 225

LEVEL II
Application

Hard

PQ 11.4 • MTP 2024-Nov [2] (a) • 12M • Pg 229	LEVEL II Application	Hard
PQ 11.6 • MTP 2025-Aug S2 [2] (a) • 12M • Pg 233	LEVEL II Application	Hard
PQ 11.7 • RTP 2025-Sep [9] • Pg 238	LEVEL II Application	Hard

CHAPTER 5

Activity Based Costing

5 Topics · 40 Classified Questions · Importance: B

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge **4.9%** 15 of 305 marks

Level II — Analysis & Application **95.1%** 290 of 305 marks

Below the paper's Level I floor: only 5% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for the paper. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Factors Prompting the Development of ABC

L2P4-C5-T01

Read first Read ICAI Study Material Chapter 5, Activity Based Costing — the factors prompting the development of ABC and the situations in which it is suitable.

NOTES

Four situations make ABC necessary, and the printed answer gives them in this order: **high amount of overhead** — where production overheads are high and form a significant portion of cost, ABC is more useful than the traditional system; **wide range of products** — ABC is most suitable where there is diversity in the product range or several products are made; **presence of non-volume related activities** — where material handling, inspection and set-up are significant and the traditional system cannot be applied, ABC is the better option; **stiff competition** — where costs must be computed accurately and selling prices set to market conditions. Learn the four headings; the marks are one per heading plus the sentence under it.

ABC is not only a costing tool, it is a cost-reduction tool. The answer closes both the first and the last limb with the same point: ABC **identifies non-value-adding activities** in the production process, which may then be focused upon for attention or elimination. Put that sentence in, whichever way the question is framed — 'usefulness', 'suitability' or 'need'.

The examiner also runs the test in reverse. The pack's situation question asks you to recommend ABC or not, and the printed answer says **no** where a company produces **one product** and the overhead is **mainly depreciation** (there is nothing to allocate between, and depreciation cannot be reduced by activity analysis), and **no** for two **labour intensive** products with **high contribution per unit and a very low break-even point** (overhead allocation on directly traceable direct labour will already be accurate, a low BEP implies low fixed cost as a percentage of cost, and efficient operation leaves nothing for ABC to reduce). It says **yes** for five products made on **different production facilities** and for a **professional services firm** of lawyers, accountants and engineers,

because the services are very different, the drivers differ, and ABC is needed for pricing.

Frame every recommendation on two grounds, not one: ABC for **cost allocation and pricing**, and ABC for **cost reduction and cost management**. The printed answer scores each situation on both, and an answer that only says 'multiple products, so yes' leaves half the mark on the table.

Analysis break it down and examine the interrelationships · 1 question

- The question asks where ABC is **useful or suitable** — so every point should describe a condition of the business, not a feature of ABC.
- The strongest points are the ones that explain why traditional absorption distorts: a high share of overhead, several products consuming support activities unevenly, and small-volume products carrying disproportionate set-up and handling.

TQ 1.1 · PYQ 2026-Jan [6] (c) · DESC · 4M · Pg 246

LEVEL II
Analysis

Easy

Topic 2: Meaning of Terms used in ABC

L2P4-C5-T02

Read first Read ICAI Study Material Chapter 5, Activity Based Costing — the meaning of activity, cost pool, cost driver and cost driver rate.

NOTES

A cost pool is a grouping of overhead by activity; a cost driver is the unit of that activity which causes the cost. The printed examples are worth memorising because they repeat in the practical questions: **Quality control** — number of inspections, or product units produced; **Research and development** — number of research projects, or personnel hours on a project; **Machine maintenance** — machine hours; **Employee training costs** — number of training hours, or employees trained; **Customer service** — number of service calls, number of products serviced, or hours spent servicing products.

A driver in the printed answers is always a count or an hour. Number of purchase orders, number of set-ups, number of production runs, number of inspections, number of deliveries, number of requisitions, machine hours, labour hours, shelf-stocking hours, kilometres travelled. Where the question asks you to suggest a driver, suggest one of these forms — a percentage or a rupee value is not accepted as a driver except where the question itself supplies it.

The one formula the whole chapter runs on: $\text{Cost driver rate} = \frac{\text{Activity cost of the pool}}{\text{Total volume of the cost driver}}$, and then Overhead charged to a product = Cost driver rate × units of the driver that product consumes. Write the rate line separately with its own units ('Rs 1,500 per order', 'Rs 190.53 per hour'), because the rate carries the method mark even if the allocation

arithmetic slips.

Cost driver capacity is not the same as cost driver consumption. Where the question says the company calculates activity cost rates **on the basis of cost driver capacity**, the denominator of the rate is the capacity, not the units actually used, and the difference is the **cost of unused capacity** — computed either as activity cost less cost allocated, or as unused driver units $\times$ rate. Using consumption as the denominator destroys both parts of that question.

Understanding explain it, and place it in context · 1 question

- A cost driver must be the thing that **causes** the cost of that pool to change. Give a driver that can actually be counted, and one per pool.
- Where the question prints a table, answer in the table. Add nothing else — the mark is the pairing.

TQ 2.1 · RTP 2026-Jan [19] (b) · DESC · Pg 247

LEVEL I
Understanding

Medium

Topic 3: Traditional Absorption Costing vs ABC

L2P4-C5-T03

Read first Read ICAI Study Material Chapter 5, Activity Based Costing — traditional absorption costing compared with ABC, and the levels of activity in the cost hierarchy.

NOTES

The four levels of activity, in the printed order and wording: **Unit level** — activities whose consumption of resources can be identified with the number of units produced; **Batch level** — activities such as setting up a machine or processing a purchase order, performed each time a batch of goods is produced, whose cost varies with the number of batches but is common to all units in the batch; **Product level** — activities performed to support the different products in the product line; **Facility level** — activities which cannot be directly attributed to individual products.

The structural difference is one rate against many. Traditional absorption costing recovers all production overhead on a **single plant-wide rate** — direct labour hours, machine hours, prime cost or units — while ABC forms a **separate rate for each activity** on a driver that actually causes that activity. In the pack the traditional rates actually used are Rs 20 per machine hour, Rs 60 and Rs 9 and Rs 52.50 per direct labour hour, 17.18% of prime cost, Rs 240 and Rs 132 per machine hour, and Rs 300 per unit produced.

The conclusion sentence the comparison questions want: under a volume-based rate the **low-volume product is under-costed and the high-volume product is over-costed**. The printed answers say exactly that three times over — 'Low volume product A is under-costed and high volume product B is over costed using direct labour hours for overhead absorption'; 'Product S is

underpriced while product M and L is overpriced'; and, in the components question, A 'highly under-costed', B 'over-costed', C 'under-costed' under the traditional system. Write the sentence, not just the figures.

Cost distortion is a subtraction, done per unit. Set out the unit cost using the labour-hour or machine-hour base, then the unit cost using ABC, then the difference, and sign it: a minus where ABC is higher (the product was under-costed) and a plus where ABC is lower. Where selling prices are cost-plus, the same subtraction on selling price tells you which product is **under-priced** and which **over-priced** — that is a separate mark.

Understanding explain it, and place it in context · 1 question

- Where the question says 'describe the levels', give all four even if the question gives you only three examples. The mark scheme is one per level.

TQ 3.1 · PYQ 2020-Nov [5] (c) · DESC · 4M · Pg 248

LEVEL I
Understanding

Easy

Topic 4: Practical Applications of ABC

L2P4-C5-T04

Read first Read ICAI Study Material Chapter 5, Activity Based Costing — the practical application of ABC to products, customers and segments, and activity based management and budgeting.

NOTES

Work every ABC sum in the same five steps, in this order: (1) find the **total overhead** to be shared; (2) build the **rate table** — activity, cost, driver, driver volume, **rate = cost ÷ volume**; (3) build the **allocation statement** — one row per activity, one column per product, each cell rate × driver units; (4) total the column and **divide by output** to get overhead per unit; (5) add **prime cost per unit** to get total cost per unit, then mark-up if asked. Every printed answer in the pack follows that sequence, and each of the three statements is separately marked.

You may allocate by ratio instead of by rate, and the answers say so. Two printed notes state that the activity cost can be split in the ratio of the driver units (24:54, 6:9:10, 90:135:125) and that 'there will be no change in the final answer'. Choose one method and label the ratio in the column heading. Do not mix — a rate for one activity and a ratio for the next invites an arithmetic slip that costs the whole column.

Total overhead is often not given, and finding it is the first mark. The printed answers derive it as **output × overhead per unit** (20,000 × 30 + 40,000 × 40 + 60,000 × 50 = 52,00,000), as **total machine hours × the machine hour rate** (12,00,000 hrs × Rs 30 = Rs 3,60,00,000), and then split it by the **percentages** the question gives (set-ups 40%, machinery 10%, material handling 30%, inspection 20%). Where the question gives departmental overheads and ABC pools separately, use

the **ABC pool figures** for the ABC statement and the departmental figures only for the traditional one.

Where the question gives ratios between overheads and activities, do a two-stage apportionment before you compute any rate. The pack's pattern: technical staff salary split between machine maintenance, set-up and quality control **1:2:2** (or 30:40:30); machine operation and machine maintenance split between stores and production set-up **2:3** (or 20:80); stores staff wages wholly to stores. Show that apportionment as a separate working with a total column that ties back to the overhead total — the rate table is worthless if the pool figures are wrong.

Customer profitability has its own format, and it is not a cost sheet. Revenue at list price, less discount (units × discount per case), **= revenue at actual price, less cost of goods sold, = gross margin**, less customer level operating activity costs (order taking, customer visits, delivery kilometres, product handling, expedited deliveries — each at its own driver rate), **= customer level operating income**, then **operating income as a percentage of revenue**, then **rank**. The comment marks come from comparing two named customers: the printed answers attribute the difference to the **discount per case** first, then to more frequent orders, more visits and more delivery kilometres.

Segment and product-line questions ask the same thing twice. First allocate **all costs other than cost of goods sold** on the traditional base the question names (usually a percentage of cost of goods sold — compute that percentage as total support cost ÷ total COGS), then allocate the same support costs by ABC drivers, then **show the comparison** of operating income as a percentage of revenue under both. The answer always ends by naming the most profitable line and noting that the ranking **reverses** between the two systems.

Two add-ons recur and both are quick marks. Cost of unused capacity = activity cost less cost allocated, or unused driver units × rate, listed activity by activity with a total. **Quoting for a new order** needs a cost sheet split into **direct costs** (material, labour at the hourly rate, and the design cost spread over the number of periods or units it covers) and **indirect costs** (production runs × rate, inspections × rate, consignments × rate), then **total cost, mark-up, sales value, selling price per unit. Activity Based Budgeting** is 'the reversing of the ABC process to produce financial plans and budgets'; **Activity Based Management** is 'the use of ABC as a costing tool to manage costs at the activity level', used for cost reduction, business process re-engineering, benchmarking and performance measurement.

Understanding explain it, and place it in context · 1 question

- For ABB and ABM, give the one-line definition and then the numbered uses. ABM carries four uses in the printed answer; each is a heading plus a sentence.

Application use the rule - work the problem · 31 questions

- Head each statement as the answer does — 'Statement Showing Activity Based Overhead Cost', 'Calculation of Cost Driver Rate' — and keep the rate table separate from the allocation table. Marks are given per statement, so a wrong rate does not lose you the format marks below it.
- Where the question asks for both methods, do the traditional one first and completely. It is the shorter half and it supplies the total overhead the ABC half needs.

PQ 4.27 · MTP 2025-Aug S2 [5] (b) · 5M · Pg 314	LEVEL II Application	Easy
PQ 4.1 · PYQ 2018-May [4] (a) · 10M · Pg 250	LEVEL II Application	Medium
PQ 4.4 · MTP 2019-Oct [2] (a) · 10M · Pg 257	LEVEL II Application	Medium
PQ 4.6 · MTP 2020-May [2] (a) · 10M · Pg 262	LEVEL II Application	Medium
PQ 4.7 · PYQ 2020-Nov [5] (b) · 6M · Pg 263	LEVEL II Application	Medium
PQ 4.12 · PYQ 2022-Nov [2] (c) · 4M · Pg 276	LEVEL II Application	Medium
PQ 4.13 · PYQ 2023-May [4] (b) · 5M · Pg 277	LEVEL II Application	Medium
PQ 4.15 · RTP 2023-Nov [4] · Pg 282	LEVEL II Application	Medium
PQ 4.17 · MTP 2024-Mar [5] (b) · 8M · Pg 286	LEVEL II Application	Medium
PQ 4.18 · PYQ 2024-May [2] (a) · 8M · Pg 290	LEVEL II Application	Medium
PQ 4.19 · RTP 2024-May [4] · Pg 291	LEVEL II Application	Medium
PQ 4.23 · MTP 2024-Nov [4] (a) · 6M · Pg 302	LEVEL II Application	Medium
PQ 4.32 · RTP 2026-May [9] · Pg 324	LEVEL II Application	Medium
PQ 4.2 · PYQ 2018-Nov [3] (b) · 10M · Pg 252	LEVEL II Application	Hard
PQ 4.3 · PYQ 2019-May [3] (b) · 10M · Pg 254	LEVEL II Application	Hard
PQ 4.5 · PYQ 2019-Nov [2] (a) · 10M · Pg 259	LEVEL II Application	Hard
PQ 4.8 · PYQ 2021-Jan [4] (b) · 10M · Pg 265	LEVEL II Application	Hard
PQ 4.10 · PYQ 2021-Dec [3] (b) · 10M · Pg 270	LEVEL II Application	Hard

PQ 4.11 · PYQ 2022-May [5] (a) · 10M · Pg 273	LEVEL II Application	Hard
PQ 4.14 · MTP 2023-Sep [2] (b) · 10M · Pg 279	LEVEL II Application	Hard
PQ 4.16 · PYQ 2023-Nov [4] (a) · 10M · Pg 284	LEVEL II Application	Hard
PQ 4.20 · MTP 2024-Jul [5] (b) · 7M · Pg 294	LEVEL II Application	Hard
PQ 4.21 · PYQ 2024-Sep [3] (a) · 8M · Pg 296	LEVEL II Application	Hard
PQ 4.22 · RTP 2024-Sep [10] · Pg 299	LEVEL II Application	Hard
PQ 4.24 · MTP 2024-Dec S2 [2] (a) · 10M · Pg 305	LEVEL II Application	Hard
PQ 4.25 · PYQ 2025-May [3] (a) · 8M · Pg 308	LEVEL II Application	Hard
PQ 4.26 · MTP 2025-Jul S1 [5] (a) · 8M · Pg 310	LEVEL II Application	Hard
PQ 4.28 · PYQ 2025-Sep [3] (a) · 8M · Pg 315	LEVEL II Application	Hard
PQ 4.29 · MTP 2025-Nov S1 [2] (a) · 10M · Pg 317	LEVEL II Application	Hard
PQ 4.31 · MTP 2026-Apr S2 [5] (b) · 6M · Pg 322	LEVEL II Application	Hard
PQ 4.33 · PYQ 2026-May [5] (a) · 10M · Pg 328	LEVEL II Application	Hard

Analysis break it down and examine the interrelationships · 2 questions

- When asked to comment, compare two named products or customers and give the reason, not the figure. The printed reasons are: the discount per case, the number of orders, visits and delivery kilometres, and volume against the absorption base.

TQ 4.2 · PYQ 2023-May [6] (c) · DESC · 5M · Pg 249	LEVEL II Analysis	Medium
PQ 4.30 · RTP 2026-Jan [11] · Pg 321	LEVEL II Analysis	Medium

Synthesis integrate the material and construct · 1 question

- Where the rates are built on **cost driver capacity** rather than on actual usage, compute the rate on capacity and then show the **cost of unused capacity** separately. That separation is the point of the question.
- Build the answer in the order the printed answers do: activity rates, then cost charged to products, then unused capacity, then the reconciliation back to total overhead. Label each step.

PQ 4.9 · PYQ 2021-Jul [3] (b) · 10M · Pg 268

LEVEL II
Synthesis

Hard

Topic 5: Stages in ABC

L2P4-C5-T05

Read first Read ICAI Study Material Chapter 5, Activity Based Costing — the practical stages in installing an ABC system, and classification of cost pools in the cost hierarchy.

NOTES

The five practical stages of implementation, in the printed order: **Staff training** — the co-operation of the workforce is critical, so training is given to create awareness of the purpose of ABC; **Process specification** — informal but structured interviews with key personnel identify the stages of the production process, the resources committed to each, processing times and bottlenecks; **Activity definition** — activities must be defined clearly at an early stage to manage problems, accepting that the new data will overload information which then has to be codified; **Activity driver selection** — a cost driver is selected for each activity; **Assigning cost** — a single representative activity driver is used to assign costs from the activity pools to the cost objects.

Learn the stage names as a list of five. The question is set as 'suggest the key practical stages', which is a recall question worth roughly a mark a stage, so the heading plus one line of explanation is the whole answer. Do not begin with the advantages of ABC; that is a different question.

The classification question gives ten cost pools and wants one level against each. The printed classification is: **Human resources** — facility; Maintenance of buildings — facility; Parts management — batch or product; **Plant security** — facility; **Purchasing** — batch; Floor manager's salary — facility; **Quality control** — batch or unit; **Machine set-up** — batch; **Designing the product** — product; **Receiving department** — batch.

Two of the ten are printed with two acceptable answers — parts management (batch or product) and quality control (batch or unit). Where a pool can sit at either level, say so and give both; the answer does not lose a mark for the alternative. The test to apply is the one from the hierarchy: if the cost is incurred each time a batch is run it is batch level, if it supports a product line it is product level, and if it cannot be attributed to individual products at all it is facility level.

Application use the rule - work the problem · 1 question

- Answer the classification question in a three-column table — serial number, cost pool, level — and nothing else. No explanation is asked for and none is marked.

TQ 5.2 · RTP 2025-Sep [18] (b) · DESC · Pg 332

LEVEL II
Application

Medium

Analysis break it down and examine the interrelationships · 1 question

- A hierarchy question: **put each pool at unit, batch, product or facility level** and give the level beside the pool, in the question's own order.
- Where a pool could sit at two levels, say which you have chosen and why in a short clause. The printed answers accept more than one reading on some pools, but not a silent one.

TQ 5.1 · PYQ 2025-May [6] (b) · DESC · 5M · Pg 331

LEVEL II
Analysis

Medium

CHAPTER 6

Cost Sheet

2 Topics · 32 Classified Questions · Importance: A

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge

3.1%

8 of 254 marks

Level II — Analysis & Application

96.9%

246 of 254 marks

Below the paper's Level I floor: only 3% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for the paper. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Functional Classification of Elements of Cost

L2P4-C6-T01

Read first Read ICAI Study Material Chapter 6, Cost Sheet — the functional classification of the elements of cost.

NOTES

Set the functions out before you place a single item. The printed answer names them as **production or works, administration, selling and distribution**, and direct costs traceable to a product or job. Once the four headings are on the page, the question becomes a matching exercise, and the marks are for the **classification, not for the explanation**.

Four of the ten items in the printed question exist only to test one point: a cost traceable to a single job or product is a **direct expense**, not an overhead. The four are the **product blueprint cost**, the **hire charges paid for factory machinery for a certain product**, the **one-time licence fee for software used on a particular job**, and the overtime wages paid to finish a certain job because of urgency created by the customer. Each is a direct expense of that job. Overtime is the one students misplace — it is only a factory overhead when it is general; caused by one customer, it is direct.

Two more items carry a trap each. Specialised packing at the customer's request is selling and distribution, not production packing — primary packing that holds and preserves the product is production, packing asked for by a customer is not. **Royalty paid for production is a direct expense of production**, not an administration or a financial charge.

Present only the columns the question asks for. Where it says give columns I and III, write the item number against its classification and nothing else. Reproducing the description column wastes the time the rest of the paper needs, and adds no mark.

Analysis break it down and examine the interrelationships · 1 question

- Classify each item in the question's own numbering, and use **the exact column headings the question prints** — an answer that invents its own classification loses the format mark.
- Decide each item on two tests in order: is it direct or indirect, and which function does it belong to. Doing them in that order stops a marketing salary being read as an administration cost.

TQ 1.1 · PYQ 2026-Sep [6] (a) · DESC · 5M · Pg 335

LEVEL II
Analysis

Medium

Topic 2: Cost Sheet/Statement

L2P4-C6-T02

Read first Read ICAI Study Material Chapter 6, Cost Sheet — the format of the cost sheet and the treatment of each item at each stage.

NOTES

Learn the format as a ladder and never reorder it. Down to prime cost the printed answers build: Opening stock of raw materials + Purchases (less returns, less trade discount) + Freight or carriage inwards + Insurance on material procured – Closing stock of raw materials = Raw materials consumed; then + **Direct wages or direct employee cost**; then + **Direct expenses**; = **Prime Cost**. Direct employee cost takes in **outstanding wages** at the year end, **production bonus** to factory workers and the employer's **PF and ESIS contribution**. Direct expenses in the pack are royalty paid for production, cost of special drawings, hire charges for specific equipment, job charges paid to job workers, fees for technical assistance, the **amortised** cost of moulds and patterns (cost ÷ the number of production cycles or years of life), and power and fuel — though one answer notes power and fuel may alternatively be taken as a factory overhead, with no change to factory cost or below.

From prime cost to factory cost there are exactly two moves, and the order matters. **Prime cost + works or factory overheads = Gross Works Cost**; then + **Opening work-in-progress – Closing work-in-progress = Works or Factory Cost**. The WIP adjustment comes **after** the overheads, never before. Factory overheads in the printed answers are depreciation and insurance on factory building and plant, insurance on stock of raw materials and WIP, apportioned factory rent, repairs and maintenance of plant, consumable stores and indirect wages, supervisors' and foremen's salaries, lease rent of production assets, pollution control and engineering, store overheads on material, and the **cost of rectifying defective output**.

From factory cost to cost of production the additions are the ones students forget. + **Quality control cost**, + **Research and development cost for improvement of the production process**, + **Administration overheads relating to production** (the production control manager's salary, expenses of administering factory work), + **Primary packing cost** (packing necessary to hold and preserve the product for the customer's use), – **realisable value of scrap, waste, defective output**

or by-products, = Cost of Production. Note the printed variation on the credit: some answers deduct the scrap realisation from **works cost** and call the result Net Works Cost before adding the production items, others deduct it just above cost of production, and one deducts the scrap of raw material from **materials consumed**. Any of the three is accepted — state where you have put it.

Then the stock and the overhead tail: Cost of production + Opening stock of finished goods – Closing stock of finished goods = Cost of Goods Sold; + Administration overheads (general) + Selling overheads + Distribution overheads = Cost of Sales; + **Profit = Sales**. Value the closing finished stock at **this period's cost of production per unit** under FIFO, and where the output figure is not given use **Units produced = Units sold + Closing stock – Opening stock**. Distribution overheads are packing for re-distribution or secondary packing, freight on delivery of finished goods, depreciation on delivery vans and warehousing charges; selling overheads are advertisement, sales promotion, sales commission, marketing staff salary and exhibition expenses.

The exclusions are examined as often as the format. Kept out of the cost sheet altogether and charged to the Costing Profit and Loss Account: **interest on a term loan**, even one taken to buy plant — the purpose does not make it a cost of production; **wages for abnormal idle time**, such as a government-imposed lockdown; **cash discount allowed on sales**, which the printed statement deducts only after net operating profit; **bad debts written off**; and **demurrage**, because it is a penalty. **GST is a cost only when the input tax credit is not available** — where ITC is eligible the material is taken net of it, where the purchase is stated to be inclusive of GST ineligible for ITC the gross figure goes in. A **subsidy** received for using a material is deducted from the cost of that material. **Other administrative overhead does not form part of cost of production**, and the **technical director's salary is an administrative cost**, not a production one.

Where the question gives you cost of sales or cost of goods sold and asks for purchases, run the ladder upwards. The printed reverse working is: Cost of sales – selling expenses – general and administration expenses = Cost of goods sold; + **closing finished goods – opening finished goods = Cost of production**; + **closing WIP – opening WIP = Works cost**; – **factory overheads = Prime cost**; – **direct labour = Raw material consumed**; + **closing raw material – opening raw material = Materials purchased**. Every sign flips. Do the reverse working as a separate statement first, then present the cost sheet forwards — the examiner marks both.

Two habits that pick up easy marks. First, the **per unit column changes its divisor**: everything down to cost of production is divided by **units produced**, and from cost of goods sold onwards by **units sold**. Second, learn the profit conversions — **profit of 20% on sales is 25% on cost**, and **12.5% on selling price is one-seventh of cost**; where profit is a percentage of sales, gross the cost of sales up, never add the percentage to cost. The pack's most repeated practical is the two-product split where **direct material per unit of one product is twice the other** and **direct wages per unit of one are 60% of the other**: set the unknown per unit, multiply by units **produced** (not sold), equate to the total, solve, and remember production overhead per unit is the **same rate for both products**.

Remembering reproduce what you have learnt · 1 question

- A treatment question: for each item say **whether it enters the cost sheet at all**, and if it does, **at which stage**. Both halves carry marks.
- Items excluded from cost still need a destination — say they go to the Costing Profit and Loss Account or are a financial item, rather than leaving them unexplained.

TQ 2.2 · PYQ 2026-Sep [6] (c) · DESC · 4M · Pg 337

LEVEL I
Remembering**Easy****Understanding** explain it, and place it in context · 1 question

- Treatment questions want the stage and a one-line reason each. Say where the item enters — 'added to factory cost', 'deducted from cost of production', 'excluded and charged to the Costing Profit and Loss Account' — and why in the same sentence.

TQ 2.1 · MTP 2024-Jul [2] (b) · DESC · 4M · Pg 336

LEVEL I
Understanding**Easy****Application** use the rule - work the problem · 29 questions

- Label every sub-total the question names: prime cost, gross works cost, works cost, cost of production, cost of goods sold, cost of sales. Each labelled line is a mark, so an unlabelled column of figures that reaches the right profit still loses.
- Put the arithmetic for any derived figure in brackets beside it or in a numbered working note — apportionment of rent by square feet, depreciation on written down value, units produced, valuation of closing stock. The workings carry the method marks.

PQ 2.26 · MTP 2026-Apr S2 [1] (a) {C} · 5M · Pg 391

LEVEL II
Application**Easy**

PQ 2.1 · PYQ 2018-May [2] (a) · 10M · Pg 338

LEVEL II
Application**Medium**

PQ 2.5 · PYQ 2020-Nov [2] (a) · 10M · Pg 346

LEVEL II
Application**Medium**

PQ 2.10 · RTP 2022-May [5] · Pg 357

LEVEL II
Application**Medium**

PQ 2.12 · MTP 2023-Mar [2] (a) · 10M · Pg 360

LEVEL II
Application**Medium**

PQ 2.14 · PYQ 2023-Nov [2] (a) · 10M · Pg 364

LEVEL II
Application**Medium**

PQ 2.15 · PYQ 2023-Nov [5] (b) · 6M · Pg 367

LEVEL II
Application**Medium**

PQ 2.16 · PYQ 2024-Sep [2] (a) · 8M · Pg 368

LEVEL II
Application**Medium**

PQ 2.17 · RTP 2024-Sep [11] · Pg 371

LEVEL II**Medium**

	Application	
PQ 2.18 • PYQ 2025-Jan [2] (a) • 9M • Pg 372	LEVEL II Application	Medium
PQ 2.19 • PYQ 2025-Jan [4] (b) • 6M • Pg 375	LEVEL II Application	Medium
PQ 2.20 • RTP 2025-Jan [11] • Pg 377	LEVEL II Application	Medium
PQ 2.21 • PYQ 2025-May [2] (a) • 7M • Pg 379	LEVEL II Application	Medium
PQ 2.23 • RTP 2025-Sep [10] • Pg 385	LEVEL II Application	Medium
PQ 2.29 • PYQ 2026-Sep [5] (a) • 7M • Pg 399	LEVEL II Application	Medium
PQ 2.2 • PYQ 2018-Nov [2] (a) • 10M • Pg 339	LEVEL II Application	Hard
PQ 2.3 • PYQ 2019-May [2] (a) • 10M • Pg 341	LEVEL II Application	Hard
PQ 2.4 • PYQ 2019-Nov [3] (b) • 10M • Pg 343	LEVEL II Application	Hard
PQ 2.6 • PYQ 2021-Jan [2] (b) • 10M • Pg 348	LEVEL II Application	Hard
PQ 2.7 • PYQ 2021-Jul [2] (a) • 10M • Pg 350	LEVEL II Application	Hard
PQ 2.8 • PYQ 2021-Dec [2] (a) • 10M • Pg 352	LEVEL II Application	Hard
PQ 2.9 • PYQ 2022-May [3] (b) • 10M • Pg 354	LEVEL II Application	Hard
PQ 2.11 • PYQ 2022-Nov [4] (b) • 10M • Pg 358	LEVEL II Application	Hard
PQ 2.13 • PYQ 2023-May [3] (b) • 10M • Pg 362	LEVEL II Application	Hard
PQ 2.22 • RTP 2025-May [11] (a) • Pg 381	LEVEL II Application	Hard
PQ 2.24 • MTP 2025-Dec S2 [4] (a) • 9M • Pg 387	LEVEL II Application	Hard
PQ 2.25 • PYQ 2026-Jan [2] (a) • 9M • Pg 389	LEVEL II Application	Hard
PQ 2.27 • RTP 2026-May [10] • Pg 393	LEVEL II Application	Hard
PQ 2.28 • PYQ 2026-May [2] (a) • 7M • Pg 397	LEVEL II Application	Hard

CHAPTER 7

Cost Accounting Systems

3 Topics · 37 Classified Questions · Importance: B

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge **14.2%** 30 of 211 marks

Level II — Analysis & Application **85.8%** 181 of 211 marks

Below the paper's Level I floor: only 14% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for the paper. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Non Integrated Accounting System

L2P4-C7-T01

Read first Read ICAI Study Material Chapter 7, Cost Accounting Systems — the non-integrated (cost ledger) system, its subsidiary ledgers, the control accounts and the journal entries.

NOTES

Four ledgers are maintained under the non-integrated system, and the 4-mark theory question wants all four with a line each. **Cost Ledger** — the principal ledger of the cost department, in which **impersonal accounts** are recorded; it is made **self-balancing** by maintaining in it a **Control Account for each subsidiary ledger**. **Stores Ledger** — an account for each item of stores, written up from the invoice, goods received note, material requisition and material received note, showing **receipt, issue and balance in physical as well as monetary terms**. **Work-in-Process Ledger** (also called the **job ledger**) — accounts of unfinished jobs and processes; all material, wages and overheads for each job are posted to the respective job account, and the balance in a job account represents the work-in-process. **Finished Goods Ledger** — an account for each completed product or job; when finished product is transferred to stock the **work-in-process ledger is credited and this ledger debited**.

The General Ledger Adjustment A/c is the pivot of the whole system, and it is the same account as the Cost Ledger Control A/c — the printed answers say so expressly. Because the cost books contain no personal or real accounts, **every transaction with the outside world enters through it**. It is **credited** with raw materials purchased, wages incurred, overheads incurred and customers' returns at cost; it is **debited** with materials returned to (credited by) suppliers, with sales transferred through the Costing P&L A/c, and with the balance c/d. Its opening credit balance equals the total of the debit balances on the three stock control accounts, which is how you know your answer balances.

Raw Material (Stores Ledger) Control A/c — the format the answers build: Debit — To Balance

b/d, To General Ledger Adjustment A/c (purchases), To Work-in-Process Control A/c (material returned from production to stores, and transfers back from WIP). **Credit** — By Work-in-Process Control A/c (issues to production), By General Ledger Adjustment A/c (materials credited by suppliers, i.e. returns outwards), By Overhead Control A/c (issues for repairs and maintenance), By Costing P&L A/c or Overhead Control A/c (deficiency found in stock), By Balance c/d. **The deficiency is the trap:** where the answer treats it as **normal** it goes to the **Overhead Control A/c**; where it is treated as **abnormal** it goes to the **Costing P&L A/c**. One printed answer does it one way and notes the other is acceptable — state your assumption in a footnote and you keep the mark.

Work-in-Process Control A/c: Debit — To Balance b/d, To Raw Material Control A/c (materials issued), To Wages Control A/c (direct wages allocated), To Factory/Overheads Control A/c (overhead charged to production). **Credit** — By Finished Stock Control A/c (goods finished at cost), By Raw Material Control A/c (material transferred back to stores), By Costing P&L A/c (work-in-progress rejected with no scrap value), By Balance c/d. Where the question gives no cost-of-finished-goods figure, **the transfer to finished goods is the balancing figure** after the closing balance is inserted — one answer says so in terms.

Finished Stock Control A/c and Cost of Goods Sold A/c: Debit — To Balance b/d, To Work-in-Process Control A/c, To General Ledger Adjustment A/c (customers' returns at cost). **Credit** — By Cost of Goods Sold A/c, By Balance c/d. The Cost of Goods Sold A/c is then debited with that figure and **closed off to the Costing P&L A/c**. Note that the customer's return comes in at **cost**, not at selling price.

Overheads Control A/c and where the difference goes: Debit — To General Ledger Adjustment A/c (overhead actually incurred), To Stores Ledger Control A/c (stores issued for repairs, and any normal deficiency), To Wages Control A/c (the **indirect** element, computed as wages paid less direct wages applied — ₹21,000 paid less ₹18,000 applied gives ₹3,000 in one answer). **Credit** — By Work-in-Process A/c (overhead absorbed), By Balance c/d for **under-absorption**. The Costing P&L A/c then carries cost of finished goods or cost of sales, abnormal losses and under-absorption on the debit side, and sales (through the General Ledger Adjustment A/c) and over-absorption on the credit side, with the profit transferred to the General Ledger Adjustment A/c.

The journal entries that are set again and again, and the one word that decides each of them is where the other side of the entry lies. Credit purchase of material: **Stores Ledger Control A/c Dr. — To Cost Ledger Control A/c**. Materials issued to production: **Work-in-Process Control A/c Dr. — To Stores Ledger Control A/c**. Material returned from production to stores: **Stores Ledger Control A/c Dr. — To Work-in-Process Control A/c**. Direct wages charged: **Work-in-Process Control A/c Dr. — To Wages Control A/c**. Indirect wages incurred: **Wages Control A/c Dr. — To Cost Ledger Control A/c**, then **Manufacturing Overhead Control A/c Dr. — To Wages Control A/c** (the answer allows the single combined entry as an alternative). Manufacturing overhead charged to production: **Work-in-Process Control A/c Dr. — To Production Overhead Control A/c**. Selling and distribution overhead recovered from sales: **Cost of Sales A/c Dr. — To Selling and Distribution Overhead Control A/c**. Overheads **over-absorbed**: **Overhead Control A/c Dr. — To Costing Profit**

and Loss A/c. Overheads under-absorbed: Costing Profit and Loss A/c Dr. — To Overhead Control A/c. Learn the last two as a pair — over-absorption is a gain and so is credited to Costing P&L; under-absorption is a loss and so is debited to it.

Remembering reproduce what you have learnt · 1 question

- Name all four ledgers with one descriptive line each. The 4-mark question is marked on the four names plus the self-balancing point about the Control Account in the Cost Ledger.

TQ 1.1 · MTP 2024-Mar [3] (a) · DESC · 4M · Pg 402

LEVEL I
Remembering

Easy

Application use the rule - work the problem · 4 questions

- Open all the accounts asked for before you post anything, put the opening balances in, then work down the transaction list posting both sides of each item as you go. A figure posted to only one account is where the account fails to balance.
- Write the narration under each journal entry. The printed answers carry one for every entry, and a bare pair of account names does not earn the full mark.
- Where a figure is not given — cost of finished goods, or the closing balance — insert it as the balancing figure and label it as such in the account. The answers do exactly that and say so in brackets.

PQ 1.2 · PYQ 2019-Nov [6] (b) · 5M · Pg 406

LEVEL II
Application

Easy

PQ 1.3 · MTP 2024-Nov [1] (b) {C} · 5M · Pg 407

LEVEL II
Application

Easy

PQ 1.4 · PYQ 2025-Sep [4] (b) · 5M · Pg 409

LEVEL II
Application

Easy

PQ 1.1 · PYQ 2018-Nov [4] (a) · 10M · Pg 403

LEVEL II
Application

Hard

Topic 2: Integrated (Or Integral) Accounting System

L2P4-C7-T02

Read first Read ICAI Study Material Chapter 7, Cost Accounting Systems — the integrated (integral) accounting system, its pre-requisites, advantages and journal entries.

NOTES

The CIMA definition, quoted in full because the marks are in it: an integrated accounting system "refers to the interlocking of the Financial and Cost Accounting system to ensure all relevant expenditure is absorbed into the Cost accounts. Under this system transactions are classified both according to their production and nature." Both sets of records are kept in **one set of books**

serving both purposes — put another way, cost accounting is integrated into the financial accounting system.

Advantages — seven, and the examiner takes them as a list: **Economical process**, being based on the **centralisation of the accounting function**; **less time consuming**, as information comes straight from the books of original entry; **no need for reconciliation**, because there is **one figure of profit only**; **less effort**, since duplicate recording and a second set of books are avoided; **complete details available** of all receipts, payments, assets and liabilities, the system using no notional account to represent impersonal accounts; **no delay** in obtaining costing data; and **complete analysis of cost and sales**, financial books being subject to rigorous accuracy checks, so the cost accounts get the same checking.

Pre-requisites — four steps, in this order: (1) **the management's decision on the extent of integration** — some concerns integrate only up to **prime cost or factory cost**, others integrate the entire accounting records; (2) **a suitable coding system** serving both financial and cost accounting purposes; (3) **an agreed routine** for the treatment of **provision for accruals, prepaid expenses and the other adjustments** needed for interim accounts; (4) **perfect coordination** between the financial and cost staff, with efficient processing of accounting documents. Add the tail the answer gives: **no separate cost ledger is needed**, but there will be subsidiary ledgers — Customers' Ledger and Purchase Ledger, plus (a) **Stores Ledger**, (b) **Stock Ledger** and (c) **Job Ledger**.

The only entries that change between the two systems are the ones that touch the outside world. Under the integrated system a purchase of raw material is **Stores Ledger Control A/c Dr. — To Payables (Creditors)/Bank A/c**, and wages paid is **Wages Control A/c Dr. — To Bank A/c**, because the real and personal accounts are there in the same books. Under the non-integrated system those same entries are credited to the **Cost Ledger Control A/c**. **Every internal entry is identical in both systems** — that is the distinction the examiner is testing when the two question types appear in the same paper.

The internal entries, as the answers set them out: direct material issued to production — **Work-in-Process Control A/c Dr. — To Stores Ledger Control A/c**; wages charged to production — **WIP Control A/c Dr. — To Wages Control A/c**; manufacturing overhead charged to production — **WIP Control A/c Dr. — To Manufacturing Overheads Control A/c**; allocation of **indirect** wages — **Factory Overheads Control A/c Dr. — To Wages Control A/c**; selling and distribution overhead — **Cost of Sales A/c Dr. — To Selling and Distribution Overhead Control A/c** for the allocation, and **Selling and Distribution Overhead Control A/c Dr. — To Bank A/c** for the payment.

Two items recur and are the ones candidates get backwards. A **normal deficiency found in the stock of raw material** is charged to overhead, not written off: **Factory Overheads Control A/c Dr. — To Stores Ledger Control A/c**. And absorption differences go to the Costing P&L: **over-absorbed** factory overhead is **Factory Overheads Control A/c Dr. — To Costing Profit and Loss A/c**, while **under-absorbed** administration or factory overhead is **Costing Profit and Loss A/c Dr. — To the relevant Overhead Control A/c**.

Where wages are given as one figure with a percentage indirect, split them in a single compound

entry. On wages of ₹2,00,000 of which 20% is indirect, the answer writes Work-in-Process Ledger Control A/c Dr. ₹1,60,000 and Factory Overhead Control A/c Dr. ₹40,000, To Wages Control A/c ₹2,00,000 for the allocation, and a **separate** entry **Wages Control A/c Dr. ₹2,00,000 — To Bank A/c ₹2,00,000** for the payment. Two entries, not one: the allocation and the payment are different events.

Understanding explain it, and place it in context • 2 questions

- Open with the CIMA definition, then the one-set-of-books sentence, then the list. Note that the question of reconciling costing and financial profit does not arise because there is one profit figure only — that point is worth a line on its own.

TQ 2.1 • PYQ 2015-May [7] (b) • DESC • 4M • Pg 410

LEVEL I
Understanding

Easy

TQ 2.2 • RTP 2023-May [15] (c) • DESC • Pg 411

LEVEL I
Understanding

Medium

Application use the rule - work the problem • 3 questions

- Before you write any entry, ask whether the item goes outside the business. If it does, debit or credit Bank or Creditors here, never the Cost Ledger Control A/c.
- Give every entry a narration in brackets underneath, and use the full account names ending in 'Control A/c'. The printed answers are graded on the exact account titles.

PQ 2.1 • PYQ 2022-May [4] (c) • 5M • Pg 412

LEVEL II
Application

Easy

PQ 2.2 • PYQ 2023-Nov [5] (c) • 4M • Pg 413

LEVEL II
Application

Easy

PQ 2.3 • PYQ 2025-Jan [5] (b) • 4M • Pg 413

LEVEL II
Application

Easy

Topic 3: Reconciliation of Cost and Financial Accounts

L2P4-C7-T03

Read first Read ICAI Study Material Chapter 7, Cost Accounting Systems — the reasons for the difference between costing and financial profit, the reconciliation statement and the Memorandum Reconciliation Account.

NOTES

The procedure is three steps, and the answer states them in this order: (i) **determine the profit according to Financial Accounts;** (ii) **determine the profit according to Cost Accounts;** (iii) **reconcile the profits from both accounts.** And the standing rider: a reconciliation statement can

be avoided where the Cost and Financial Accounts are integrated, because the same set of accounts fulfils the requirements of both — there is one figure of profit, so there is nothing to reconcile. That rider is set as a sub-part of the practical question more than once, so keep two sentences ready for it.

Three lists decide almost every item you will meet. Purely financial expenses (financial books only): interest on loans or bank mortgages; expenses and discounts on the issue of shares and debentures; other capital losses, such as **loss by fire not covered by insurance**; losses on the sale of fixed assets and investments; goodwill written off; preliminary expenses written off; **income tax, donations, subscriptions**; expenses of the company's share transfer office. **Purely financial income (financial books only):** interest received on bank deposits, loans and investments; dividends received; profits on the sale of fixed assets and investments; **transfer fee received**; rent receivable. **Notional items (cost books only):** **salary for the proprietor at a notional figure though not incurred**; **charges in lieu of rent where the premises are owned**; **interest on capital at a notional figure though not incurred**; notional depreciation on assets fully depreciated whose book value is nil. The classification question hands you ten items and asks only 'Cost Accounts or Financial Accounts' — these three lists answer it.

Fix the direction once and the rest is arithmetic. Starting from **profit as per Cost Accounts** and working towards **profit as per Financial Accounts**: **ADD** overheads **over-recovered or over-absorbed** in cost accounts, depreciation **over-charged** in cost accounts, all **purely financial income**, all **notional charges** made in the cost books (notional rent, charges in lieu of rent), **opening stock over-valued** in cost accounts and **closing stock under-valued** in cost accounts. **LESS** overheads **under-recovered or under-absorbed**, depreciation **under-charged** in cost accounts, all **purely financial expenses**, **opening stock under-valued** in cost accounts and **closing stock over-valued** in cost accounts. If the question instead gives the financial profit and asks for the cost profit, **every sign reverses** — three of the printed questions run that way and candidates lose the whole statement by forgetting it. **The stock rule, stated the way the answers footnote it:** over-valuation in cost accounts = value in Cost Accounts – value in Financial Accounts. Apply it to opening and closing stock separately and then remember they pull in opposite directions: an over-valued **opening** stock has already depressed the costing profit, so it is **added back**; an over-valued **closing** stock has inflated the costing profit, so it is **deducted**. Where the question gives the closing stock in cost accounts and only a market price per unit, value the financial figure yourself (500 units × ₹80 = ₹40,000 against ₹41,000 in cost accounts, so ₹1,000 over-valued and deducted).

The under/over-recovery table is a question type of its own, and the printed answer runs five columns: Financial Accounting figure, Cost Accounting figure, Difference, Under/Over-recovery, Effect on Cost Accounting Profit, Net Effect (taking cost profit as base). Read it this way: where the **financial figure exceeds the cost figure** the overhead is **under-recovered**, the cost profit has been **increased**, and the item is **to be reduced or deducted**; where the **cost figure exceeds the financial figure** it is **over-recovered**, the cost profit has been **decreased**, and the item is **to be added**. For stock, an **over-valued opening stock decreases** the cost profit and is added, an **over-valued closing stock increases** it and is deducted. The answer notes that credit is given either for the under/over-

recovery with its effect, or for the treatment — but write both columns and you cannot be marked down.

The Memorandum Reconciliation Account is the same reconciliation in T-account form, and the sides are fixed. Everything that would be **added** in the statement goes on the **credit** side; everything that would be **deducted** goes on the **debit** side. The starting figure — a **net loss as per Cost Accounts** — is entered on the **debit** side, and the concluding financial figure is the balancing item: a **net profit as per Financial Accounts on the debit side**, a **net loss as per financial books on the credit side**. It is 'memorandum' because it is a presentation device only and forms no part of the double entry.

Where the question gives you the two sets of raw figures and asks for both statements, the answers always build them in this order. **Cost sheet:** Raw materials consumed, Direct labour, **Prime cost**, Factory overheads at the stated recovery rate (70% or 60% of direct wages, 120% of wages, 25% of prime cost, 20% of prime cost — read the rate off the question), **Factory cost**, add opening work-in-process, less closing work-in-process, **Factory cost of goods produced**, Administration overheads at the stated rate (15% or 20% of factory cost, or ₹ per unit), **Cost of production**. Then **cost of production per unit = cost of production ÷ units produced**, where **units produced = units sold + closing stock – opening stock**, and that per-unit figure is what values the closing finished stock. Then **Sales revenue (A)**; opening finished stock at the rate the cost books use (₹120 or ₹105 per unit); add cost of production; less closing stock at the computed per-unit cost; **Cost of goods sold**; add selling and distribution overheads at ₹ per unit sold; **Cost of sales (B)**; **Profit = (A) – (B)**. The financial statement is drawn in account form with the purely financial charges — goodwill written off, income tax, bad debts, dividend paid — on the debit side and rent and interest received on the credit side, profit being the balancing figure. **Two more patterns worth knowing before you sit down.** First, where the question says **indirect expenses are absorbed on the basis of normal production capacity**, the **variable** element is charged in full but the **fixed** element is charged at **fixed cost × actual units ÷ normal capacity** (₹55,000 × 35,000/40,000), and the shortfall against the actual financial expense is **deducted** in the reconciliation; notional rent charged in the cost sheet is **added back**. Second, where the question says a difference remains after all the listed items and asks you to find it, put X in the statement, carry it through, equate the closing line to the given financial profit and solve — the printed answer does exactly that, reaching $X - 1,300 = 7,000$ and so $X = 8,300$.

The traps you can see corrected across several answers. Notional rent, or charges in lieu of rent for owned premises, is cost-only and is added when going from cost profit to financial profit — candidates keep deducting it because it looks like an expense. Income tax, goodwill written off, preliminary expenses, donations, fines, bad debts, provision for doubtful debts, interest on loan or debentures, obsolescence loss, discount allowed and loss on sale of assets are financial-only expenses and are all deducted. Transfer fees and stores adjustments credited in the financial books are financial-only income and are added. Where the question prints '**factory overheads absorbed ₹52,000**' and '**factory overheads charged ₹45,000**', the over-absorption is the **difference** of ₹7,000, not either figure. And where an expense is described as **capital in nature** — brand-

building advertisement, in one answer — it is **excluded from the financial profit and loss account altogether**.

Remembering reproduce what you have learnt · 2 questions

- Learn the two financial-only lists (six expenses, five incomes) and the four notional items as blocks. The list question is set on its own for 5 marks and is pure recall.

TQ 3.2 · MTP 2020-Oct [6] (c) · DESC · 5M · Pg 415

LEVEL I
Remembering

Medium

TQ 3.5 · RTP 2025-Jan [19] (b) · DESC · Pg 417

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 1 question

- When asked whether reconciliation is necessary under an integrated system, answer no and give the reason — one set of books, one figure of profit — then add the sentence that integration means the same accounts satisfy both requirements.

TQ 3.3 · PYQ 2022-Nov [6] (b) · DESC · 5M · Pg 416

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 22 questions

- Head the statement with the base the question names ('taking costing net loss as base'), then Add: items grouped, then Less: items grouped, then the closing line. Use two money columns — individual items in the inner column, the sub-totals of the Add and Less blocks in the outer one — exactly as the printed answers do.
- Where the question says to maintain the serial order given, do not group additions and deductions; take the items in the printed order and mark each one plus or minus.
- A loss is carried in brackets and stays negative through the statement. Losing the sign on the opening loss costs every subsequent line.

PQ 3.1 · PYQ 2018-May [1] (d) · 5M · Pg 418

LEVEL II
Application

Easy

PQ 3.4 · PYQ 2021-Dec [4] (b) · 5M · Pg 424

LEVEL II
Application

Easy

PQ 3.5 · PYQ 2022-Nov [5] (b) · 5M · Pg 425

LEVEL II
Application

Easy

PQ 3.6 · PYQ 2023-May [5] (b) · 5M · Pg 426

LEVEL II
Application

Easy

PQ 3.10 · MTP 2024-Jul [1] (b) {C} · 5M · Pg 433

LEVEL II
Application

Easy

PQ 3.11 · PYQ 2024-Sep [1] (b) {C} · 5M · Pg 435

LEVEL II

Easy

	Application	
PQ 3.13 · MTP 2024-Dec S2 [4] (c) · 4M · Pg 437	LEVEL II Application	Easy
PQ 3.17 · MTP 2025-Dec S2 [1] (a) {C} · 5M · Pg 444	LEVEL II Application	Easy
PQ 3.2 · RTP 2018-Nov [6] · Pg 419	LEVEL II Application	Medium
PQ 3.7 · RTP 2023-May [6] · Pg 427	LEVEL II Application	Medium
PQ 3.8 · PYQ 2024-May [3] (b) · 7M · Pg 428	LEVEL II Application	Medium
PQ 3.9 · RTP 2024-May [6] · Pg 430	LEVEL II Application	Medium
PQ 3.12 · RTP 2024-Sep [12] · Pg 436	LEVEL II Application	Medium
PQ 3.14 · PYQ 2025-May [4] (a) · 8M · Pg 438	LEVEL II Application	Medium
PQ 3.15 · MTP 2025-Jul S1 [3] (b) · 5M · Pg 440	LEVEL II Application	Medium
PQ 3.16 · RTP 2025-Sep [11] · Pg 442	LEVEL II Application	Medium
PQ 3.18 · PYQ 2026-Jan [4] (b) · 7M · Pg 445	LEVEL II Application	Medium
PQ 3.20 · RTP 2026-May [11] · Pg 450	LEVEL II Application	Medium
PQ 3.21 · PYQ 2026-May [1] (c) {C} · 4M · Pg 453	LEVEL II Application	Medium
PQ 3.22 · PYQ 2026-Sep [3] (a) · 7M · Pg 454	LEVEL II Application	Medium
PQ 3.3 · PYQ 2021-Jul [3] (a) · 10M · Pg 422	LEVEL II Application	Hard
PQ 3.19 · RTP 2026-Jan [12] · Pg 447	LEVEL II Application	Hard

Analysis break it down and examine the interrelationships · 2 questions

- For the under/over-recovery table, take one line at a time and say for each: which set of books carries more, whether that is under- or over-recovery, what it did to the costing profit, and therefore whether it is added or deducted. The examiner marks each row separately.

TQ 3.1 · MTP 2019-Mar [6] (c) · DESC · 5M · Pg 415	LEVEL II Analysis	Medium
TQ 3.4 · PYQ 2025-Jan [6] (a) · DESC · 5M · Pg 417	LEVEL II Analysis	Medium

CHAPTER 8

Unit and Batch Costing

6 Topics · 19 Classified Questions · Importance: B

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge **18.0%** 18 of 100 marks

Level II — Analysis & Application **82.0%** 82 of 100 marks

Below the paper's Level I floor: only 18% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for the paper. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Unit Costing

L2P4-C8-T01

Read first Read ICAI Study Material Chapter 8, Unit and Batch Costing — unit (single or output) costing, the methods of costing and the cost unit appropriate to each.

NOTES

Unit costing is also called single costing or output costing, and the printed table defines it by the nature of the output: it applies where there are similar units of a single product, produced by a single process. The **cost unit** is described as '**for the entire activity, but averaged for the output**' — that is the whole idea of the method. The industry example the answer gives is **cold drinks**.

The table the examiner sets, all four rows, learn it as a block. A series of processes → Process costing or Operation Costing → cost unit **for each process** → **Sugar**. Similar units of a single product produced by a single process → **Unit or Output or Single Costing** → cost unit for the entire activity but averaged for the output → **Cold drinks**. Customer specifications: single unit → **Job Costing** → cost unit **for each order, assignment or job** → **Advertising**. Consisting of multiple varieties of activities and processes → **Multiple Costing** → cost unit a **combination of any method** → **Car assembly**.

Read the 'nature of output' column, not the industry name. The question gives you the nature of the output and asks for the method, the cost unit **and** an example of an industry — three columns, and the answer must fill all three for each row. An answer that names the method only throws away two-thirds of the marks.

The dividing line between unit costing and job or batch costing is uniformity. Unit costing averages the cost over identical output of a single product; job costing ascertains cost **for each order separately** because the work is to the customer's specification; multiple costing is used where a product is an assembly of parts made by several methods, so the cost unit is a

combination.

Understanding explain it, and place it in context • 1 question

- Give the industry example that matches the row, not a generic one. Sugar for process costing, cold drinks for unit costing, advertising for job costing, car assembly for multiple costing.

TQ 1.1 • MTP 2025-Aug S2 [6] (a) • DESC • 5M • Pg 459

LEVEL I
Understanding

Medium

Topic 2: Cost Collection Procedure in Unit Costing

L2P4-C8-T02

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 8, Unit and Batch Costing — the cost collection procedure in unit costing and the build-up of the cost sheet.

NOTES

No question has been printed on this topic in the Scanner, so treat it as the concept base that the practical questions in this chapter and in Chapter 7 draw on. What the printed answers show you is the **order** in which costs are collected and presented, and that order is itself examinable elsewhere.

The build-up the answers use, every time, in this order: Direct material, Direct wages (or direct labour), direct or chargeable expenses, giving **Prime Cost**; add **factory or production overheads** at the stated absorption rate, giving **Factory Cost or Works Cost**; adjust for **opening and closing work-in-process** (add opening, deduct closing) to give the **factory cost of goods produced**; add **administration overheads** to give **Cost of Production**; adjust for **opening and closing finished stock** to give **Cost of Goods Sold**; add **selling and distribution overheads** to give **Cost of Sales**; then **profit** and **sales**. Each element is collected from its own source — materials from the stores ledger, wages from the wages control account, overheads from the overhead control accounts — which is why the control accounts of Chapter 7 and the cost sheet of this chapter carry the same figures.

Cost per unit is the point of the method: $\text{cost per unit} = \text{total cost} \div \text{number of units produced}$, and the number of units is not always given. The answers derive it as $\text{units produced} = \text{units sold} + \text{closing stock of finished goods} - \text{opening stock of finished goods}$. Get that working wrong and the closing stock valuation, the cost of goods sold and the profit are all wrong together.

Work-in-process is valued at factory cost where the question says so, and the answers state the assumption expressly before using it. Closing finished stock is valued at the current period's cost of

production per unit, while **opening finished stock comes in at the rate the cost books used last period** (₹120 per unit, ₹105 per unit in the printed questions) — the two are deliberately different, and the difference is what later has to be reconciled with the financial accounts.

Topic 3: Batch Costing

L2P4-C8-T03

Read first Read ICAI Study Material Chapter 8, Unit and Batch Costing — batch costing operated through an integrated set of control accounts.

NOTES

Where a batch costing system is fully integrated with the financial accounts, the question is a control-account question. Six accounts are asked for and they interlock: Stores Ledger Control, Wages Control, Production Overhead Control, Work-in-Process Control, Finished Goods Control and Costing Profit and Loss. Open all six first, put the opening balances in, then post each item to both of its accounts.

Stores Ledger Control A/c: Debit — To Balance b/d, To Creditors/Bank A/c (materials purchased during the period). **Credit** — By Work-in-Process Control A/c (materials issued to production), By Balance c/d. Because the system is **integrated**, the purchase is credited to **Creditors or Bank**, not to a cost ledger control account.

Wages Control A/c is where the marks are lost. Debit — To Bank A/c with the **total wages paid**. **Credit** — By Work-in-Process Control A/c with the **direct wages charged to batches**, By Production Overhead Control A/c with the **indirect wages**, and By Production Overhead Control A/c again with the **payment for non-productive time of direct workers**. Read the two fractions carefully: in the printed answer the **indirect element is 1/6 of the total wages paid** ($₹5,79,900 \times 1/6 = ₹96,650$), but the **non-productive time is 1/5 of the direct wages paid**, that is **1/5 of (total wages – indirect wages)** — $₹5,79,900 - ₹96,650 = ₹4,83,250$, and $1/5$ of that is ₹96,650. Both of those amounts go to Production Overhead Control, not to work-in-process, because idle time of direct workers is an overhead.

Production Overhead Control A/c: Debit — To Bank A/c (overheads incurred), To Wages Control A/c (indirect wages **plus** non-productive time). **Credit** — By Work-in-Process Control A/c with the amount absorbed at the stated rate — 130% of the direct wages charged to work-in-process (130% of ₹3,86,600 = ₹5,02,580). The balance is the **over- or under-absorption**, taken to the **Costing Profit and Loss A/c**; in the printed answer it is an **over-absorption of ₹77,320 entered on the debit side as the balancing figure**.

Work-in-Process Control A/c, and the stock gain: Debit — To Balance b/d, To Stores Ledger Control A/c, To Wages Control A/c, To Production Overhead Control A/c (absorbed). **Credit** — By Finished Goods Control A/c (cost of goods completed and transferred), By Balance c/d at the

physical value of work-in-process at the end of the period. Where the closing balance is given as a **physical value** that exceeds what the account would otherwise leave, the difference is a **stock gain** and is **debited to Work-in-Process Control with the credit to the Costing P&L A/c** (₹1,73,970 in the printed answer). That is the item candidates omit, and without it the account will not balance.

Finished Goods Control A/c and Costing P&L: Finished Goods — **Debit** To Balance b/d, To Work-in-Process Control A/c; **Credit** By Costing P&L A/c (cost of finished goods sold), By Balance c/d. Costing P&L — **Debit** To Finished Goods Control A/c (cost of goods sold) and To Balance c/d for the profit; **Credit** By Sales A/c, By Production Overhead Control A/c (over-absorption), By Work-in-Process Control A/c (stock gain). **Both the over-absorption and the stock gain are credits in the Costing P&L**, which is the check that you have taken them the right way in the accounts above.

Application use the rule - work the problem · 1 question

- Do the wages split on a separate line of working before you draw the accounts. Two fractions on two different bases is the whole difficulty of this question.
- Absorb overheads on the wages charged to work-in-process, not on the wages paid. The rate is expressed as a percentage of direct wages charged to WIP and the question says so.

PQ 3.1 · RTP 2025-May [12] · Pg 460

LEVEL II
Application

Hard

Topic 4: Costing Procedure in Batch Costing

L2P4-C8-T04

Read first Read ICAI Study Material Chapter 8, Unit and Batch Costing — the costing procedure in batch costing, the batch cost statement and the determination of price per unit.

NOTES

The **batch cost statement**, in the order every printed answer builds it, and with two columns — **cost per batch** and **total cost for the order**: **Direct Material Cost**; **Direct Wages**; **Set-up cost** (called oven set-up, lab set-up or batch set-up cost depending on the question); add **Production Overheads** at the stated rate, which is a **percentage of direct wages** (20% in three of the answers); giving **Total Production Cost**; add **Selling, Distribution and Administration overheads** at the stated **percentage of total production cost** (10%, 15% or 20%); giving **Total Cost**; add **Profit**; giving **Sales price**. Then **cost per unit = total cost of the batch ÷ units in the batch** and **selling price per unit = sales price of the batch ÷ units in the batch**. **Where the job is costed department by department**, the batch statement runs: **Direct Material**; **Direct Labour** by department at each department's hourly rate (300 hours at ₹50, 200 hours at ₹40); **Prime Cost**; add **Factory Overheads** by department at the given hourly rate; **Factory Cost or Works Cost**; add **Administrative and Selling Overheads** at a percentage of works cost; **Total Cost**; then profit and selling price, with selling price

per unit = total sales ÷ number of units in the batch.

Number of batches = order quantity ÷ batch size, and it is always rounded up. The trap is what happens to the odd units, and one answer tests it directly. An order for **600 cakes at 50 per batch is 12 batches**; an order for **605 cakes is 13 batches** — but only the **set-up cost** follows the batch count ($₹750 \times 13$ batches), while **direct material and direct wages follow the units** ($₹5,000 \div 50 \times 605$, $₹500 \div 50 \times 605$). Set-up cost is a step cost and material and labour are per unit; charging all three on 13 batches, or all three on 605 units, is the classic wrong answer.

Convert the profit margin before you use it. Profit of 25% on sales value = 1/3 of total cost; the answers write the line as '**Add: Profit (25% of sales value or 1/3 of total cost)**'. Read which base the question names — 'profit margin of 25% of sales value' and 'profit of 20% on cost' are different figures. Where the question is set out as a percentage split, the answers use the 100-part frame: **Total Cost (75) + Profit (25) = Revenue (100)**.

The service-batch variant — a coaching batch, a training course — is costed the same way but the divisor changes. Build the **total cost per batch** by extending each period rate over the life of the batch: hall rent per week $\times$ 30 weeks; lecture fee $\times$ lectures per day $\times$ days per week $\times$ 30 weeks; travel per day $\times$ days $\times$ weeks; refreshment and administration per week $\times$ 30 weeks. Then **cost per student = total cost per batch ÷ seating capacity** where the batch is **fully occupied**. But when the question asks for the fee at **80% occupancy** with a profit margin, first gross the cost up to revenue (cost 75, profit 25, revenue 100) and then **divide by the actual number of students, 80% of 250 = 200**, not by the capacity. Dividing by capacity at that last step is the commonest error here.

The jobbing-factory variant, where a batch order is opened each month: materials and labour are booked **at actual** and **overheads are levied at a rate per labour hour**. So compute the rate first — overhead rate = the month's chargeable expenses ÷ the month's total direct labour hours — then **overhead for the batch = the batch's labour hours $\times$ that rate**. Where labour hours are not given directly, derive them: **labour hours = wages ÷ the hourly wage rate** ($₹5,000 \div ₹2 = 2,500$ hours). Set the answer out as a statement with one column per month and a Total column: batch output, sale value, material, wages, chargeable expenses, **total cost, profit per batch, cost per unit, profit per unit**. Then state the **overall position of the order separately** using the **contracted quantity** at the **overall cost per unit** — 1,800 units at ₹6.57 against 1,800 units at ₹8, even though 1,830 units were actually produced.

Where a rejection rate is given, the good units are the denominator. Good units = units manufactured $\times$ (1 – rejection rate) — $20,000 \times 97\% = 19,400$. Build the total column first: sales (good units $\times$ selling price), less direct material, direct labour and variable overhead to give **total variable cost, less the scrap value of the rejected units** ($₹75 \times 20,000 \times 3\% = ₹45,000$) to give **net variable cost**, and **contribution = sales – net variable cost**. **Contribution per good unit = contribution ÷ good units**, and **monthly profit = total contribution – fixed overheads**. Note how the printed per-unit column is derived: the gross variable cost is divided by **units manufactured** while the net variable cost and contribution are divided by **good units** — so work in the total column and divide only at the end.

Where the batch is limited by plant capacity rather than by an order, first work out how many units fit: **bottles per batch** = plant capacity in litres ÷ litres per bottle ($5,000 \div 3 \div 1.5 \div 0.6$), then **number of batches** = demand ÷ bottles per batch. Cost each input on the demand: material quantity per litre of output × output; **direct wages by man-shifts** (total hours ÷ shift hours × number of workers × rate per shift); packing cost per bottle; power at the rated consumption for processing hours and at only 20% of it during set-up; and other variable cost per batch. Profit before fixed cost is sales less total variable cost, and the single fixed cost is deducted once at the end, not batch by batch.

Application use the rule - work the problem · 9 questions

- Show the number of batches as a one-line working above the statement ('600 units ÷ 50 units = 12 batches'). Every printed answer opens with it.
- Keep two columns throughout — per batch and per order — and carry both down to the sales line. The question usually asks for the total price and the per-unit price, and both come free if the columns are there.
- State the profit conversion in the line itself: 'Profit (25% of sales value or 1/3 of total cost)'. That single bracket shows the examiner you knew which base you were working on.

PQ 4.6 · MTP 2024-Nov [2] (b) · 2M · Pg 471	LEVEL II Application	Easy
PQ 4.2 · PYQ 2022-Nov [1] (a) {C} · 5M · Pg 464	LEVEL II Application	Medium
PQ 4.3 · RTP 2024-May [7] · Pg 465	LEVEL II Application	Medium
PQ 4.5 · RTP 2024-Sep [13] · Pg 469	LEVEL II Application	Medium
PQ 4.7 · PYQ 2025-Jan [1] (b) (i) (ii) {C} · 5M · Pg 472	LEVEL II Application	Medium
PQ 4.8 · RTP 2025-Jan [13] · Pg 473	LEVEL II Application	Medium
PQ 4.9 · PYQ 2026-May [1] (a) {C} · 5M · Pg 474	LEVEL II Application	Medium
PQ 4.1 · MTP 2018-Aug [1] (d) {C} · 5M · Pg 462	LEVEL II Application	Hard
PQ 4.4 · PYQ 2024-Sep [1] (a) {C} · 5M · Pg 468	LEVEL II Application	Hard

Topic 5: Economic Batch Quantity (EBQ)

L2P4-C8-T05

Read first Read ICAI Study Material Chapter 8, Unit and Batch Costing — Economic Batch Quantity,

optimum run size and the comparison of total cost at different batch sizes.

NOTES

The formula, with the terms as the answers define them: $EBQ = \sqrt{(2DS \div C)}$, where **D = annual demand for the product**, **S = set-up cost per batch or per run** and **C = carrying (inventory holding) cost per unit per annum**. Write the formula and define all three terms before substituting — the definitions are set out in full in the printed answers and carry the method marks.

The single commonest error is the holding cost period. The question gives holding cost **per unit per month** and the formula needs it **per annum**: ₹1.50 per month $\times 12 = ₹18$ per annum, ₹0.20 per month $\times 12 = ₹2.40$, ₹12 per vaccine per month $\times 12 = ₹144$. Convert it, show the multiplication, and use the annual figure everywhere afterwards including in the carrying-cost comparison. Note that where the question gives the holding cost already as '₹5 per unit' with an annual demand, no conversion is needed — read the words, not the number.

Derive the demand where it is not given directly. One answer computes **D = total market demand $\times$ the company's market share** (40 million $\times 2.5\% = 10,00,000$ units). Another builds the **set-up cost** rather than the demand: set-up cost per batch = power cost during set-up time + other variable cost per batch, the latter being assumed to form part of set-up cost, and the assumption stated.

The three follow-on figures the questions ask for: **number of runs (or set-ups) = annual demand $\div$ EBQ** — $48,000 \div 3,919 = 12.25$ runs, 'say 13 runs'; **interval between two consecutive runs** = $365 \text{ days} \div \text{number of runs} = 365 \div 12.25 = 29.80$ days; and **minimum inventory holding cost** = **average inventory $\times$ carrying cost per unit per annum** = $(EBQ \div 2) \times C = (5,000 \div 2) \times ₹18 = ₹45,000$.

The extra-cost comparison is set out as a two-column table and the structure never varies. **Total Cost = Total Set-up Cost + Total Carrying Cost**, where **total set-up cost = (annual demand $\div$ run size) $\times$ set-up cost per run** and **total carrying cost = $\frac{1}{2} \times$ run size $\times$ carrying cost per unit per annum**. Compute both totals — one column at the policy run size, one at the EBQ — and **extra cost = total cost at the policy size – total cost at the EBQ**. Show the number of set-ups as its own line; the answers do, and it is separately creditable.

Use the equality as a free check. At the optimum run size the total set-up cost and the total carrying cost are equal — the printed answer says so in terms (₹4,703.24 against ₹4,702.80, and ₹45,000 against ₹45,000) and concludes that it is therefore the most economical batch quantity. If your two figures at the EBQ are not roughly equal, your EBQ is wrong, and you can say so before going on.

The theory limb, when the question asks you to explain rather than compute: a higher batch size means fewer set-ups and so a lower total set-up cost, but more units held in inventory and so a higher holding cost; a lower lot size gives lower holding cost but only at a higher set-up cost. Economic batch quantity is the batch size at which the total of set-up and holding costs is at a minimum — the point where the two cost lines **intersect** represents the lowest cost combination.

It may be found either by computing the total cost for a series of possible batch sizes and picking the minimum, or by a **formula derived in the same way as the Economic Order Quantity**, the objective being to determine the production lot that optimises on both set-up and inventory holding costs.

Remembering reproduce what you have learnt • 1 question

- State $EBQ = \sqrt{(2DS/C)}$ and define D, S and C before substituting. A correct figure with no formula and no definitions does not earn the method marks.

PQ 5.2 • PYQ 2021-Jan [1] (d) {C} • 5M • Pg 477

LEVEL I
Remembering

Hard

Application use the rule - work the problem • 5 questions

- Show the annualisation of the holding cost on its own line. It is the single step the examiner is watching for.
- Lay the extra-cost comparison out as two columns side by side with the same four rows — number of set-ups, total set-up cost, total carrying cost, total cost — and put the difference underneath. A one-line answer stating only the extra cost loses most of the marks.

PQ 5.5 • MTP 2023-Sep [1] (b) {C} • 5M • Pg 480

LEVEL II
Application

Easy

PQ 5.6 • MTP 2026-Mar S1 [6] (c) • 4M • Pg 481

LEVEL II
Application

Easy

PQ 5.3 • PYQ 2021-Jul [1] (c) {C} • 5M • Pg 478

LEVEL II
Application

Medium

PQ 5.4 • PYQ 2023-May [1] (a) {C} • 5M • Pg 479

LEVEL II
Application

Medium

PQ 5.1 • PYQ 2018-Nov [3] (a) • 10M • Pg 476

LEVEL II
Application

Hard

Topic 6: Difference between Job and Batch Costing

L2P4-C8-T06

Read first Read ICAI Study Material Chapter 8, Unit and Batch Costing — the meaning of job costing and batch costing and the distinction between them.

NOTES

Job costing, as the printed answer defines it: a method of costing used when the work is undertaken as per the customer's special requirement. When an enquiry is received, the **costs expected to be incurred on the job are estimated and a price is quoted** on that estimate. The

actual costs of materials, labour and overhead are then accumulated, and **on completion of the job the actual costs are compared with the quoted price** so that the **profit or loss on that job** is determined. Industries: printing press, hardware foundry, ship building, heavy machinery, general engineering works, machine tools, interior decoration, repairs.

Define 'batch' before you define batch costing — the answer does, and it is a separate mark. A batch is a group of similar and identical products produced in a factory and treated as a single cost unit. **Batch costing is a specific type of job costing**, used in industries whose production is of a **repetitive nature** and where articles are **produced in definite batches and held in stock**. It is the form of job costing in which cost is ascertained collectively for a batch and the cost per unit is then determined.

The three salient features of batch costing: (1) it is applied in industries where **identical products** are produced; (2) the output of a batch consists of a number of units and it is not economical to ascertain the cost of every unit of output independently; (3) certain physical characteristics such as size, colour, taste and quality are required uniformly over a collection of units — garments of the same size, pharmaceuticals. Industries: pharmaceuticals, garment manufacture, manufacture of spare parts, radio, television and computer manufacture.

The computation line that ties the two together: batch costing is but a specific type of job costing, so the cost of each batch is ascertained in the same way as that of an individual job, and then **cost per unit = cost of the batch ÷ number of units in the batch**. Quote that sentence — it is the answer to 'how are they related' as well as half the answer to 'how do they differ'.

For the distinguish-between question, run the contrast on these axes, each taken from the definitions above: the **trigger** — a customer's special requirement against repetitive production held in stock; the **cost unit** — the individual job or order against the batch as a single cost unit; **identity of the output** — each job is separate and made to specification, a batch is a group of similar and identical products; **how unit cost arises** — a job's cost is the total booked against that job, whereas a batch's cost is divided by the number of units in it; **the outcome measured** — profit or loss on the job against the quotation, against a cost per unit for stock; and **the industries** — printing, ship building, general engineering against pharmaceuticals, garments and spare parts.

Understanding explain it, and place it in context · 2 questions

- Say expressly that batch costing is a specific type of job costing before you distinguish them. An answer that treats them as unrelated methods misses the framing mark.

TQ 6.1 · PYQ 2018-May [6] (d) · DESC · 5M · Pg 482

LEVEL I
Understanding

Medium

TQ 6.2 · PYQ 2025-May [5] (b) · DB · 3M · Pg 483

LEVEL I
Understanding

Medium

CHAPTER 9

Job Costing

1 Topics · 9 Classified Questions · Importance: D

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **on profile**Level I — Comprehension & Knowledge **26.4%** 14 of 53 marksLevel II — Analysis & Application **73.6%** 39 of 53 marks

This chapter sits inside ICAI's own band for the paper — 26% Level I against 20-30%. Prepare it in those proportions: know the method, then drill it. Read the split with care: the chapter carries only 9 classified questions, so a single question moves it several points.

Topic 1: Job Costing

L2P4-C9-T01

Read first Read ICAI Study Material Chapter 9, Job Costing — the meaning and advantages of job costing, the job cost sheet, the recovery of overheads on a job and the distinction from process costing.

NOTES

The definition, quoted as the answers print it: job costing is a method of costing which is used when the work is undertaken as per the customer's special requirement. On an enquiry from the customer, the costs expected to be incurred on the job are estimated and a price is quoted on the basis of that estimate. The **actual** costs of materials, labour and overhead are then **accumulated**, and **on completion of the job those actual costs are compared with the quoted price**, so the **profit or loss on the job** is determined. The industries the answer names: printing press, hardware foundry, ship building, heavy machinery, general engineering works, machine tools, interior decoration, and repairs. The question sometimes asks for four industries only — give four from that list and no others. **The five advantages, as a numbered list:** (1) the details of cost of material, labour and overhead for every job are available, and so controllable; (2) **the profitability of each job can be derived**; (3) **it facilitates production planning**; (4) **budgetary control and standard costing can be applied** in job costing; (5) **spoilage and defectives can be identified and responsibility fixed accordingly**. Five marks, five points — write them short and numbered.

Job costing against process costing — the five distinctions the answer draws, in this order. (1) **A job is carried out or a product produced by specific order**, whereas in process costing the process of producing the product has a continuous flow and the product produced is homogeneous. (2) **Costs are determined for each job**, whereas process costs are compiled on a time basis, i.e. for a given accounting period, for each process or department. (3) **Each job is separate and independent of other jobs**, whereas products lose their individual identity as they are manufactured in a continuous flow. (4) **Each job or order has a number and costs are collected against that job number**, whereas **the unit cost of a process is an average cost for the period**. (5) **Costs are**

computed when a job is completed and the cost of a job is found by adding all costs booked against it, whereas **process costs are calculated at the end of the cost period** and the unit cost of a process is **the total cost for the period ÷ the output of the process during that period**.

The job cost sheet, with the heading the answers actually print: **Customer details, Job No., Date of Commencement, Date of Completion** across the top — put them in, they are part of the format. Then the body, in this order: **Direct Materials; Direct Wages**, analysed department by department as **hours × hourly rate; Chargeable Expenses; Prime Cost; Overhead Cost**, again department by department; **Works Cost; Selling Expenses; Total Cost; Profit; Selling Price**. The sentence 'average hourly rates for all the departments are similar' is doing real work. It is what allows you to split the job's total direct wages across the departments by **hours at one common rate** — ₹4 per hour over 4, 7, 2 and 2 hours, or ₹47.50 per hour over 8, 6 and 4 hours. Without that assumption you could not allocate the wages, so state it before you use it. Read the profit base with care — the two questions in the pack use different ones. '**Add 20% profit on selling price**' means the total cost is 80% of the selling price, so **profit = total cost × 20/80 = 25% of total cost** and the selling price follows (₹326.30 total cost, ₹81.575 profit, ₹407.88 selling price). '**Adding 20% to the total cost**' means **profit = 20% of total cost** (₹3,004.38 total cost, ₹600.88 profit, ₹3,605.26 selling price). Likewise '**profit 15% on selling price**' means the total cost is 85% of the selling price, so **selling price = total cost ÷ 0.85** (₹1,27,500 ÷ 0.85 = ₹1,50,000). The classic wrong answer takes a percentage of cost when the question said 'on selling price'.

The recovery percentages are almost never given — you derive them from the analysis of the Profit and Loss Account. Departmental overhead rate = that department's overheads ÷ that department's direct wages × 100, and it is then applied to **that department's wages on the job**: Dept. A ₹12,000 ÷ ₹12,000 = 100% of ₹16; Dept. B ₹6,000 ÷ ₹8,000 = 75% of ₹28; Dept. C ₹9,000 ÷ ₹10,000 = 90% of ₹8; Dept. D ₹17,000 ÷ ₹20,000 = 85% of ₹8. **Selling expenses are recovered as a percentage of works cost**: total selling expenses ÷ total works cost × 100 — ₹90,000 ÷ ₹3,00,000 = 30%, ₹3,80,000 ÷ ₹38,00,000 = 10%. **Compute each rate on a separate line and show the fraction**; the rates carry more marks than the final figure.

The simultaneous-equation question, which is the hardest thing in this chapter. Where factory overhead is recovered as a **fixed percentage of direct wages** and administrative overhead as a **fixed percentage of factory cost**, and two jobs are given with their selling prices and profit percentages, proceed like this. First get each job's **total cost** from its selling price: **profit 12% on total cost** means ₹3,33,312 ÷ 1.12 = ₹2,97,600, and **20% on total cost** means ₹2,52,000 ÷ 1.20 = ₹2,10,000. Then let **x = factory overhead as a fraction of direct wages** and **y = administrative overhead as a fraction of factory cost**, and write for each job **Total cost = [Material + Wages (1 + x)] (1 + y)**. **Divide the first equation by the second** — that eliminates (1 + y) — solve for **x = 66.67% of direct wages**, substitute back to get **y = 20% of factory cost**, and only then cost the jobs. Part 3 then quotes a third job on those same two rates.

Where labour is costed into the job from attendance data, work the hourly rate before anything else. **Normal hours = (shift hours – lunch break – tea breaks) × days present** — (8 – ½ – ½) × 5 = 35 hours. **Normal hourly rate = (basic + dearness allowance) × days ÷ normal hours** — (₹500 +

$\text{₹}200) \times 5 \div 35 = \text{₹}100$ per hour. **Overtime rate = double the normal hourly rate = ₹200.** Then apportion the **normal time between the jobs on the stated percentages** (60% and 40% of 35 hours at ₹100) and charge the **overtime only to the job for which it was worked.** Overheads are applied at a rate per labour hour on the hours booked to each job, including that job's overtime hours — (21 + 4) hours $\times$ ₹15 for one job, 14 hours $\times$ ₹15 for the other. Where the job runs on a machine and you are asked to choose between machines, the question has turned into a relevant-cost question. Compute **variable cost per running hour = variable running costs $\div$ running hours** and **fixed cost per running hour = fixed costs $\div$ running hours.** The **cost of one job is machine hours $\times$ rate + the consumable cost**, and the **cost of a satisfactory job is that cost $\div$ (1 – reject rate)** — $\text{₹}212.73 \div 0.9 = \text{₹}236.37$. But for the **choice between two machines where sufficient capacity is available on both**, use **only the variable costs:** $\text{₹}140.00 \div 0.9 = \text{₹}155.56$ against $\text{₹}112.60 \div 0.94 = \text{₹}119.79$, and recommend the cheaper. Fixed costs are excluded from the comparison because they do not change with the decision — including them is the error the question is set to catch.

Where the job cost sheet is built from last year's actuals for a special order, the sequence is: derive the two recovery rates from last year — **factory overhead as a percentage of direct labour** and **administrative overhead as a percentage of factory cost**; then build the sheet as direct material, direct labour, prime cost, factory overhead, factory cost, administrative overhead. **Last year's material figure is consumption, not purchases: opening stock + purchases – closing stock**, and the order's estimate is a percentage of that. Where a **safety margin** is to be added to estimated material and labour and the question says overheads are to be taken after considering it, **apply the overhead rates to the increased figures, not the original ones.** Delivery and installation at the customer's site is a selling and distribution cost and so comes **after the cost of production**, not inside factory cost. And where the question expressly leaves the profit margin to management, **stop at total cost and do not invent a selling price.**

Remembering reproduce what you have learnt · 1 question

- Give the definition in full — special requirement, estimate and quotation, accumulation of actual costs, comparison on completion. All four limbs carry marks; the one-mark version of this question wants the first limb at least.
- Number the five advantages. A paragraph covering the same ground scores lower than five short numbered lines.

TQ 1.3 · PYQ 2025-Sep [6] (b) · DESC · 5M · Pg 488

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 2 questions

- For the distinguish-between question set the answer as a two-column table with five numbered rows, and make each row a genuine contrast — the same point stated twice is one mark, not two.

TQ 1.1 · PYQ 2016-Nov [7] (a) · DESC · 4M · Pg 487	LEVEL I Understanding	Easy
TQ 1.2 · PYQ 2022-May [2] (c) · DB · 5M · Pg 487	LEVEL I Understanding	Medium

Application use the rule - work the problem · 6 questions

- Head the job cost sheet with Customer details, Job No. and the two dates. The printed answers carry the heading and it is part of the format mark.
- Compute each overhead recovery percentage on its own line, showing the fraction and the result, before applying it. The rates are where the marks are; the arithmetic that follows is worth little on its own.
- Write down which base the profit percentage is on before you compute it — 'on selling price' or 'on total cost' — and show the conversion. That one line protects the whole bottom of the sheet.

PQ 1.4 · MTP 2026-Mar S1 [1] (a) {C} · 5M · Pg 495	LEVEL II Application	Easy
PQ 1.3 · RTP 2025-May [13] · Pg 493	LEVEL II Application	Medium
PQ 1.5 · RTP 2026-May [12] · Pg 496	LEVEL II Application	Medium
PQ 1.6 · PYQ 2026-Sep [2] (b) · 7M · Pg 497	LEVEL II Application	Medium
PQ 1.1 · PYQ 2019-Nov [1] (b) {C} · 5M · Pg 489	LEVEL II Application	Hard
PQ 1.2 · PYQ 2022-May [2] (a) · 10M · Pg 491	LEVEL II Application	Hard

CHAPTER 10

Process and Operation Costing

6 Topics · 36 Classified Questions · Importance: C

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge

6.3%

16 of 253 marks

Level II — Analysis & Application

93.7%

237 of 253 marks

Below the paper's Level I floor: only 6% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for the paper. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Meaning of Process Costing

L2P4-C10-T01

Read first Read ICAI Study Material Chapter 10, Process and Operation Costing — the meaning and scope of process costing.

NOTES

Process costing is a method of costing employed to ascertain the costs of goods or services of processing industry at each process or stage of manufacture. The printed answer then gives the formal definition — "a method of cost accounting whereby costs are charged to processes or operations and averaged over units produced". For a one-mark "explain very briefly" both sentences are worth writing, because the second carries the words the examiner is looking for.

The operative word is "averaged". Cost is not traced to a job or a batch; the process collects its costs and they are divided over the units the process produces. Every practical answer in this chapter turns on that single rate — the same cost per unit values the good output, the abnormal loss and the abnormal gain, and that is the link between the definition and the numbers.

Process costing applies where production is continuous and the output of one process is the input of the next. The printed solutions carry both units and value forward: Process P transfers 9,000 kg at ₹15.50 per kg to Process Q, Process Q transfers its output to Process R, and only the last process transfers to finished stock or to the warehouse. Say this when asked where process costing is used.

Understanding explain it, and place it in context · 1 question

- If asked where it is used, name a processing industry and show the chain — the output of one process becomes the input of the next, and costs are averaged over units at each stage.

TQ 1.1 · PYQ 2023-Nov [6] (d) (v) · DESC · 1M · Pg 502

LEVEL I

Easy

Topic 2: Costing Procedure in Process Costing

L2P4-C10-T02

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 10, Process and Operation Costing — the costing procedure and the form of the process account.

NOTES

Each process has its own account, with a units column and an amount column on both sides. Debit: opening work-in-progress, the units and cost brought in from the preceding process, materials added in this process, direct wages, direct expenses, production overheads, and **abnormal gain**. Credit: **normal loss at its scrap value**, output transferred to the next process or to finished stock, **abnormal loss**, and closing work-in-progress. The unit columns must agree on both sides — make that your first check before you total the money columns.

Overheads are recovered, not handed to you. The answers apportion a single overhead figure in whatever way the question states: as a percentage of direct wages (₹90,000 of production overhead recovered as a percentage of direct labour; 150% of direct wages in another answer), on **labour hours** (overhead of ₹92,000 absorbed on the basis of labour hours), or on **direct labour cost** (departmental overhead of ₹30,000 absorbed on direct labour cost). Show the apportionment as a working note before you post it into the accounts.

The cost per unit is struck after the scrap credit and over expected output, not actual output: Normal cost per unit of output = (Direct material + Direct labour + Direct expenses + Factory overheads – Scrap value of normal loss) ÷ Expected output, where expected output is input units less normal loss units. That one rate then values the transfer out, the abnormal loss and the abnormal gain.

Transfer at that rate. The amount transferred out is cost per unit × units transferred, and it becomes the opening debit of the next process, carrying its units with it. Where the question introduces additional material in a later process, it may add units as well as cost — in one printed answer Process Y's input is 846 tons from Process X **plus** 454 tons of fresh material, a total of 1,300 tons, and the loss percentages are worked on that combined input.

Where part of a process's output is sold instead of transferred, split the credit. In the printed answer three-quarters of Process P's output went on to Process Q and one-quarter was sold; the sold quarter is credited to the process at the **same cost per unit** and carried to the Costing Profit and Loss Account, where its sales value appears on the credit side. The process account itself never shows a profit.

Topic 3: Treatment of Normal, Abnormal Loss and Abnormal Gain

L2P4-C10-T03

Read first Read ICAI Study Material Chapter 10, Process and Operation Costing — normal loss, abnormal loss and abnormal gain and their treatment in cost accounts.

NOTES

Learn the three treatments as three sentences, because that is exactly how the five-mark theory question is marked. **Normal loss:** the cost of normal process loss is **absorbed by the good units produced** under the process, and the amount realised by the sale of the normal loss units is **credited to the process account**. **Abnormal loss:** the cost of an abnormal process loss unit is **equal to the cost of a good unit**; the total is credited to the process account from which it arises, it is **not treated as part of the cost of the product**, and it is **debited to the Costing Profit and Loss Account**. **Abnormal gain:** the process account is **debited** with the abnormal gain and the Abnormal Gain Account credited, and that account is closed by transfer to the Costing Profit and Loss Account; **the cost of abnormal gain is computed on the basis of normal production**.

The rate that does all the work: Normal cost per unit of output = (Direct material + Direct labour + Direct expenses + Factory overheads – Scrap value of normal loss) ÷ Expected output, expected output being input less normal loss. Then **abnormal loss units = normal production – actual production** and **abnormal gain units = normal loss – actual loss**, and both are valued at that same rate. **Normal loss is never valued at this rate** — it enters the account at its scrap realisation only, which is why it absorbs no cost and the good units carry it.

The three memorandum accounts, in the form the answers print them. **Normal Loss A/c:** debited with each process's normal loss at scrap value; credited by cash for the units actually sold and by the Abnormal Gain A/c for the gain units at the same scrap rate. **Abnormal Loss A/c:** debited by the process with the full cost; credited by bank or cost ledger control with the scrap realisation on those units; the balance goes to the Costing Profit and Loss Account. **Abnormal Gain A/c:** debited with the scrap value forgone (to Normal Loss A/c) and with the balance of gain to the Costing Profit and Loss Account; credited by the process with the full cost of the gain units.

The classic wrong answer is to sell all the normal loss units for cash when there is an abnormal gain. An abnormal gain means fewer units were actually lost than were expected, so the scrap available to sell falls. In the printed answer Process Y's normal loss was 280 kg at ₹5, but only 250 kg were sold for cash and 30 kg went to the Abnormal Gain Account at ₹5 — that ₹150 is the scrap revenue the company gave up by producing more good units, and it is why the gain credited to Costing P&L is ₹5,574 and not ₹5,724.

Where the normal loss has no realisable value there is nothing to credit. Two printed answers show it: a weight loss line carrying **units but a blank amount column**, and a normal loss "with no disposal value". The cost per unit is then simply total process cost ÷ expected output. Do not drop the units from the account because there is no money against them — the unit columns must still

cross-cast, and a process can carry both a weight loss with no value and a scrap that does sell.

When the question asks for a Costing Profit and Loss Account, the format is fixed. Debit: To Cost of sales (the output sold out of each process, at that process's cost per unit), To Abnormal loss (the amount **after** its scrap credit), To management and selling expenses that are **not allocable to the processes**, To Net profit. Credit: By Sales (units sold × the selling price of that process's output), By Abnormal gain (the amount **after** its scrap debit). Where the account does not balance in your favour, a net loss goes on the credit side as the balancing figure.

Where a selling price is asked for, work forward from the finished cost. Take the cost of the output transferred to finished goods, add the profit at the stated margin, and divide by the units. A profit of **25% on selling price** is **one-third of cost**, not 25% of cost: the printed answer loads ₹3,79,600 with ₹1,26,533 to reach sales of ₹5,06,133 and ₹69.33 per kg. Misreading "on selling price" as "on cost" is the single commonest slip in these sub-parts.

Understanding explain it, and place it in context · 1 question

- State why normal loss absorbs no cost (it is expected, so the good units carry it) and why abnormal loss does not enter product cost (it goes to Costing P&L). One sentence each is enough.

TQ 3.1 · PYQ 2023-May [6] (e) · DESC · 5M · Pg 503

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 13 questions

- Compute the cost per unit first and write the formula with its substitution under the account. Every other figure in the answer is that rate multiplied by a quantity, so a shown rate saves the method marks even if a quantity is wrong.

PQ 3.7 · PYQ 2023-Nov [4] (c) · 5M · Pg 516	LEVEL II Application	Easy
PQ 3.11 · PYQ 2026-Jan [2] (b) · 5M · Pg 526	LEVEL II Application	Easy
PQ 3.1 · PYQ 2018-May [3] (b) · 10M · Pg 504	LEVEL II Application	Medium
PQ 3.2 · PYQ 2019-Nov [4] (b) · 10M · Pg 506	LEVEL II Application	Medium
PQ 3.4 · PYQ 2021-Dec [1] (d) {C} · 5M · Pg 512	LEVEL II Application	Medium
PQ 3.6 · MTP 2023-Mar [4] (a) · 10M · Pg 515	LEVEL II Application	Medium
PQ 3.9 · PYQ 2025-Jan [3] (a) · 8M · Pg 520	LEVEL II Application	Medium
PQ 3.10 · RTP 2025-Sep [13] · Pg 522	LEVEL II Application	Medium

PQ 3.12 · MTP 2026-Mar S1 [4] (b) · 7M · Pg 527	LEVEL II Application	Medium
PQ 3.13 · PYQ 2026-Sep [4] (b) · 3M · Pg 530	LEVEL II Application	Medium
PQ 3.3 · PYQ 2021-Jul [4] (a) · 10M · Pg 508	LEVEL II Application	Hard
PQ 3.5 · PYQ 2022-Nov [3] (b) · 10M · Pg 513	LEVEL II Application	Hard
PQ 3.8 · PYQ 2024-May [4] (a) · 8M · Pg 517	LEVEL II Application	Hard

Topic 4: Valuation of Work-in-Progress

L2P4-C10-T04

Read first Read ICAI Study Material Chapter 10, Process and Operation Costing — equivalent production and the valuation of work-in-progress under FIFO and weighted average.

NOTES

Two methods, defined as the printed answer defines them. FIFO: the units completed and transferred are taken from both the opening work-in-process and the freshly introduced input; the cost to complete the opening WIP and the cost of the other completed units are calculated **separately**; the cost of opening WIP is added to the cost incurred on completing it; and closing work-in-process is valued at **current cost**. **Weighted average:** the cost of opening work-in-process and the cost of the current period are **aggregated** and divided by output in completed units, so equivalent production consists of the work already contained in the opening WIP plus the work of the current period. The difference in one line: under average the opening WIP units and their cost are taken in full, while under FIFO only the remaining work done now is considered.

Answer in the order the marks are allotted — (1) Statement of Equivalent Production, (2) Statement showing cost for each element, (3) Statement of distribution of cost, (4) the Process Account, and then the Normal Loss, Abnormal Loss or Abnormal Gain accounts. Each is a separate statement with its own heading. A process account with no equivalent production statement behind it earns almost nothing, because the whole method mark sits in the first two statements.

The FIFO equivalent production statement has an input side (opening WIP, units introduced) and an output side with a **percentage column and a units column for every cost element**. The output rows in order: units completed — **from opening WIP** at the **balance** of completion (70% complete last period means 30% this period, and the material column is usually nil because material was all introduced then), and **from fresh inputs** at 100%; **normal loss** with no equivalent units at all; **abnormal loss** at its stated degree of completion; **closing WIP** at its stated percentages; and where there is an abnormal gain, **less abnormal gain** shown as a deduction at 100%.

Under weighted average the output side is shorter: completed and transferred at 100% for every

element, normal loss at nil, abnormal loss at its degree of completion (usually the balancing figure), closing WIP at its percentages, and abnormal gain deducted. **There is no "from opening WIP" row at all** — that is the visible difference between the two layouts, and writing the FIFO layout when the question says average (or the reverse) loses the whole question. Read the instruction line before you rule the statement.

Statement showing cost for each element has columns for Material, Labour, Overhead and Total. Under **weighted average** the first two rows are **cost of opening work-in-process** and **cost incurred during the month**; under **FIFO** the opening WIP cost is not in the rate at all and is added back only at the distribution stage. Then **less: realisable value of normal scrap**, deducted from the **material column only** — one question says it in terms, "scrap value is ₹8 per unit to be adjusted in direct material cost". Divide each column by its own equivalent units; the element rates add up to the total cost per unit.

Read the base of the normal loss percentage — it is where these questions are won. The printed questions repeatedly say normal loss is a percentage of **total input including units in process at the beginning**: 12% of (3,000 + 17,000), 5% of (10,000 + 55,000), 8% of (1,82,000 + 8,000), 4% of "opening stock plus units put in". Taking the percentage on units introduced alone corrupts every figure below it. Where the question gives units scrapped instead, **abnormal loss = units scrapped – normal loss** (9,500 – 3,250 = 6,250), and where the actual loss is **less** than normal the shortfall is an **abnormal gain**, deducted in the equivalent production statement.

Transferred-in cost is a separate element and is always 100% complete — give it its own column, carrying the previous process's cost less the scrap value of this process's normal loss. **Packing material added at the end of the process** attaches only to the completed units: the answer values the closing WIP without it and adds the whole packing cost to the finished output figure.

Distribution of cost then reads: value of units completed and transferred, value of abnormal loss element by element, value of closing WIP element by element — and under FIFO the transferred figure is opening WIP cost brought forward **plus** the cost of completing it **plus** the fresh units at the full rate, set out as (i), (ii), (iii).

Understanding explain it, and place it in context · 1 question

- For "describe the methods of valuation of work-in-process", give both methods and then the sentence of difference — in full under average, only the remaining work under FIFO. That last sentence is the mark.

TQ 4.1 · PYQ 2025-May [6] (c) · DESC · 4M · Pg 531

LEVEL I
Understanding

Easy

Application use the rule - work the problem · 17 questions

- Rule the equivalent production statement with a percentage and a units column for each element before you write a single figure, then fill it row by row. Where the elements have different completion percentages, work the columns separately — they will not agree, and they are not meant to.

PQ 4.1 • PYQ 2018-Nov [1] (c) {C} • 5M • Pg 532	LEVEL II Application	Easy
PQ 4.13 • PYQ 2025-May [5] (a) • 4M • Pg 558	LEVEL II Application	Easy
PQ 4.16 • MTP 2026-Apr S2 [1] (b) • 5M • Pg 565	LEVEL II Application	Easy
PQ 4.17 • PYQ 2026-Sep [4] (b) (iii) • 2M • Pg 567	LEVEL II Application	Easy
PQ 4.2 • MTP 2019-Mar [2] (a) • 10M • Pg 533	LEVEL II Application	Medium
PQ 4.3 • PYQ 2020-Nov [4] (a) • 10M • Pg 536	LEVEL II Application	Medium
PQ 4.4 • PYQ 2021-Jan [1] (c) {C} • 5M • Pg 538	LEVEL II Application	Medium
PQ 4.5 • RTP 2021-May [8] • Pg 540	LEVEL II Application	Medium
PQ 4.10 • MTP 2024-Jul [2] (a) • 10M • Pg 551	LEVEL II Application	Medium
PQ 4.15 • RTP 2026-Jan [14] • Pg 562	LEVEL II Application	Medium
PQ 4.6 • PYQ 2022-May [4] (a) • 10M • Pg 543	LEVEL II Application	Hard
PQ 4.7 • RTP 2023-May [9] • Pg 545	LEVEL II Application	Hard
PQ 4.8 • RTP 2023-Nov [8] • Pg 547	LEVEL II Application	Hard
PQ 4.9 • RTP 2024-May [8] • Pg 549	LEVEL II Application	Hard
PQ 4.11 • RTP 2024-Sep [14] • Pg 554	LEVEL II Application	Hard
PQ 4.12 • MTP 2024-Nov [5] (a) • 10M • Pg 556	LEVEL II Application	Hard
PQ 4.14 • MTP 2025-Dec S2 [2] (a) • 8M • Pg 560	LEVEL II Application	Hard

Topic 5: Inter Process Profit

L2P4-C10-T05

Read first Read ICAI Study Material Chapter 10, Process and Operation Costing — inter-process profit and the elimination of unrealised profit.

NOTES

Every inter-process account has three money columns on each side — Cost, Profit, Total. The debit side runs in a fixed order: opening stock (split into its cost and the inter-process profit the question gives you), the transfer from the previous process (with its cost and profit split carried across), materials, wages — **sub-total is prime cost** — **less closing stock**, giving the net balance; then manufacturing overheads, giving total cost; then the profit loading. The account closes at the transfer price, and that total is what the next process is debited with.

Stock in process is valued at prime cost, so the closing stock is deducted at the prime cost stage, before overheads are added. Its profit element is stripped out in the same proportion the prime cost line carries: $\text{cost of closing stock} = \text{closing stock} \times (\text{cost in the prime cost line} \div \text{total prime cost})$. In the printed answer ₹2,490 of closing stock splits into ₹2,080 of cost and ₹410 of profit; the ₹410 is the **unrealised profit** you must be able to name when asked.

The trap is the words "on cost" and "on transfer price", and the answers convert them explicitly in a working note. 25% **on cost** means profit = 25% of total cost. 25% **on transfer price** means: let transfer price be 100, profit 25, so cost is 75 and **profit = $25/75 = \text{one-third of cost}$** (₹21,600 of cost carries ₹7,200 of profit). 20% on transfer price means cost 80 and profit 20, so **profit = one-quarter of cost** (₹49,340 carries ₹12,335). Write the two-line working; it is a separate mark.

The Finished Stock Account runs the same three columns. Debit: opening stock with its cost and profit as given, transfer from the last process with its cost and profit, **less closing stock** apportioned between cost and profit in the ratio the debits carry, giving cost of goods sold; the balancing figure on the debit side is the period's profit. Credit: the transfer to the Costing Profit and Loss Account at the sales figure. Unrealised profit on closing finished stock = $\text{closing stock} \times (\text{profit in the account} \div \text{total in the account})$ — the answer notes it may also be computed on average cost.

The question asks for the profit element at each stage, so show it at each stage. Every process loads its own profit and transfers it to the Costing Profit and Loss Account, but the profit sitting inside stock that has not been sold is unrealised and is removed from the closing stock figure at that process. Compute the unrealised profit product by product — the answer lists it as Process XM nil, Process YM ₹8,758, Process ZM ₹19,500, Finished stock ₹42,467 — rather than leaving it buried in the account.

Application use the rule - work the problem · 2 questions

- Rule three columns before you start and post every figure into all three, even where the profit column is nil. An answer written in a single money column cannot show the unrealised profit and cannot score.

PQ 5.2 · PYQ 2019-May [2] (b) · 10M · Pg 571

LEVEL II
Application

Medium

PQ 5.1 · PYQ 2017-May [2] (a) · 8M · Pg 568

LEVEL II
Application

Hard

Topic 6: Operation Costing

L2P4-C10-T06

Read first Read ICAI Study Material Chapter 10, Process and Operation Costing — operating (service) costing, its features and application.

NOTES

Operating costs, or service costing, are the costs incurred by undertakings which do not manufacture any product but provide a service — the answer's own examples are transport concerns, gas agencies, electricity undertakings, hospitals and theatres. Because of the varied nature of the activities carried out by service undertakings, the cost system used is obviously different from that followed in manufacturing concerns; that sentence is worth writing out, as it is the link between the definition and the features.

The first essential feature is the three-fold classification of cost, which for a transport undertaking runs: (a) **Operating and running charges** — expenses of a **variable** nature, such as petrol, diesel, lubricating oil and grease; (b) **Maintenance charges** — **semi-variable**, covering tyres and tubes, repairs and maintenance, spares and accessories and overhaul; (c) **Fixed or standing charges** — garage rent, insurance, road licence, depreciation, interest on capital and the salary of the operating manager. Give the head, its cost behaviour and two examples for each; a bare list of expenses does not show the classification.

The second essential feature is that the cost unit is composite — **passenger-mile, kilowatt-hour** and the like. Name at least two composite units, because the question that asks for features expects this point separately from the classification of costs.

Where it can usefully be implemented: in all firms of transport — airlines, bus services and the like — and in **all firms of distribution undertakings**. The question is set as "what do you understand by, describe its features, and state where it can be implemented", so answer in those three parts and do not stop after the features.

Understanding explain it, and place it in context · 1 question

- Anchor the three cost categories to one industry (transport is the one the answer uses) and label each as variable, semi-variable or fixed. The behaviour label is what distinguishes this from an ordinary cost classification answer.

TQ 6.1 · RTP 2025-May [20] (b) · DESC · Pg 574

LEVEL I
Understanding

Medium

CHAPTER 11

Joint Products and By Products

4 Topics · 30 Classified Questions · Importance: A

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge **15.2%** 23 of 151 marks

Level II — Analysis & Application **84.8%** 128 of 151 marks

Below the paper's Level I floor: only 15% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for the paper. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Meaning of Joint and By Products

L2P4-C11-T01

Read first Read ICAI Study Material Chapter 11, Joint Products and By Products — the meaning of joint products, by-products and co-products, and the split-off point.

NOTES

Joint products are "two or more products separated in the course of the same processing operation usually requiring further processing, each product being in such proportion that no single product can be designated as a major product". The answer then gives the plainer form: two or more products of **equal importance**, produced **simultaneously from the same process**, each having a **significant relative sale value**. The example the answer uses is the oil industry — gasoline, fuel oil, lubricants, paraffin, coal tar, asphalt and kerosene all produced from crude petroleum.

By-products are "products recovered from material discarded in a main process, or from the production of some major products, where the material value is to be considered at the time of severance from the main product". They emerge as a result of the processing operation of another product, or are produced from the **scrap or waste** of a process; in short a by-product is a **secondary or subsidiary product** emanating from the manufacture of the main product. Examples to quote: **molasses** in the manufacture of sugar; **tar, ammonia and benzole** from the carbonisation of coal; **glycerine** in the manufacture of soap. The question says "with an example of each", so the examples carry marks.

The split-off point is the point at which the products are separated from the main product or products, and the expenses of processing are joint till the split-off point. The whole chapter hangs on that sentence: costs incurred **before** it are joint and must be apportioned on some basis, while costs incurred **after** it belong to the individual product, are called post split-off or further processing costs, and are never apportioned.

Co-products are two or more products which are contemporary but do not emerge necessarily

from the same material in the same process. That is the whole of the one-mark answer. The distinguishing words are "not necessarily from the same material in the same process" — which is precisely what joint products do emerge from, and that contrast is what the examiner is testing.

What fixes the label is relative value, not the name the question uses. A product "recovered incidentally from the material used in the manufacture of" the main products is treated in the printed answer as a **by-product**, even though the question calls it a third product. And where by-products are of **considerable total value they may be regarded as joint products** rather than by-products. Say which you are treating it as, and why, before you apportion anything.

Understanding explain it, and place it in context · 2 questions

- Give one example for each term from the answer's own list (crude petroleum for joint products, molasses or glycerine for by-products). An answer with definitions and no examples is half an answer where the question asks for examples.

TQ 1.2 · PYQ 2023-Nov [6] (d) (iii) · DESC · 1M · Pg 579

LEVEL I
Understanding

Easy

TQ 1.1 · PYQ 2021-Dec [6] (b) · DESC · 5M · Pg 578

LEVEL I
Understanding

Medium

Topic 2: Methods of Apportionment of Joint Cost to Joint Products

L2P4-C11-T02

Read first Read ICAI Study Material Chapter 11, Joint Products and By Products — the methods of apportioning joint cost to joint products and the further-processing decision.

NOTES

Learn the methods with the circumstance attached, because a four-mark question asks for exactly that pairing. **Net realisable value at split-off point** — used when the realisable value of the joint products **at split-off is not known**. **Technical estimates** — used when the result obtained by the NRV method **does not match the resources consumed** by the joint products. **Market value at the point of separation** — used where further processing costs are incurred **disproportionately**; it is difficult to apply if the market value at the point of separation is not available. **Market value after further processing** — used where further processing costs after separation are **proportionate and all the joint products are subject to further processing**; it is unfair otherwise.

The NRV formula, exactly as the answers write it: Net Realisable Value = Sale value of the joint product (at finished stage) – estimated profit margin – selling and distribution expenses, if any – post split-off cost. **Joint costs are then apportioned in the ratio of net realisable value.** Where the question gives no profit margin and no selling expense, the only deduction is the post split-off (further processing) cost — which is the form nearly all the practical answers take. A product sold

at split-off with no further processing has **nothing deducted**: its NRV is its full sales value.

The same three-table answer recurs in four separate printed solutions, in this order. (1) **Statement of joint cost allocation**: Final sales value of total production; less Additional cost; = Net realisable value at split-off; Joint cost allocated = $(\text{Total joint cost} \div \text{Total NRV}) \times \text{NRV of each product}$. (2) **Cost of goods sold**: allocated joint cost + additional costs = cost of goods available for sale (CGAS); less cost of ending inventory ($\text{CGAS} \times \text{closing quantity} \div \text{total production}$); = cost of goods sold. (3) **Comparative statement of gross profit**: sales revenue (quantity sold $\times$ price) less cost of goods sold.

The classic wrong answer is to build the allocation on the quantity sold. Final sales value must be struck on **total production** — quantity sold **plus** closing inventory — while the gross profit statement uses quantity sold. Every one of these answers opens with the same working note: a table of quantity sold, quantity of ending inventory, total production, and the **ending inventory percentage** = $\text{closing} \div \text{total production}$. Build that table first and the rest of the question follows.

Contribution margin method, in the order the answers do it: apportion the **variable** joint cost on the basis of **physical units**; contribution margin = sales value – apportioned variable cost; then apportion the **fixed** joint cost **in the ratio of those contribution margins**. **Proviso, stated in a footnote to the printed answer**: where one product's contribution margin is **negative**, the fixed cost cannot be apportioned on it and is **charged to the other product only** — the whole ₹32,000 went to Product A. Watch for the negative contribution; it is planted deliberately.

Physical quantity method apportions in the ratio of output units (or of weights derived from them, 100 : 70 : 80 giving 0.4 : 0.28 : 0.32). But **read whether the question ties a particular cost to a particular basis**: in one answer labour is chargeable to the two products in the ratio **100 : 80** and only the balance of the joint cost — material and other processing cost — is apportioned in the ratio of output, 5,400 : 810. Putting the whole joint cost through one ratio there loses the question.

For the process-further decision, joint cost is irrelevant — the printed answer says so in terms: "for decision regarding whether to process further or not, joint cost need not be considered". The format: sales value after further processing, **less** sales value at split-off, = **incremental revenue**; **less** further processing cost **and any further marketing cost**; = incremental profit or loss; then a conclusion product by product. Two adjustments the questions plant: where a percentage of quantity is **lost in further processing**, compute the later revenue on the reduced quantity (98% of 4,000 = 3,920 units; 10% of Product A lost), and where selling expenses change, **savings in selling expenses reduce the incremental cost**.

Understanding explain it, and place it in context · 3 questions

- When asked to describe a method, give the basis of apportionment in one line and then the circumstance in which it is used or is unfair. The circumstance is a separate mark from the description.

TQ 2.1 • MTP 2025-Mar S1 [2] (c) • DESC • 2M • Pg 580	LEVEL I Understanding	Easy
TQ 2.4 • PYQ 2026-Sep [6] (b) (ii) • DESC • 1M • Pg 582	LEVEL I Understanding	Easy
PQ 2.4 • PYQ 2021-Jul [2] (b) • 5M • Pg 587	LEVEL I Understanding	Easy

Application use the rule - work the problem • 13 questions

- Set out the allocation as a table with the products across the top and a Total column at the right, and make the Total column add back to the joint cost given. A total that does not reconcile tells the examiner the ratio was wrong.

PQ 2.1 • PYQ 2019-Nov [1] (c) {C} • 5M • Pg 582	LEVEL II Application	Easy
PQ 2.2 • PYQ 2020-Nov [1] (c) {C} • 5M • Pg 584	LEVEL II Application	Easy
TQ 2.3 • MTP 2025-Dec S2 [6] (c) • DESC • 4M • Pg 581	LEVEL II Application	Medium
PQ 2.5 • PYQ 2022-May [5] (c) • 5M • Pg 589	LEVEL II Application	Medium
PQ 2.6 • PYQ 2023-Nov [1] (c) {C} • 5M • Pg 591	LEVEL II Application	Medium
PQ 2.8 • MTP 2024-Nov [1] (a) {C} • 5M • Pg 594	LEVEL II Application	Medium
PQ 2.9 • PYQ 2025-May [1] (b) {C} • 5M • Pg 596	LEVEL II Application	Medium
PQ 2.10 • RTP 2025-May [15] • Pg 598	LEVEL II Application	Medium
PQ 2.13 • RTP 2026-May [14] • Pg 604	LEVEL II Application	Medium
PQ 2.3 • PYQ 2021-Jan [4] (a) • 10M • Pg 585	LEVEL II Application	Hard
PQ 2.7 • PYQ 2024-May [1] (b) {C} • 5M • Pg 592	LEVEL II Application	Hard
PQ 2.11 • RTP 2025-Sep [14] • Pg 600	LEVEL II Application	Hard
PQ 2.12 • PYQ 2026-May [3] (a) • 8M • Pg 602	LEVEL II Application	Hard

Analysis break it down and examine the interrelationships • 1 question

- Where the question asks you to respond to a management view that a product is being sold at a loss, show both statements — the loss on the given (equal) apportionment and the profit on NRV apportionment — and then state plainly that the apportionment basis, not the product, was at fault.

Topic 3: Methods of Apportionment of Joint Cost to By Products

L2P4-C11-T03

Read first Read ICAI Study Material Chapter 11, Joint Products and By Products — apportioning joint cost to by-products and the net realisable value method.

NOTES

The rule, in the answer's own words: the realisation on the disposal of the by-product may be deducted from the total cost of production, so as to arrive at the cost of the main product — the amount realised by the sale of molasses in a sugar factory goes to reduce the cost of the sugar produced. Where the by-product requires some additional processing to make it saleable, the expenses so incurred should be deducted from the total value realised, and only the net realisation is deducted from the total cost of production. The answer also requires **separate accounts** for (i) further processing of the by-product and (ii) the selling, distribution and administration expenses attributable to it.

Work backwards from the eventual sale value to get the net realisable value at split-off: selling price after further processing, **less** further processing cost, **less** further marketing (selling and distribution) cost, **× quantity**. In the printed answer ₹10 – ₹2 – ₹1 = ₹7 per kg on 300 kg, giving ₹2,100. That net figure, and not the gross sale value, is what is credited to the joint process, so the main product is relieved only of what the by-product is genuinely worth at separation. If the further processing cost exceeds the sale value, say the by-product should not be processed further.

Where the question gives an estimated profit percentage and an estimated selling expense percentage, the by-product's share of joint cost is found by reverse working, and the statement has these lines in this order: Sales value (units × selling price); **less** estimated profit (the stated % of sales); = **Cost of sales**; **less** estimated selling expenses (the stated % of sales); = **Cost of production**; **less** cost after separation; = **Joint cost allocated to the by-product**. The main product then bears **total joint cost less the by-products' shares** — ₹2,12,400 – ₹11,800 – ₹25,500 = ₹1,75,100 in one answer.

The profitability statement that follows has a fixed shape: Sales value (A); less joint cost, cost after separation and selling expenses, totalled as (B); Profit = A – B; and finally the overall profit as the sum of the three columns. **Use it as an arithmetic check** — the by-product's profit must come back to exactly the estimated percentage you deducted (20% of ₹72,000 = ₹14,400; 25% of ₹1,21,000 = ₹30,250). If it does not, the reverse working is wrong.

Deduct the by-product's credit from the joint cost before you apportion anything to the joint products. One answer takes joint input cost of ₹90,800, credits the by-product's sales of ₹1,000 less its profit of ₹200, and allocates only the **net ₹90,000**; another deducts a by-product NRV of

₹2,100 from ₹1,46,100 and apportions **₹1,44,000** between the two joint products on sales value at split-off. **Apportioning the gross joint cost is the commonest error in this topic**, and it makes every later figure wrong.

Watch the phrase "net margin of 25 per cent of cost". The printed answer converts it in the same line — **25% on cost is 20% on sales** — and deducts 20% of the selling price to reach cost of sales. Where the question instead says "estimated net profit as a percentage **to sales value**", the percentage is applied to sales directly with no conversion. Reading one as the other shifts every figure below it, and the working note showing the conversion is itself a mark.

Understanding explain it, and place it in context · 2 questions

- For the theory question, state the deduction rule, then the further-processing variation (deduct the processing expenses first, credit only the net), then the requirement to keep separate accounts for the by-product's processing and selling expenses. Three points, three marks.

TQ 3.2 · PYQ 2026-Sep [6] (b) (iii) · DESC · 2M · Pg 607

LEVEL I
Understanding

Easy

TQ 3.1 · MTP 2018-Aug [6] (d) · DESC · 5M · Pg 607

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 6 questions

- Do the by-product column first and label the result "joint cost allocated to by-product". Only then open the main product's statement — it needs that figure, and an answer that starts with the main product has nothing to put in it.

PQ 3.5 · MTP 2025-Jul S1 [3] (a) · 5M · Pg 615

LEVEL II
Application

Easy

PQ 3.1 · RTP 2023-Nov [9] · Pg 608

LEVEL II
Application

Medium

PQ 3.2 · MTP 2024-Jul [3] (a) · 6M · Pg 610

LEVEL II
Application

Medium

PQ 3.3 · RTP 2024-Sep [15] · Pg 611

LEVEL II
Application

Medium

PQ 3.4 · RTP 2025-Jan [14] · Pg 613

LEVEL II
Application

Medium

PQ 3.6 · PYQ 2026-Jan [1] (b) {C} · 5M · Pg 616

LEVEL II
Application

Hard

Topic 4: Treatment of By Products Cost in Cost Accounting

L2P4-C11-T04

Read first Read ICAI Study Material Chapter 11, Joint Products and By Products — the treatment of

by-product cost in cost accounting.

NOTES

When by-products are of small total value, the amount realised from their sale may be dealt with in any one of two ways. (1) The **sales value** of the by-products may be **credited to the Costing Profit and Loss Account** and **no credit given in the cost accounts** — the credit there being treated either as **miscellaneous income** or as **additional sales revenue**. (2) The **sale proceeds** may be treated as a **deduction from the total costs** — deducted either from the **production cost** or from the **cost of sales**. Give both routes and both sub-limbs of each; the marks are in the alternatives, not in the preamble.

When by-products are of considerable total value, they may be regarded as joint products rather than as by-products. To determine their exact cost, the costs incurred **up to the point of separation** should be apportioned over the by-products and the joint products **using a logical basis** — the answer names three: **relative market values**, the **physical output method (at the point of split-off)**, or **ultimate selling prices (if sold)**.

Where the by-products require further processing, the net realisable value at split-off is arrived at by subtracting the further processing cost from the realisable value of the by-product. Then — and this is the part candidates leave out — if the total sales value at split-off is small, treat it under the small-value rules; if it is considerable, treat it as a joint product. So the third case is not a third treatment at all: it is a valuation step that routes you back into the first two.

Applied to the standard fact pattern — the amount realised on the sale of molasses, a by-product of sugar manufacture — the realisation goes to reduce the cost of the sugar produced, that is, it is credited against the cost of the main product rather than shown as income, on the footing that the value is small. If you take the other permitted route, name it: credited to the Costing Profit and Loss Account as miscellaneous income or additional sales revenue, with no credit in the cost accounts.

Structure the answer by the three cases in the printed order — small total value, considerable total value, where further processing is required — and number the sub-ways inside the first. An answer that gives only the deduction from cost is describing one of four permitted treatments and will be marked as such. The examiner is counting the alternatives, not the prose.

Understanding explain it, and place it in context · 1 question

- Say what turns each case — total value — and that the same by-product can fall under either rule depending on it. That sentence shows you understand the classification rather than reciting it.

TQ 4.3 · PYQ 2026-Sep [6] (b) (i) · DESC · 2M · Pg 620

LEVEL 1
Understanding

Easy

Analysis break it down and examine the interrelationships · 2 questions

- The treatment depends on **the value of the by-product**, so open by naming the three cases — small value, considerable value, and where it needs further processing — and then take each in turn.
- For each case say precisely what is credited and against what: net realisation credited to the process, or to the main product's cost, or the by-product treated as a joint product. A general statement that it is 'credited' is not enough.

TQ 4.1 · PYQ 2024-Sep [6] (c) · DESC · 4M · Pg 618

LEVEL II
Analysis

Easy

TQ 4.2 · RTP 2025-Jan [19] (c) · DESC · Pg 619

LEVEL II
Analysis

Medium

CHAPTER 12

Service Costing

13 Topics · 36 Classified Questions · Importance: B

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge

6.2%

16 of 260 marks

Level II — Analysis & Application

93.8%

244 of 260 marks

Below the paper's Level I floor: only 6% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for the paper. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Introduction

L2P4-C12-T01

Read first Read ICAI Study Material Chapter 12, Service Costing — the nature of a service, and how service costing differs from product costing.

NOTES

Four differences, and the answer sets them out in this order. (i) Unlike products, services are intangible and cannot be stored, hence there is no inventory for services. (ii) Composite cost units are used for cost measurement and to express the volume of output. (iii) **Employee (labour) cost is a major cost element, larger than material cost**, the reverse of a manufacturing concern. (iv) Indirect costs such as administration overheads form a significant proportion of the total cost of a service, because the service sector depends heavily on support services and tracing costs to a single service may not be economically feasible. Give one sentence to each limb; the marks are spread across the four, not concentrated in one.

The absence of inventory changes the shape of the statement. Every operating cost statement in this chapter runs straight from the period's costs to total cost, and then on to takings — there is **no opening or closing stock line and no cost of goods sold**. If you find yourself writing a stock adjustment in a service question, you have imported a format from the cost sheet chapter.

The intangibility point is what forces the composite unit. There is no physical article to count, so output has to be expressed by combining a quantitative measure with a qualitative one — passenger-kilometre, tonne-kilometre, patient-day, room-day. Topic 2 is the whole of that idea; read the two together, because the distinguish question and the composite cost unit question are the same material seen from two sides.

Understanding explain it, and place it in context · 1 question

- Name the cost consequence in each limb — no inventory means no stock valuation, composite units mean output is measured in two dimensions, and heavy indirect cost means apportionment matters more than tracing.

TQ 1.1 · RTP 2024-Sep [19] (b) · DB · Pg 623

LEVEL I
Understanding

Medium

Topic 2: Service Cost Unit and KPI

L2P4-C12-T02

Read first Read ICAI Study Material Chapter 12, Service Costing — the service cost unit, composite cost units and equivalent service units.

NOTES

Definition, quoted as the answer gives it: sometimes two measurement units are combined together to know the cost of a service or operation; these are called composite cost units. The printed examples are **Tonne-km, Quintal-km, Passenger-km and Patient-day**. A public transport undertaking measures **operating cost per passenger per kilometre**. State the definition, then give two or three examples — that is the whole of the two-mark opening.

A composite unit may be computed in two ways, and the answer names both. (i) **Absolute (Weighted Average) basis** — a summation of the products of the qualitative and quantitative factors: $(\text{Weight Carried} \times \text{Distance})_1 + (\text{Weight Carried} \times \text{Distance})_2 + \dots + (\text{Weight Carried} \times \text{Distance})_n$. (ii) **Commercial (Simple Average) basis** — the product of the average qualitative factor and the total quantitative factor: for goods transport, **Commercial Tonne-km = Total distance × Average load**. Learn the two labels together with the two arithmetic descriptions; questions ask for both figures side by side.

Which factor is which, and why it matters. Distance is the quantitative factor because the variable cost depends on it. Weight carried is the qualitative factor, because the weight does not affect the variable cost. In a cinema the same logic gives a higher weight to a first class seat than to a second class seat, since the first class seat carries higher quality service and a higher price.

The worked illustration to memorise (MTP 2026-Mar). A truck leaves Delhi with 30 MT, unloads 12 MT at Agra, the rest at Jaipur, and returns from Jaipur with 20 MT; distances 230, 240 and 280 km. Absolute MT-km = $(30 \times 230) + (18 \times 240) + (20 \times 280) = 6,900 + 4,320 + 5,600 = 16,820$ MT-km. Commercial MT-km = $[(30 + 18 + 20) \div 3] \times (230 + 240 + 280) = 22.667 \text{ MT} \times 750 \text{ km} = 17,000$ MT-km. Note the two things students get wrong: the absolute basis uses the **load actually on the vehicle for that leg** (18 MT, not 30, between Agra and Jaipur), and the commercial basis averages the loads over the **number of legs** and then multiplies by the **whole** distance. The two answers are not equal, and the question always says which it wants.

Equivalent cost unit (equivalent service unit). Where **two or more different grades of service use common resources, each grade is assigned a weight and converted into equivalent units**, which makes the grades equivalent and comparable. This is the engine of half the practical questions in the chapter — equivalent deluxe room days in a hotel, equivalent Bronze memberships in a club, equivalent light weight vehicles at a toll plaza, equivalent Classic seats in a cinema. The weight is normally the **ratio of the prices** the question fixes between the grades.

Understanding explain it, and place it in context · 1 question

- Give the definition, the two bases with their formulae, and one example of each. An answer that names the two bases but cannot say how each is computed earns half the marks.

TQ 2.1 · PYQ 2019-Nov [6] (a) · DESC · 5M · Pg 623

LEVEL I
Understanding

Medium

Topic 3: Statement of Cost for Service Sector

L2P4-C12-T03

Read first Read ICAI Study Material Chapter 12, Service Costing — the statement of cost for the service sector and pricing from it.

NOTES

The statement is headed 'Statement showing Total Cost per annum' and every cost is brought to the year before anything else happens. The printed working converts each item on its own stated basis: **rent per month $\times$ 12; depreciation = cost of equipment $\div$ service life; licences and permits renewed every six months $\times$ 2; utilities per quarter $\times$ 4; AMC per month $\times$ 12**; insurance and marketing already annual. Bring the periods to a common footing in the statement itself, with the arithmetic shown in brackets — that is where the method marks sit.

Usage-based costs are built from the hours the facility is open, not from occupancy. Electricity in the fitness club answer is **25 days $\times$ 16 hours $\times$ number of months $\times$ units per hour $\times$ rate per unit**, computed separately for the two blocks of the year that have different consumption rates. Occupancy is used later, to build the equivalent units — not to scale the electricity.

Then profit, then price. The statement ends **Total cost per annum**, then **Add: Profit 25% on sale or 1/3 on cost**, then **Total amount to be charged**. Read the profit wording with care: a margin stated **on sale** (on membership fees, on takings, on revenue) has to be converted before you add it — 25% on sale is 1/3 on cost, 20% on sale is 1/4 on cost.

Equivalent units convert the different plans into one denominator. The club's Gold fee is 1.5 times Silver and Silver is twice Bronze, so the weights are **Gold 3, Silver 2, Bronze 1**. Apply occupancy to capacity first (200 $\times$ 100%, 200 $\times$ 70% and so on), then weight, then multiply by the number of months in each block: **3,920 + 5,920 = 9,840 equivalent Bronze memberships. Rate per**

Bronze = $98,40,000 \div 9,840 = ₹1,000$, Silver = ₹2,000, Gold = ₹3,000. Never average the three fees; build the weights from the price relationship the question gives.

Application use the rule - work the problem · 1 question

- Work in three visible stages: total cost per annum, amount to be charged after profit, then equivalent units and the rate per base unit. Label each stage; a single block of arithmetic loses the structure marks.
- Put the equivalent-unit table in a working note, showing occupancy applied before the weights and the months applied after them.

PQ 3.1 · RTP 2026-May [16] · Pg 625

LEVEL II
Application

Medium

Topic 4: Costing of Transport Services

L2P4-C12-T04

Read first Read ICAI Study Material Chapter 12, Service Costing — costing of transport services, the operating cost sheet and passenger-kilometre and tonne-kilometre units.

NOTES

The cost unit is the composite one — passenger-km for passenger transport, tonne-km (or MT-km, ton-km) for goods — and the statement is an **Operating Cost Sheet** in three blocks: **(A) Standing Charges, (B) Maintenance Charges, (C) Running Charges**, then **Total cost before commission and profit**, then commission, passenger tax and profit, then **Takings**. The printed answers put insurance, road tax, licence and permit fees, garage rent, depreciation and office and administration overheads in the standing block; **repairs and maintenance, tyres and tubes** in the maintenance block; **diesel, petrol, oil and sundries** in the running block. Some answers collapse it to two blocks, **Fixed Charges** and **Running Cost**; either layout is accepted, but the blocks must be labelled and sub-totalled.

The treatment rule that decides a doubtful item: classify it the way the question states it. The Scanner's own note on the lorry question says it plainly — cost of engine oil and repairs may also be treated as fixed cost, as the question relates these with time, i.e. in weeks, instead of running of the vehicle. So a cost quoted **per week or per month** is a standing charge and a cost quoted **per km or per 100 km** is a running charge, whatever its name. Driver's and conductor's salary follow the same test, and you will see them in the running block in one answer and in the standing block in another. **Write one line saying which treatment you have adopted and why**; the marks follow the reasoning.

Depreciation appears in three different forms across the printed answers — take the one the question's data supports. **(Cost – Scrap value) ÷ Life in years** where life is in years; **Cost ÷ Life in kilometres × kilometres run** where life is given in kilometres, which makes depreciation a **running**

cost; and **(Cost – Subsidy – Residual value) ÷ Life** where a government subsidy is given. Tyres are depreciated separately over **their own life in kilometres**, and a replacement due at a fixed interval is **amortised**: number of replacements over the vehicle's life × cost of each, divided by the life, divided by 12 for a monthly figure.

Build the distance before you build the cost. Total kilometres = **round trips × 2 × one-way distance × days per month × months** — the outward and return legs both count, whether or not the vehicle is loaded. **Passenger-km = total km × seating capacity × occupancy ratio.** **Absolute tonne-km** multiplies each leg's actual load by that leg's distance and adds; the goods answer computing 1,72,240 ton-km does exactly this for the up and down weights of six journeys. **Commercial tonne-km** multiplies the **average load** by the distance covered. The classic error is charging tonne-km for an empty return leg: the kilometres are run, the tonne-kilometres are not.

Where the question fixes commission, passenger tax or profit as a percentage of takings, you must work backwards — the base is takings, not cost. Two forms appear. Direct: cost before commission and profit is 65% of takings, so takings = $21,84,000 \div 65 \times 100 = ₹33,60,000$ when commission is 10% and profit 25% of takings. Algebraic: **let takings = x; x = cost + 0.10x + 0.15x, so 0.75x = cost;** and with a passenger tax, **X = 7,25,800 + 0.22X + 0.25X**, giving $X = ₹13,69,434$. Where profit is quoted as **20% of total revenue** the answer notes it is the same as **25% of total cost**. Show the equation — the method mark is for the equation, not the quotient.

Splitting a semi-variable maintenance cost uses the high-low method on two years' data. Variable maintenance cost per km = difference in cost ÷ difference in kilometres = $(46,050 - 45,175) \div (1,60,200 - 1,56,700) = ₹0.25$ per km; Fixed maintenance cost = total maintenance cost – variable maintenance cost = $46,050 - (1,60,200 \times 0.25) = ₹6,000$. The annual cost for the year under review is then **(kilometres × 0.25) + 6,000**.

Two fare classes and the contribution format. Where one class of passenger is charged double, convert to **equivalent passengers** — full-fare travellers counted twice, half-fare once — divide the cost by the equivalent number, and scale: the mini-bus answer gives **₹1,541.11** for the shorter distance and **₹1,541.11 × 2 = ₹3,082.22** for the longer. The airline question breaks the pattern and is answered on **marginal costing** lines instead: fare collection, less variable costs (**fuel per flight, food per passenger, commission as a percentage of fare**), equals **contribution per flight**; less fixed costs (**lease and landing charges, salaries of flight crew**) equals **net income per flight**. There the advice is decided on the **increase in contribution**, not on the cost per passenger-km.

Application use the rule - work the problem · 14 questions

- Open with the working notes — total kilometres, passenger-km or tonne-km, and any semi-variable split — before the cost statement. Every later line depends on them and they are marked separately.
- Sub-total each block (A), (B), (C) and carry the totals down. An unlabelled column of figures loses the presentation marks even when the arithmetic is right.
- State the per-unit answer to the same number of decimals the question implies, and say which unit it is — per km, per passenger-km or per tonne-km are three different answers from the same statement.

PQ 4.5 • PYQ 2022-May [1] (d) {C} • 5M • Pg 636	LEVEL II Application	Easy
PQ 4.12 • MTP 2026-Mar S1 [1] (c) {C} • 4M • Pg 649	LEVEL II Application	Easy
PQ 4.4 • PYQ 2021-Dec [3] (a) • 10M • Pg 633	LEVEL II Application	Medium
PQ 4.6 • RTP 2022-May [10] • Pg 637	LEVEL II Application	Medium
PQ 4.7 • MTP 2024-Mar [2] (a) • 9M • Pg 640	LEVEL II Application	Medium
PQ 4.8 • PYQ 2024-May [2] (b) • 6M • Pg 642	LEVEL II Application	Medium
PQ 4.9 • MTP 2024-Jul [3] (b) • 8M • Pg 644	LEVEL II Application	Medium
PQ 4.10 • PYQ 2025-Jan [4] (a) • 8M • Pg 645	LEVEL II Application	Medium
PQ 4.13 • MTP 2026-Apr S2 [2] (b) • 7M • Pg 649	LEVEL II Application	Medium
PQ 4.14 • PYQ 2026-Sep [3] (b) • 7M • Pg 651	LEVEL II Application	Medium
PQ 4.1 • PYQ 2018-Nov [4] (b) • 10M • Pg 627	LEVEL II Application	Hard
PQ 4.2 • MTP 2019-Mar [5] (a) • 10M • Pg 629	LEVEL II Application	Hard
PQ 4.3 • PYQ 2019-May [4] (a) • 10M • Pg 631	LEVEL II Application	Hard
PQ 4.11 • MTP 2025-Jul [5] (b) • 6M • Pg 647	LEVEL II Application	Hard

Topic 5: Costing of Hotels and Lodges

L2P4-C12-T05

Read first Read ICAI Study Material Chapter 12, Service Costing — costing of hotels and lodges, room-days and tariff fixation.

NOTES

The cost unit is the room-day, and the first working note is always the count of room-days: **number of rooms × number of days in the period × occupancy percentage**, taken type by type and totalled. Assume **360 days in a year** where the question says so. Everything downstream — attendant wages, lighting, the apportionment of electricity, the divisor for the tariff — is built on this number, so get it out first and label it.

Where tariffs differ between room types, convert to equivalent room-days of the cheapest room. Rent of super deluxe is 2 times deluxe and luxury suite 3 times deluxe, so **equivalent deluxe room days** = $(32,400 \times 1) + (16,200 \times 2) + (8,640 \times 3) = 90,720$. Then let x be the rent of the deluxe room, so **total takings** = $90,720x$, and solve against the cost: $90,720x - 22,680x = ₹16,66,98,000$ where profit is 25% of takings, giving $x = ₹2,450$; the other tariffs follow by the ratio.

An off-season concession is handled by equivalent full room-days, not by a second statement. Where half the full rent is charged for six off-season months, the season's 28,800 room days count in full and the off-season's 14,400 room days count at 50% = 7,200, so the divisor is **36,000 equivalent full room days** against 43,200 actual room days. **Total rent ÷ equivalent full room days** = ₹158.72 is the season rate, and the **off-season rate** is $158.72 \times 50\% = ₹79.36$. Note which figure each cost uses: room attendants are paid on actual occupancy, so their wages are ₹15 × 43,200 room days, not on the equivalent figure.

Read a time-based cost against the season the question defines. In the hill-station answer the winter months are expressly **part of the off season**, so the eight non-winter months are the six peak months plus two off-season months, and lighting is computed in three blocks — **200 rooms × 80% × 6 months × ₹110**, **200 rooms × 40% × 2 months × ₹110** and **200 rooms × 40% × 4 months × ₹30** — totalling ₹1,32,800. Lighting is charged on **occupied** rooms because the rate is stated on the basis of full occupancy for a month.

Profit wording again decides the arithmetic. Profit margin 20% of room rent is the same as 25% on cost, and 25% on total taking means total cost is 75% of takings. Add the profit as a separate line after Total Cost and label it with both readings, exactly as the printed answers do.

Where the question asks for profit by room type instead of a tariff, the layout changes to a columnar profit statement. Columns are the room types plus a total; rows in order: room-days, tariff per room-day, Total Revenue (I); housekeeping expenses per room-day (II); breakfast cost (III); swimming pool cost (IV); salaries to staff apportioned in the given ratio (V); electricity apportioned in proportion to occupancy, i.e. in the ratio of room-days (VI); Profit = I – II – III – IV – V – VI. With **double occupancy**, per-person charges are doubled per room-day — breakfast at ₹150 per person becomes **₹300 per room** and the pool at ₹200 per person becomes **₹400 per room** — and a facility given free only to one class of room is charged only to that column.

Application use the rule - work the problem · 3 questions

- Room-days first, equivalent room-days second, cost statement third, tariff last. Reversing the order buries the two workings that carry the most marks.
- When solving for the base tariff, write the equation in x and solve it on the page. Jumping to the rent figure loses the marks for the profit adjustment.

PQ 5.1 · MTP 2018-Mar [5] (b) · 10M · Pg 653

LEVEL II
Application

Medium

PQ 5.2 · PYQ 2019-Nov [3] (a) · 10M · Pg 656

LEVEL II

Medium

Application

PQ 5.3 · PYQ 2023-Nov [3] (b) · 10M · Pg 658

LEVEL II
Application

Medium

Topic 6: Costing of Hospitals

L2P4-C12-T06

Read first Read ICAI Study Material Chapter 12, Service Costing — costing of hospitals, the patient-day unit and break-even in patient days.

NOTES

The cost unit is the patient-day, and the first working note counts them: each block of days at the beds occupied in that block, added, **plus the extra beds hired**. In the critical care answer, $(50 \text{ beds} \times 200 \text{ days}) + (30 \text{ beds} \times 105 \text{ days}) + (20 \text{ beds} \times 60 \text{ days}) = 14,350$, plus 250 hired beds = 14,600 patient days; in the intensive care answer, $(100 \times 120) + (40 \times 80) = 15,200$, **plus 400 extra beds = 15,600**. The hired beds are counted as patient days because a patient occupied them.

Hospital questions are answered in marginal costing form, not as a three-block operating cost sheet. The statement runs: Revenue (patient days $\times$ charge per day); less Variable costs; = Contribution; less Fixed costs; = Profit. Then **Contribution per patient day = Total contribution $\div$ Total patient days** and **Profit per patient day = Total profit $\div$ Total patient days**.

Learn the classification, because it is the same in both printed answers. Variable: food and laundry services, medicines supplied to patients, doctors' payment, caretaker and other services for patients, and hire charges for extra beds. Fixed: building rent, managers', supervisors', nurses' and ward boys' salaries, repairs and maintenance, cost of oxygen other than that borne directly for treatment, administrative and general administration overheads allocated to the unit, and depreciation on equipment. Doctors' payment is variable because the fees are paid on the basis of the number of patients attended and the time spent by them — the question always says so, and that sentence is the authority for the treatment.

State the assumption the printed answer states. Its own note says higher charges for extra beds are a semi-variable cost; still, for the sake of convenience it has been considered a variable cost. Write that line into your answer. Depreciation is **15% per annum on original cost** where the question gives a rate rather than a life.

Break-even is asked in patient days. Break-even point = Fixed Cost $\div$ Contribution per patient day — $\text{₹}1,63,51,000 \div \text{₹}1,605.103 = 10,187 \text{ patient days}$, and $\text{₹}10,74,000 \div \text{₹}112.50 = 9,547 \text{ patient days}$. Keep the contribution per patient day to the decimals the answer carries; rounding it to the nearest rupee moves the break-even figure. The answer is a number of **patient days**, not of patients and not of rupees.

Application use the rule - work the problem · 2 questions

- Put the patient-day count in a working note before the statement, showing each block of beds and days on its own line and the hired beds added last.
- Split the cost list into variable and fixed on the page, then compute contribution per patient day before you attempt the break-even — both parts of the question run off that one figure.

PQ 6.1 · PYQ 2018-May [4] (b) · 10M · Pg 659

LEVEL II
Application

Medium

PQ 6.2 · PYQ 2021-Jan [5] (a) · 10M · Pg 662

LEVEL II
Application

Hard

Topic 7: Costing of IT and ITES

L2P4-C12-T07

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 12, Service Costing — costing of IT and ITES undertakings and the cost units used there.

NOTES

No question has been printed on this topic in the Scanner — it is a concept-base topic, so prepare it for a short theory question rather than a ten-mark computation, and prepare it from the Study Material's own list of cost units and cost heads. Do not carry a format into the exam that you have not seen in the Study Material.

What the chapter's general method gives you, and what will be marked: the service has **no inventory**, **employee cost is the dominant element**, and indirect costs are a significant proportion of total cost — the three features from the Introduction apply here with particular force, since a services undertaking is almost entirely people and support cost.

The costing pattern of the nearest printed answers in this chapter is the safe model for any per-unit computation: **identify the costs incurred exclusively for the service**, **add the share of common overheads at the percentage the question gives**, and **divide by the number of service units handled in the period**. The loan-processing answers (Topics 9 and 11) build cost per application exactly that way, and the same three steps would carry an IT or ITES computation.

Topic 8: Costing of Toll Roads

L2P4-C12-T08

Read first Read ICAI Study Material Chapter 12, Service Costing — costing of toll roads, the BOT approach and computation of the toll rate.

NOTES

BOT, in the words the answers use: BOT is an option for the Government to outsource public projects to the private sector. Under BOT, the private sector designs, finances, constructs and operates the facility and eventually, after a specified concession period, the ownership is transferred to the Government. Add the fundamental principle where the question invites it: if the price for a transport facility is set at a level that reflects the benefit each user gains from the improvements in the facility, it will result in traffic flow levels that equate social costs with user benefits. **Concession period** is the period for which the infrastructure is allowed to be operated to recover the investment.

The toll rate formulae, exactly as printed: $\text{Toll Rate} = (\text{Total Cost} + \text{Profit}) \div \text{Number of Vehicles}$; and, alternatively, $\text{User Fee} = \text{Total Distance} \times \text{Toll Rate per km}$, rounded off to the nearest multiple of five. The rate should have a direct relation with the benefits road users gain from the improvement, which are fuel savings, improvement in travel time and good riding quality — three benefits, worth naming in a theory answer.

The classification question recurs, and the answer's own list is the authority: Land acquisition — **Capital Cost**; Interest expenses incurred for servicing term loans — Operating expenses; **Material and Labour** — **Capital Cost**; Toll collection expenses — Operating expenses; **Contingency Allowance** — **Capital Cost**; Periodic painting cost of railings etc. — Maintenance Cost. Note the one that surprises students: interest on term loans is operating, not capital.

The statement spreads the capital cost over the concession period and then adds the period's operating and maintenance cost. **Appropriation of capital cost** for the month is the project cost divided by the tenure — ₹900 crore over 10 years is ₹7,50,00,000 a month — and the number of vehicles for the month is worked on the same basis, 120 crore vehicles over 10 years giving **1 crore vehicles a month**. Where the question is set per day, **concession period in days** = $25 \text{ years} \times 365 = 9,125 \text{ days}$ and the cost per day is the total project cost, including administration and toll plaza operation cost, divided by that. **Cost per kilometre** = $\text{Total cost} \div \text{length of the highway}$ is a separate ask; do not confuse it with cost per vehicle.

Different classes of vehicle are handled by equivalent vehicles, in the ratio of the weights the question assigns. Weights of 5%, 20%, 30% and 45% become the ratio **1 : 4 : 6 : 9**; toll charges fixed at 2.5 times and 2 times become **1 : 2.5 : 5**. Multiply each class's traffic by its ratio, total the equivalent vehicles, divide the recoverable amount by that total to get the **base rate**, then multiply the base rate by each ratio for the class rates — ₹19.06 × 1, × 4, × 6 and × 9; or ₹26, ₹65 and ₹130.

Two adjustments to the traffic count, both easy to miss. Exempt vehicles are removed before equivalence — 10% of light vehicles used for medical emergencies, Members of Parliament and essential services leave **45,000** chargeable, not 50,000. A **return journey concession** reduces the equivalent count rather than the toll: 30% of the returning light vehicles paying 25% less gives $45,000 - (45,000 \times 30\% \times 25\%) = 41,625$ equivalent return vehicles, and the new rate is the **unchanged revenue divided by the reduced equivalent number**, $₹23,40,000 \div 86,625 = ₹27.01$.

Read the profit wording before you gross up. 30% profit over total cost means $\text{total cost} \times 1.30$; a **20% profit margin over total takings** means $\text{takings} = \text{total cost} \div 80\%$, and the class rates are then solved from $3,00,000X + 75,000(5X) + 1,25,000(4X) = 11,75,000X = \text{takings}$. Writing the single equation in X is the printed method and is worth doing on the page.

Understanding explain it, and place it in context · 1 question

- Two asks: **what the BOT approach is**, and **how the toll rate is computed**. Give the second as a formula with its terms defined — that is where the marks concentrate.
- In explaining BOT, cover the concession period and what happens at the end of it. The transfer is the part candidates leave out.

TQ 8.1 · PYQ 2021-Jul [6] (d) · DESC · 5M · Pg 664

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 4 questions

- Put the equivalent-vehicle table in a working note with columns for traffic, weight, ratio and equivalent vehicles, then compute one base rate and read the class rates off it.
- Spread the capital cost over the concession period in the statement itself, with the division shown — that line alone carries marks.

PQ 8.2 · PYQ 2023-May [1] (d) {C} · 5M · Pg 668

LEVEL II
Application

Medium

PQ 8.3 · RTP 2024-Sep [16] · Pg 670

LEVEL II
Application

Medium

PQ 8.1 · PYQ 2020-Nov [5] (a) · 10M · Pg 666

LEVEL II
Application

Hard

PQ 8.4 · PYQ 2025-Sep [2] (a) · 10M · Pg 672

LEVEL II
Application

Hard

Analysis break it down and examine the interrelationships · 1 question

- Where a concession or an exemption changes the traffic, say which vehicles have been removed or reduced and why, before you recompute the rate.

TQ 8.2 · PYQ 2024-Sep [4] (b) · DESC · 5M · Pg 665

LEVEL II
Analysis

Medium

Topic 9: Costing of Educational Institutions

L2P4-C12-T09

Read first Read ICAI Study Material Chapter 12, Service Costing — costing of educational institutions, and cost per application in a service department.

NOTES

Build the cost of a batch from the periodicity the question uses, week by week. The training answer totals: **hall charges ₹25,000 × 25 weeks**; **honorarium ₹3,600 × 3 sessions × 5 days × 25 weeks**; **travel reimbursement ₹500 × 5 days × 25 weeks**; **refreshment ₹1,200 × 25 weeks**; **weekend lectures ₹5,000 × 2 × 25 weeks**; **trainee support services ₹2,020 × 25 weeks** — **Total Cost ₹23,68,000 for one batch.** Note that the weekend lecture fee is stated to be **inclusive of travelling and refreshment**, so nothing further is added for those two lectures; a cost stated as inclusive is not grossed up.

Minimum fee to cover cost is the total cost divided by the full seating capacity — $₹23,68,000 \div 320 = ₹7,400$ per trainee. The word **minimum** means no profit element; do not add a margin unless the part asks for one.

Where a profit margin is on the fee, gross up before you divide. 20% profit margin on the fee = $1/5$ of sales or $1/4$ of the cost, so total fee to be recovered is $₹23,68,000 \times 5/4 = ₹29,60,000$. At ₹14,800 a trainee that needs $29,60,000 \div 14,800 = 200$ trainees, and the **minimum percentage of batch size** = $200 \div 320 = 62.5\%$. The final answer is a percentage of capacity, not a number of trainees — read the requirement.

The loan-processing question printed under this topic sets the overhead trap that recurs across the chapter. A legal advice cost of ₹11,000 relates to **one specific education loan**, so it is charged **in full** to the education loan service and **taken out of the overhead pool before the share is applied**: **Overhead cost** = $30\% \text{ of } (₹16,40,000 - ₹11,000) = ₹4,88,700$. Total processing cost is **salary ₹21,60,000 + legal advice ₹11,000 + overhead ₹4,88,700 = ₹26,59,700**, and **cost per application** = $₹26,59,700 \div 500 = ₹5,319.40$. The classic wrong answer takes 30% of the whole ₹16,40,000 and then adds the ₹11,000 again, counting the same cost twice.

Application use the rule - work the problem - 2 questions

- List the cost lines in the order the question gives them, with the multiplication written out in brackets on each line, and total to a single 'Total cost per batch'.
- Answer exactly what is asked in part three — a percentage of batch size — and show the trainee number it came from.

PQ 9.1 · MTP 2024-Dec S2 [3] (c) · 2M · Pg 675

LEVEL II
Application

Easy

PQ 9.2 · PYQ 2026-Jan [3] (b) · 6M · Pg 675

LEVEL II
Application

Hard

Topic 10: Costing of Insurance Company

L2P4-C12-T10

Read first Read ICAI Study Material Chapter 12, Service Costing — costing of an insurance company

and cost per policy.

NOTES

The total cost may be given indirectly, and finding it is the first mark. Total Cost = Total insured value $\times$ Cost per rupee of insured value — ₹3,500 crore $\times$ 0.002 = **₹7,00,00,000**. Once that total is fixed, the costs listed in the question are grouped under it, and the one cost left blank is found by difference.

Group the expenditure under the four activity heads the question names, in this order: (a) Marketing and Sales Support — cost of marketing of the policy, policy development cost, sales support expenses; (b) Operations — claim management cost, policy issuance cost, policy servicing cost; (c) **I.T. Cost**; (d) Support Functions — office administration cost, employees cost, postage and logistics, facilities cost. Learn which head each expense sits under; the marks are for the grouping, and the arithmetic is only addition.

The unknown head is the balancing figure. I.T. Cost = Total cost – (Marketing and Sales Support + Operations + Support Functions) = ₹7,00,00,000 – (₹2,05,90,000 + ₹1,29,75,000 + ₹1,43,35,000) = ₹2,21,00,000. Show it in the statement labelled [**Balancing Figure**] so the examiner sees it was derived and not guessed.

Cost per policy = Total cost $\div$ Number of policies sold — ₹7,00,00,000 $\div$ 2,800 = **₹25,000 per policy**. The divisor is the number of policies, not the insured value; the insured value has already done its work in fixing the total cost.

Application use the rule - work the problem · 1 question

- Compute the total cost from the insured value first and state it above the statement, so that the balancing figure has something to balance against.
- Present the four heads as lettered blocks with sub-totals in an inner column and the grand total in the outer column, exactly as the printed answer does.

PQ 10.1 · PYQ 2021-Jul [4] (b) · 5M · Pg 677

LEVEL II
Application

Hard

Topic 11: Costing in Financial Institutions

L2P4-C12-T11

Read first Read ICAI Study Material Chapter 12, Service Costing — costing in financial institutions, and the cost of processing a loan application.

NOTES

The cost unit is one loan application processed, and the statement is columnar: a column for each type of loan and a total column. Rows, in the order the printed answers use: **Employee cost** (the staff engaged exclusively on that type of application), **Apportionment of branch manager's salary**, **Legal charges, printing and stationery and advertising expenses** taken as one line, **Other expenses**, and **Depreciation**. Only the employee cost is direct; every other row is apportioned at the percentage of branch overheads the question assigns to that loan type.

Bring every cost to the same period before apportioning. Other expenses given per quarter are divided by 3 and depreciation given per annum is divided by 12 to reach the month, because the branch manager's salary and the other expenses are monthly and the applications are counted per month. Doing the apportionment first and the conversion afterwards produces a figure that cannot be checked.

The two computations the question alternates between. Cost of processing one application = Total cost of that loan type ÷ Number of applications processed — ₹2,48,000 ÷ 496 = ₹500. And in reverse, **Number of applications = Total cost ÷ Processing cost per application** — ₹1,88,000 ÷ ₹500 = **376 applications** — used where the question tells you the cost per application is the same for both loan types.

Where the salary itself is unknown, set it as x and equate the two costs per application. With three professionals on one product and four on the other, the total cost rows become ₹45,000 + $3x$ and ₹33,750 + $4x$, and equating the cost per application gives $1,500x + 2,25,00,000 = 1,600x + 1,35,00,000$, so $x = ₹90,000$. The salaries are then $3x = ₹2,70,000$ and $4x = ₹3,60,000$, and **cost per car loan application = (₹33,750 + ₹3,60,000) ÷ 500 = ₹787.50**. Write the equation out; the marks are on the equation and the substitution, not on the final quotient.

Overheads are apportioned at the stated percentages only — the residue stays with the branch. Where 20% goes to one product and 15% to the other, 65% of the branch's overheads belong to the branch's other services and never enter this statement. Do not force the percentages to add to 100.

Application use the rule - work the problem · 2 questions

- Draw the table with a Total column first, fill the monthly figures into it, and then apply each percentage across — it makes the apportionment visible and self-checking.
- Where a salary is unknown, carry x through the table rather than guessing a figure; the printed answer does exactly that.

PQ 11.1 · PYQ 2022-Nov [1] (b) {C} · 5M · Pg 679

LEVEL II
Application

Medium

PQ 11.2 · PYQ 2026-Jan [3] (a) · 8M · Pg 680

LEVEL II
Application

Hard

Topic 12: Costing For Power Houses

L2P4-C12-T12

Read first Read ICAI Study Material Chapter 12, Service Costing — costing for power houses and the cost per kilowatt-hour.

NOTES

The cost unit is the kWh, and the statement carries two columns — 'Per annum' and 'Per kWh' — split into fixed and variable blocks. Fixed costs: plant supervision, administration overheads, insurance charges, depreciation; Variable costs: operating labour, fuel charges, lubricants, spares and stores, repairs and maintenance, and coal cost. Give the per-kWh figure for **each block and for the total** — ₹3.87 fixed plus ₹3.27 variable equals **₹7.14 per kWh** — because the split is the point of the question.

Depreciation is computed at the rate on capital cost — 5% of ₹3,10,00,000 = ₹15,50,000 per annum — and sits in the fixed block. Coal cost is derived from the generation ratio, not given: (units generated ÷ kWh generated per kg) × rate per kg, that is (16,50,000 kWh ÷ 7) × ₹4.75 = ₹11,19,643, and it belongs in the variable block.

A captive power plant is set out in three cost blocks, in this order. Boiler House Cost (I): coal consumed, freight, loading and unloading at the stated percentage of the coal value, oil, water, depreciation of the steam boiler = (cost – residual value) ÷ life ÷ 12 for a month, and the boiler house wages by grade of worker; then **Less: recovery from sale of ash**, deducted inside this block. **Generating Station Costs (II):** generating station wages by grade, repairs and maintenance of generating equipment, depreciation of generating equipment, insurance premium on the plant, fuel handling and storage expenses, rent of the generating station premises and the share of administration and general expenses. **Other Costs (III): electricity purchased from the grid at the rate per unit.** The total is (I) + (II) + (III).

The divisor is units available, and building it is where the marks are. Total units generated, less normal loss in generation, = net own units generated; add units purchased from the grid = total effective units available; less the percentage used by the generating department itself = units available for factory operations. In the printed answer: 2,00,000 – 3,000 = 1,97,000; + 5,000 purchased = 2,02,000; – 10% (20,200) = 1,81,800 units, and **cost per unit = ₹9,97,080 ÷ 1,81,800 = ₹5.48**. Two rules stated in the question drive this: **purchased units are not subject to any loss adjustment, and the emergency purchase is added to the effective units** before the internal usage is taken out. The classic wrong answer divides by the units generated and ignores both the normal loss and the department's own consumption.

Application use the rule - work the problem - 2 questions

- Do the units-available working note before the cost sheet and label each step; the cost per unit is only as good as that figure.

- Keep the fixed and variable blocks separate with sub-totals even when the question asks only for a single cost per kWh — the split is free marks.

PQ 12.1 · RTP 2023-May [11] · Pg 682

LEVEL II
Application

Medium

PQ 12.2 · RTP 2025-Sep [15] · Pg 683

LEVEL II
Application

Medium

Topic 13: Costing of other Services

L2P4-C12-T13

Read first Read ICAI Study Material Chapter 12, Service Costing — costing of other services, including cinemas and other entertainment undertakings.

NOTES

Split the capacity in the ratio the question gives before anything else. Total capacity 306 seats in the ratio **12 : 4 : 1** gives Classic 216, Prime 72, Recliner 18. Then occupied seats per day = seats × occupancy percentage × number of shows per day — **$216 \times 75\% \times 4 = 648$, $72 \times 50\% \times 4 = 144$, $18 \times 50\% \times 4 = 36$.**

Compound the price ratios; do not add them. Prime is twice Classic and Recliner is three times Prime, so in Classic terms the weights are **Classic 1, Prime 2, Recliner 6**. Equivalent Classic seats per day = $(648 \times 1) + (144 \times 2) + (36 \times 6) = 648 + 288 + 216 = 1,152$. Taking the Recliner at 3 instead of 6 is the mistake the ratio is designed to catch.

Gross the cost up to revenue before dividing. Profit at 25% on total revenue means cost is 75% of revenue, so Total revenue = $\text{₹}77,760 \times 100/75 = \text{₹}1,03,680$ for the day. Ticket price of the base seat = Total revenue ÷ Equivalent Classic seats = $\text{₹}1,03,680 \div 1,152 = \text{₹}90$, and the others follow the same weights: **Prime $\text{₹}90 \times 2 = \text{₹}180$ and Recliner $\text{₹}90 \times 6 = \text{₹}540$.**

Watch the period in the divisor and in the answer. The cost is given **per day** and the equivalent seats are computed **per day across all four shows**, so the quotient is the **price per show** for the base seat. If the cost were annual, the equivalent seats would have to be annual too. Match the two or the price is wrong by the number of shows or days.

Application use the rule - work the problem · 1 question

- Show the equivalent-seat table with a column for occupied seats and a column for equivalent seats, then one line for total revenue and one for the base price. Four short steps, each separately marked.

PQ 13.1 · PYQ 2025-May [3] (b) · 6M · Pg 686

LEVEL II
Application

Medium

CHAPTER 13

Standard Costing

10 Topics · 34 Classified Questions · Importance: B

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge

0.8%

2 of 243 marks

Level II — Analysis & Application

99.2%

241 of 243 marks

Below the paper's Level I floor: only 1% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for the paper. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Introduction

L2P4-C13-T01

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 13, Standard Costing — the meaning of standard cost, standard costing and variance.

NOTES

The definition, in the words the printed answer uses: standard costing is the technique whereby standard costs are predetermined and subsequently compared with the recorded actual costs. It is a technique of **cost ascertainment and cost control**. It establishes predetermined estimates of the cost of products and services based on management's standards of efficient operation, and so lays emphasis on **what the cost should be**, which is then compared with what the cost was.

Variance, and the sign convention that carries marks in every practical question. The difference between standard cost and actual cost of actual output is defined as the variance — note the words **of actual output**, because the standard must always be flexed to what was actually produced before it is compared. If the actual cost is less than the standard cost the variance is favourable; if the actual cost is more than the standard cost the variance is unfavourable (adverse). Mark every figure **(F)** or **(A)**; several questions say in terms that the nature of the variance must be indicated, and an unmarked figure is an incomplete answer.

Calculating the variance is not the end of the exercise. Mere calculation and analysis of variances is of no use; you must **trace their origin and the causes of their occurrence** so that remedial steps can be taken. A detailed probe, particularly into the **controllable** variances, lets management ascertain (a) the amount of the variance, (b) the factors or causes of their occurrence, (c) the responsibility to be laid on executives and departments, and (d) the corrective action which should

be taken to obviate or reduce the variances. Variance gives information; information is the means and the action taken on it is the end — which is the sentence the 'means to an end' question is answered with.

No question has been printed under this topic heading in the Scanner, but the material is examined through the descriptive questions at Topics 4 and 9. Learn the definition and the favourable/adverse rule here, because every later topic assumes them.

Topic 2: Process of Standard Costing

L2P4-C13-T02

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 13, Standard Costing — the process of standard costing and the steps in the system.

NOTES

The process is a cycle, and the printed answers show all four of its stages even though no question is set on the cycle itself. **Set the standard cost** in advance for each element (Topic 3 gives the procedure); **record the actual cost** of actual output; **compare the two and compute the variance** for each element; and **analyse the variance for its cause, fix responsibility, and act**. The last stage is the one candidates omit, and it is the stage the descriptive questions test.

Standards are set element by element, not for the product as a whole. The standard cost card in every practical question is built as direct material quantity at a standard price, **direct labour hours at a standard rate**, **variable overhead per hour or per unit** and **fixed overhead per unit or per hour**, each with its own standard. That is why the variances are computed element by element and only then totalled.

Standards are not permanent. Standards once set do not always remain stable; they have to be revised — the criticism answer makes the point expressly, and adds that **standard costs are normally set for a short period**, so changes in the product mix or in technology are dealt with by revising the standard rather than by abandoning the system.

No question has been printed under this topic heading in the Scanner, so prepare it as supporting material for the theory questions at Topics 3, 4 and 9 rather than as a question in its own right.

Topic 3: Setting Up of Standard Cost

L2P4-C13-T03

Read first Read ICAI Study Material Chapter 13, Standard Costing — setting up standard costs, and

in particular the procedure for setting labour time standards.

NOTES

Six steps, each with a name and a one-line content — the answer is set out as a two-column table and the names carry the marks. **1. Standardisation** — the products to be produced are decided on the basis of the production plan and the customer's order. **2. Labour specification** — the types of labour and the labour time are specified; the labour time specification is based on past records and takes into account normal wastage of time. **3. Standardisation of methods** — selection of proper machines so as to use the proper sequence and method of operations. **4. Manufacturing layout** — a plan of operation for each product, listing the operations to be performed, is prepared. **5. Time and motion study** — conducted for selecting the best way of completing the job, or the motions to be performed by the workers, and **the standard time which an average worker will take for each job**; it also takes into account **the learning efficiency and the learning effect**. **6. Training and trial run** — workers are trained to do the work and **the time spent at the time of the trial run is noted down**.

Two phrases are the examiner's markers, so use them. Normal wastage of time is built into the labour time standard — the standard is not the time an ideal worker would take with no interruption. And the standard time is **the time an average worker will take**, not the best worker's time. An answer that describes an ideal standard has described the wrong thing.

Write it as a numbered list with the step name in bold and the explanation beside it. The printed answer is a table of six rows; a five-mark answer is six named steps with a sentence each, and nothing else. Padding the answer with the advantages of standard costing earns nothing here.

Analysis break it down and examine the interrelationships · 1 question

- The ask is the **steps in setting a standard**, so answer as a sequence and number it. An unordered list of considerations does not read as steps.
- Name who sets each standard and against what — the time study, the standard operating conditions, the allowance for rest and normal idle time. The allowance is the step most often missed.

TQ 3.1 · PYQ 2021-Dec [6] (c) · DESC · 5M · Pg 696

LEVEL II
Analysis

Medium

Topic 4: Types of Variance

L2P4-C13-T04

Read first Read ICAI Study Material Chapter 13, Standard Costing — the classification of variances, including controllable and uncontrollable variances.

NOTES

The two definitions, quoted as printed. Controllable variances are those which can be controlled under normal operating conditions if a responsibility centre takes preventive measures and acts prudently. Uncontrollable variances are those which occur due to conditions which are beyond the control of a responsibility centre and cannot be controlled even though all preventive measures are in place. The phrase **responsibility centre** appears in both limbs and is the hinge of the distinction — a variance is controllable or not **by reference to a particular centre**, not in the abstract.

Why the classification matters in the exam and not only in theory. It is the **controllable** variances that management probes in detail, to fix **the amount, the cause, the responsibility and the corrective action**. Where a question asks you to comment on a variance, say which centre could have controlled it and what it should do — that is what converts a computation into an answer.

The other classification you need is the favourable and adverse one. Actual cost less than standard cost is favourable; actual cost more than standard cost is adverse (unfavourable). Every practical question in this chapter requires the nature to be indicated against each figure, and several say so in terms.

Only one short definition question is printed on this topic, so do not over-prepare it; learn the two sentences and move on to the variance computations, which is where the chapter's marks are.

Remembering reproduce what you have learnt · 1 question

- Two sentences, each naming the responsibility centre and preventive measures. A two-mark question wants exactly that and nothing more.

TQ 4.1 · PYQ 2024-Sep [6] (b) · DESC · 2M · Pg 697

LEVEL I
Remembering

Easy

Topic 5: Material Variance

L2P4-C13-T05

Read first Read ICAI Study Material Chapter 13, Standard Costing — material variances: cost, price, usage, mix and yield.

NOTES

Build the four columns before you write a single variance; every material variance is the difference between two of them. **SQ × SP** (standard quantity for actual output at standard price), **AQ × SP** (actual quantity at standard price), **AQ × AP** (actual quantity at actual price) and **RSQ × SP** (revised standard quantity at standard price). The terms: SQ is the quantity that should have been used for the output actually produced; **AQ is the quantity actually used**; **RSQ is the total actual quantity**

re-apportioned in the standard mix ratio; SP and AP are the standard and actual prices per unit.

The five formulae, written exactly as the answers write them, each in both of its forms. Material Cost Variance = Standard cost of actual output – Actual cost = $(SQ \times SP) - (AQ \times AP)$. Material Price Variance = Actual Quantity (Std. Price – Actual Price) = $(AQ \times SP) - (AQ \times AP)$. Material Usage Variance = Standard Price (Std. Quantity – Actual Quantity) = $(SQ \times SP) - (AQ \times SP)$. Material Mix Variance = Standard Price (Revised Std. Quantity – Actual Quantity) = $(RSQ \times SP) - (AQ \times SP)$. Material Yield Variance = Standard Price (Std. Quantity – Revised Std. Quantity) = $(SQ \times SP) - (RSQ \times SP)$. Write the formula, then the substitution, then the figure with (F) or (A) — the printed answers do all three on every line and so should you.

The two checks, and use them. Material Cost Variance = Material Price Variance + Material Usage Variance, and **Material Usage Variance = Material Mix Variance + Material Yield Variance**. A mix and a yield that do not add back to your usage figure mean the RSQ is wrong. Note that price and usage together reconcile to cost; mix and yield are a sub-division of usage only.

Where there is a standard loss, the standard quantity for actual output has to be worked back through the loss — this is the single commonest slip. Two routes are printed. **Gross up the output:** input required for actual output = **actual output ÷ (1 – loss percentage)**, so 1,480 kg of output with a 10% normal loss needs **1,645 kg of input**, split in the standard ratio to give **SQ of A = 940 kg and SQ of B = 705 kg**. **Or scale the standard cost:** Standard cost of actual output = Standard cost of standard output × (Actual output ÷ Standard output) — ₹12,000 × 195/200 = **₹11,700**, and ₹43,200 × 680/640 = **₹45,900**. Both appear; use whichever the data fits, and note that the second gives you the cost variance without needing SQ item by item.

The mix and yield variances also appear in an 'average price' form, and a question may be set in either. Material Mix Variance = Total Actual Quantity × (Average Standard Price per unit of Standard Mix – Average Standard Price per unit of Actual Mix) — 110 kg × (₹2,700/100 – ₹3,060/110) = ₹90 (A). Material Yield Variance = Average Standard Price per unit of Standard Mix × [Total Standard Quantity – Total Actual Quantity] — (₹2,700/100) × (100 – 110) = ₹270 (A). One answer writes the yield as **(Std. total quantity – Actual total quantity) × Standard weighted average price**, that is $(22,000 - 23,000) \times ₹8,40,000/22,000 = ₹38,182$ (A), which is the same thing.

Missing-figure questions are solved one equation at a time, and the order is fixed by which variance has only one unknown. The printed chains run: **use the cost variance to find $(SQ \times SP)$ and so the missing standard price; then the price variance to find $(AQ \times SP)$ and so the missing actual quantity; then $(AQ \times AP)$ to find the missing actual price; then the total actual quantity to build RSQ; then the mix variance**. Two facts unlock most of them: **the standard mix ratio holds for SQ and for RSQ**, and actual output and standard output are always equal numerically in any material variance analysis — that sentence is printed in the answer and is what lets you write standard output as the actual output less the standard loss on the standard input.

Material variances are computed on the quantity consumed, not the quantity purchased. The printed note says so in terms — **material variances are calculated on the basis of consumption** — where a question gives purchases of 3,20,000 kg and usage of 2,96,000 kg, the price variance as

well as the usage variance runs on the 2,96,000 kg. The purchase figure is there to be left alone unless the question expressly asks for the price variance at the point of purchase.

Application use the rule - work the problem · 9 questions

- Draw the four-column table first, headed $SQ \times SP$, $AQ \times SP$, $AQ \times AP$ and $RSQ \times SP$, with a row per material and a total row. Every variance is then a subtraction you can point at, and the examiner can follow it.
- State each formula above its substitution. A correct figure with no formula loses the method mark, and a wrong figure with the right formula keeps it.
- Total the material-wise variances and mark the total (F) or (A); questions ask for the variance 'for each raw material and for the product'.

PQ 5.1 · PYQ 2018-May [5] (a) (ii) · 5M · Pg 697	LEVEL II Application	Easy
PQ 5.2 · PYQ 2019-Nov [5] (b) · 10M · Pg 699	LEVEL II Application	Medium
PQ 5.4 · PYQ 2022-Nov [5] (a) · 10M · Pg 703	LEVEL II Application	Medium
PQ 5.7 · RTP 2025-May [17] · Pg 709	LEVEL II Application	Medium
PQ 5.8 · RTP 2026-Jan [16] · Pg 711	LEVEL II Application	Medium
PQ 5.3 · MTP 2020-Oct [2] (a) · 10M · Pg 701	LEVEL II Application	Hard
PQ 5.5 · MTP 2023-Sep [5] (b) · 10M · Pg 704	LEVEL II Application	Hard
PQ 5.6 · RTP 2025-Jan [16] · Pg 706	LEVEL II Application	Hard
PQ 5.9 · MTP 2026-Apr S2 [1] (c) {C} · 4M · Pg 714	LEVEL II Application	Hard

Topic 6: Labour Variance

L2P4-C13-T06

Read first Read ICAI Study Material Chapter 13, Standard Costing — labour variances: cost, rate, efficiency, mix, yield and idle time.

NOTES

The same four-column construction, in hours. $SH \times SR$ (standard hours for actual output at standard rate), $AH \times SR$, $AH \times AR$ and $RSH \times SR$ (actual hours re-apportioned in the standard gang

ratio). Build the table by category of worker — skilled, semi-skilled, unskilled — with a total row, because the questions ask for category-wise variances and then the total.

The formulae as printed. **Labour Cost Variance** = $(SH \times SR) - (AH \times AR)$. **Labour Rate Variance** = $AH (SR - AR) = (AH \times SR) - (AH \times AR)$. **Labour Efficiency Variance** = $SR (SH - AH) = (SR \times SH) - (SR \times AH)$. **Labour Idle Time Variance** = **Idle hours** $\times$ **Standard Rate**, and it is **always adverse**. **Labour Mix (Gang) Variance** = **Total actual time worked** $\times$ (**Average standard rate per hour of the standard gang** – **Average standard rate per hour of the actual gang**), computed on the basis of hours worked. **Labour Yield Variance** compares standard hours for actual output against actual hours worked in the standard mix.

Hours paid and hours worked are not the same, and the two bases are the heart of the chapter's labour questions. **Hours worked** = **hours paid** – **abnormal idle hours**. The rate variance is computed on hours paid; the efficiency and mix variances are computed on hours worked. In the printed answer, 120 workers $\times$ 48 hours = **5,760 hours paid**, 5% lost = **288 idle hours**, leaving **5,472 hours worked**; **Labour Rate Variance** = $(25 - 25.70) \times 5,760 = \text{₹}4,032 \text{ (A)}$ while **Labour Efficiency Variance** = $(6,000 - 5,472) \times 25 = \text{₹}13,200 \text{ (F)}$ and **Idle Time Variance** = $288 \times 25 = \text{₹}7,200 \text{ (A)}$. Getting the two bases the wrong way round changes every figure in the answer.

Standard hours for actual output must be scaled from the standard card before anything else. Where the standard says 120 workers produce 20 units in an hour, **standard man hours per unit** = $120 \div 20 = 6 \text{ hours}$ and **standard hours for 1,000 units** = **6,000**. Where the standard is stated for a batch — for two units of the product, or for a packet of 10 kg — **multiply the standard by the number of batches in the actual output**. The editorial note on the 2026 September question says this is the single most common slip in that question: the standard is given for two units and the output is 5,000 units.

Where the question gives an efficiency percentage instead of standard hours, invert it. **Labour efficiency** = $\text{Standard hours} \div \text{Actual hours}$, so at 106.8% on 17,820 actual hours the **standard hours** = **19,031.76**, and **Labour Efficiency Variance** = $(19,031.76 - 17,820) \times 9 = \text{₹}10,905.84 \text{ (F)}$. From there, **standard labour cost per unit** = $(SH \times SR) \div \text{units}$ and **actual labour cost per unit** = $(AH \times AR) \div \text{units}$.

A rate variance can also be back-solved. **Labour Rate Variance** = $(\text{Standard Rate} - \text{Actual Rate}) \times \text{Actual Hours}$, so $\text{₹}71,280 \text{ (A)}$ on 17,820 hours at a standard rate of $\text{₹}9$ gives $(9 - AR) = -4$, hence **AR = ₹13**. Keep the sign discipline: an adverse variance is negative in the equation, and dropping the minus sign produces a rate on the wrong side of the standard.

Application use the rule - work the problem · 4 questions

- Set out the categories in rows and the four columns across, with a note under the table saying how hours paid, idle hours and hours worked were derived. That note is where the rate/efficiency split is justified.
- Compute the idle time variance separately and do not net it into efficiency; questions list it as its own requirement and it is always adverse.

- Mark each category's variance (F) or (A) and then the total — the sign is marked as much as the figure.

PQ 6.2 · PYQ 2022-May [5] (b) · 5M · Pg 718	LEVEL II Application	Easy
PQ 6.1 · PYQ 2019-May [3] (a) · 10M · Pg 715	LEVEL II Application	Medium
PQ 6.4 · PYQ 2026-Sep [4] (a) · 9M · Pg 720	LEVEL II Application	Medium
PQ 6.3 · PYQ 2025-Jan [5] (a) · 6M · Pg 719	LEVEL II Application	Hard

Topic 7: Overhead Variance

L2P4-C13-T07

Read first Read ICAI Study Material Chapter 13, Standard Costing — overhead variances, fixed and variable, and the control ratios.

NOTES

Fix the three overhead anchors first, because every fixed overhead variance is a difference between two of them. Absorbed (recovered) fixed overhead = Actual output × Standard fixed overhead rate per unit, or equivalently **Standard hours for actual production × Standard rate per hour**. **Budgeted fixed overhead** is the figure in the budget for the period. **Budgeted fixed overhead for actual hours = Actual hours × Standard rate per hour**. A fourth, **possible fixed overhead**, appears where the days differ: **Budgeted overhead ÷ budgeted days × actual days**.

The fixed overhead family, as the answers write it. Fixed Overhead Cost Variance = Absorbed Fixed Overhead – Actual Fixed Overhead. **Fixed Overhead Expenditure Variance = Budgeted Overhead – Actual Overhead**. Fixed Overhead Volume Variance = Absorbed (Recovered) Overhead – Budgeted Overhead. Fixed Overhead Efficiency Variance = Absorbed Fixed Overhead – Budgeted Fixed Overhead for Actual Hours, that is **Standard rate × (Standard hours for actual production – Actual hours)**. Fixed Overhead Capacity Variance = Budgeted Fixed Overhead for Actual Hours – Budgeted Fixed Overhead, that is **Standard rate × (Actual hours – Budgeted hours)**. Fixed Overhead Calendar Variance = Possible Fixed Overhead – Budgeted Fixed Overhead, or **(Actual days – Budgeted days) × Standard fixed overhead rate per day**.

The variable overhead family is shorter, and it turns on hours. Variable Overhead Cost Variance = Standard variable overhead for actual production – Actual variable overhead. Variable Overhead Expenditure Variance = Standard overhead for actual hours – Actual variable overhead. Variable Overhead Efficiency Variance = Standard rate per hour × (Standard hours for actual production – Actual hours). And **Variable Overhead Cost Variance = Expenditure Variance + Efficiency Variance** — the printed answer adds ₹11,400 (F) and ₹37,000 (A) to reach ₹25,600 (A).

Use the identities as checks and as a route when data is missing. Fixed Overhead Cost Variance =

Expenditure Variance + Volume Variance, which is how one answer finds the expenditure variance as $-2,800 + 2,000 = ₹800$ (A). **Volume Variance = Efficiency Variance + Capacity Variance**, with the **Calendar Variance** carved out of capacity where the working days differ from the budget. From the volume variance you can recover the absorbed overhead, and from the absorbed overhead the standard hours: **absorbed ÷ standard rate per hour**.

Either basis works — per unit or per hour — provided you stay on one of them. The 2023 November answer is printed twice, once on hours (standard rate per hour = $₹6,72,000 ÷ 67,200$ hours = ₹10) and once on units (standard rate per unit = $₹6,72,000 ÷ 84,000 = ₹8$), and both reach ₹33,600 (A) efficiency and ₹62,400 (F) capacity. Say at the top which basis you are using and derive the rate on the page.

Two preliminary workings the questions hide. Budgeted hours must be struck net of normal down time: $(52 \text{ workers} \times 25 \text{ days} \times 8 \text{ hours}) \times 85\% = 8,840 \text{ hours}$ where down time is 15%. And **semi-variable overheads are split before use** — where 60% is fixed and 40% variable, the fixed element joins budgeted fixed overhead and the variable element joins budgeted variable overhead, on the budget side and on the actual side alike.

The three control ratios, with their formulae. Capacity Ratio = $(\text{Actual hours} \div \text{Budgeted hours}) \times 100 = 8,100/8,840 = 91.63\%$. Efficiency Ratio = $(\text{Standard hours for actual production} \div \text{Actual hours}) \times 100 = 8,800/8,100 = 108.64\%$. Activity Ratio = $(\text{Standard hours for actual production} \div \text{Budgeted hours}) \times 100 = 8,800/8,840 = 99.55\%$. Note that **Activity Ratio = Capacity Ratio × Efficiency Ratio**, which is the check; and note that all three are ratios of **hours**, so a question set in units must be converted first.

Application use the rule - work the problem · 8 questions

- Write out the three anchors — absorbed, budgeted, budgeted for actual hours — as a short working before the variances, then each variance is one subtraction.
- Where the question gives variances and asks for the underlying figures, use the identities in the order cost → expenditure → volume → capacity → efficiency, naming the identity at each step.
- Quote the standard rate derivation (budgeted overhead ÷ budgeted units, or ÷ budgeted hours) explicitly; several answers award it separately.

PQ 7.1 · PYQ 2018-Nov [1] (b) {C} · 5M · Pg 722	LEVEL II Application	Easy
PQ 7.2 · PYQ 2020-Nov [3] (a) · 10M · Pg 723	LEVEL II Application	Medium
PQ 7.3 · PYQ 2021-Jan [5] (b) · 10M · Pg 724	LEVEL II Application	Hard
PQ 7.4 · PYQ 2021-Dec [5] (a) · 10M · Pg 726	LEVEL II Application	Hard
PQ 7.5 · PYQ 2023-Nov [5] (a) · 10M · Pg 729	LEVEL II Application	Hard

PQ 7.6 • PYQ 2025-May [4] (b) • 6M • Pg 731

LEVEL II
Application

Hard

PQ 7.7 • PYQ 2025-Sep [1] (c) {C} • 4M • Pg 732

LEVEL II
Application

Hard

PQ 7.8 • PYQ 2026-May [3] (b) • 6M • Pg 733

LEVEL II
Application

Hard

Topic 8: Comprehensive Questions

L2P4-C13-T08

Read first Read ICAI Study Material Chapter 13, Standard Costing — comprehensive questions computing material, labour and overhead variances together.

NOTES

Work in a fixed order and the comprehensive question falls apart into four small ones. **First flex the standard to the actual output** — standard quantity, standard hours and standard overhead for the units actually produced. **Then material** (cost, price, usage, and mix and yield if there is more than one material). **Then labour** (cost, rate, efficiency, and idle time if any time paid was lost). **Then variable overhead, then fixed overhead.** Each element is marked separately, so an error in the material section does not travel into the labour marks unless you let it.

The flexing step, which is where the marks are lost. **Standard quantity for actual output = actual output × standard quantity per unit** — $1,800 \text{ units} \times 10 \text{ kg} = 18,000 \text{ kg}$; **standard hours = actual output × standard hours per unit** — $1,800 \times 8 = 14,400 \text{ hours}$. Where the budget is given in totals rather than per unit, flex it by the volume ratio: a materials budget of 2,88,000 kg for 60,000 units becomes $2,88,000 \times 66,000/60,000 = 3,16,800 \text{ kg}$ for actual sales of 66,000, and it is that revised standard, not the original budget, that goes into the usage variance.

The overhead formulae in their comprehensive-question form. Variable Overhead Cost Variance = Standard variable cost for actual output – Actual variable cost = $(14,400 \text{ hrs} \times ₹15) - ₹2,17,500 = ₹1,500 \text{ (A)}$. **Fixed Overhead Cost Variance = Absorbed Fixed Overhead – Actual Fixed Overhead** = $(1,800 \text{ units} \times ₹400) - ₹7,68,000 = ₹48,000 \text{ (A)}$. Where the fixed overhead is given as a monthly amount against a normal volume of hours, derive the rate both ways and say which you used: $₹45,00,000 \div 5,000 \text{ units} = ₹900 \text{ per unit}$, or $₹45,00,000 \div 30,000 \text{ hours} = ₹150 \text{ per hour}$ — the two give the same variance.

Comprehensive questions frequently withhold the standard itself and make you derive it from a given variance. The printed chain is worth learning: **Material Price Variance = Standard cost of actual quantity – Actual cost** gives the standard price ($₹12,500 \text{ F} = \text{SP} \times 25,000 - ₹3,12,500$, so **SP = ₹13**); **Material Cost Variance = Standard cost – Actual cost** then gives the standard quantity ($₹1,800 \text{ A} = \text{SQ} \times 13 - ₹3,12,500$, so **SQ = 23,900 kg**); and the actual output follows from the standard yield ($23,900 \times 8 \text{ units} = 1,91,200 \text{ units}$). Never start such a question by guessing the standard — start from the variance that has one unknown.

Where two grades of labour are paid different actual rates against one common standard rate, the rate variance is computed grade by grade and the efficiency variance on the total. In the printed answer the budget is 5,000 hours at ₹50, the revised standard is 4,780 hours at ₹50 = ₹2,39,000, and the actual is skilled 3,000 hours at ₹50 plus semi-skilled 2,000 hours at ₹40 = ₹2,30,000;

Labour Cost Variance = ₹2,39,000 – ₹2,30,000 = ₹9,000 (F) while **Labour Efficiency Variance** = ₹50 × (4,780 – 5,000) = ₹11,000 (A). A favourable cost variance sitting beside an adverse efficiency variance is not a mistake — it is the rate saving outweighing the time overrun, and saying so earns the comment mark.

Idle time inside a comprehensive question. Where 5% of the time paid was lost due to an abnormal reason, deduct it grade by grade to get hours worked (6,000 – 300 = 5,700 and 4,000 – 200 = 3,800, total **9,500 hours worked**), run the **idle time variance at the standard rate** (300 × 20 and 200 × 20 = ₹10,000 A), and run the **efficiency variance on the 9,500 hours worked** — (9,600 – 9,500) × 20 = ₹2,000 (F).

Finish with the totals and the signs. Every printed requirement ends 'indicating whether Favourable or Adverse'. Total the material variances, total the labour variances, state the overhead variances, and check **price + usage = cost** and **rate + efficiency = cost** before you move on; the check costs a line and catches a transposed figure.

Application use the rule - work the problem - 8 questions

- Open with a single table of the standard for actual output — quantity, hours and overhead — and refer back to it in each section rather than recomputing.
- Answer the requirements in the order the question numbers them, even if you computed them in a different order, and label each with its formula.

PQ 8.2 • MTP 2021-Mar [1] (d) {C} • 5M • Pg 736	LEVEL II Application	Easy
PQ 8.4 • PYQ 2024-Sep [4] (a) • 9M • Pg 741	LEVEL II Application	Medium
PQ 8.1 • RTP 2020-Nov [12] • Pg 735	LEVEL II Application	Hard
PQ 8.3 • PYQ 2023-May [5] (a) • 10M • Pg 738	LEVEL II Application	Hard
PQ 8.5 • MTP 2025-Jul [1] (b) • 5M • Pg 744	LEVEL II Application	Hard
PQ 8.6 • PYQ 2026-Jan [4] (a) • 7M • Pg 746	LEVEL II Application	Hard
PQ 8.7 • RTP 2026-May [15] • Pg 747	LEVEL II Application	Hard
PQ 8.8 • PYQ 2026-May [1] (b) {C} • 5M • Pg 749	LEVEL II Application	Hard

Topic 9: Advantages and Criticism of Standard Costing

L2P4-C13-T09

Read first Read ICAI Study Material Chapter 13, Standard Costing — the advantages of standard costing and the criticisms levelled against the system.

NOTES

Five criticisms, each with its name — and each with the rebuttal the printed answer supplies, which is what turns a list into a five-mark answer. **1. Variation in price** — the precise estimation of likely prices or rates to be paid is difficult and the variability of prices is so great that even actual prices are not necessarily adequately representative of cost; but **sophisticated forecasting techniques** cover price fluctuation to some extent, and the system **isolates uncontrollable variances** to be dealt with separately. **2. Varying levels of output** — if the standard level of output is not achieved the standard costs are said not to be realised; but forecasting, market research and the like estimate output with reasonable accuracy, **prime cost is not affected by such variation**, and variance analysis measures the effect of idle time. **3. Changing standard of technology** — standard costing may not suit an industry with frequent technological change; but **standards once set do not always remain stable, they have to be revised**, and cost reduction and cost control remain the cardinal features. **4. Attitude of technical people** — technical people think of standards as physical standards and may be misled by standard costs; but they **can be educated through orientation courses**. **5. Mix of products** — standard costing presupposes a pre-determined combination of products in variety and quantity; but **standards are normally set for a short period**, so changes are taken care of by revision.

Structure matters here: name, criticism, answer to it. Every one of the five paragraphs in the printed answer follows that shape, and a bare list of five complaints with no rebuttal reads as half an answer. If the question asks only for the criticisms, still give the rebuttal in a clause — it shows you know why the system survives them.

The 'means to an end' question is a separate four-mark discussion, and it has its own shape. **The crux of standard costing lies in variance analysis**; the calculation of variances is simple and they are easily expressible, but **they do not provide the detailed analysis needed to exercise control**. It is not enough to know the figures of these variances from month to month; we are required to trace their origin and the causes of their occurrence. A detailed probe into the controllable variances lets management ascertain the amount of the variance, the causes, the responsibility of executives and departments, and the corrective action. Close on the printed sentence: variance gives information; information is the means and the action taken on it is the end.

Where a question asks whether standard costing suits a particular industry, the third criticism is your test. **Frequent technological change** and **an unstable product mix** are the conditions that strain the system, and the answer in each case is **revision of the standards for a short period**, not abandonment. Say which condition the facts show before you conclude.

Analysis break it down and examine the interrelationships · 2 questions

- Where the question asks for **criticism**, give the limitation and then its consequence. A bare list of limitations reads as half an answer.
- On the 'means to an end' statement, the answer is that computing a variance achieves nothing until it is **traced to a cause and a responsible manager** and acted on. Say that first, then illustrate.

TQ 9.2 · MTP 2025-Jul S1 [6] (c) · DESC · 4M · Pg 752

LEVEL II
Analysis

Easy

TQ 9.1 · PYQ 2022-May [6] (d) · DESC · 5M · Pg 750

LEVEL II
Analysis

Medium

Topic 10: Miscellaneous

L2P4-C13-T10

Read first Read ICAI Study Material Chapter 13, Standard Costing — reporting variances, the reconciliation of standard with actual gross margin, and incentive schemes based on hours saved.

NOTES

Material variances run on consumption, and the question will give you a purchase figure to test it. The printed note is explicit — **material variances are calculated on the basis of consumption** — so with 3,20,000 kg purchased at ₹5.20 and **2,96,000 kg used**, the **Price Variance = $2,96,000 \times (\text{₹}5.00 - \text{₹}5.20) = \text{₹}59,200 \text{ (A)}$** and the Usage Variance = $\text{₹}5.00 \times (3,07,200 - 2,96,000) = \text{₹}56,000 \text{ (F)}$, with the standard quantity flexed to the **51,200 units actually completed**.

Watch the two different volumes in the same question. Variances are computed on units produced (51,200) while the income statement is built on units sold (50,000). Using the sales figure for the variances, or the production figure for the sales line, is the trap the question is constructed around.

The income statement runs from standard gross margin to actual gross margin, in this order. **Sales (units sold × selling price); less Standard cost of goods sold (units sold × standard cost per unit); = Standard gross margin; less total adverse variances; add total favourable variances; = Actual gross margin.** The selling price comes from the mark-up rule: a mark-up of 25% on selling price means selling price = standard cost ÷ 0.75 — $\text{₹}46.25 \div 0.75 = \text{₹}61.6667$. List the adverse variances and the favourable ones as two named blocks, so the reconciliation can be read line by line.

The overhead variance in a single-rate question is absorbed against actual hours. **Factory overhead absorbed = Actual hours × Standard factory overhead rate per hour = $1,25,000 \times \text{₹}2.00 = \text{₹}2,50,000$, and Total Factory Overhead Variance = Overhead absorbed – Actual overhead incurred = $\text{₹}2,50,000 - \text{₹}2,80,000 = \text{₹}30,000 \text{ (A)}$.**

An hours-saved bonus is computed against the standard hours for actual output, not against the budget. **Standard hours allowed = $51,200 \text{ units} \times 2.5 \text{ hours} = 1,28,000$; actual hours worked**

1,25,000; hours saved 3,000. Bonus rate = 60% of the standard direct labour rate per hour = $60\% \times ₹4.50 = ₹2.70$, so **bonus payable = $3,000 \times ₹2.70 = ₹8,100$** . If the hours worked exceed the standard hours there are no hours saved and no bonus — say so rather than returning a negative figure.

Application use the rule - work the problem · 1 question

- Compute the variances first, tag each (F) or (A), and only then draft the income statement — the statement simply collects the tagged figures into two blocks.
- Derive the selling price from the mark-up rule on a separate line before the statement; the conversion of a margin on selling price into a divisor is separately marked.

PQ 10.1 · MTP 2025-Dec S2 [5] (a) · DESC · 11M · Pg 753

LEVEL II
Application

Hard

CHAPTER 14

Marginal Costing

8 Topics · 53 Classified Questions · Importance: A

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge **12.0%** 39 of 324 marks

Level II — Analysis & Application **88.0%** 285 of 324 marks

Below the paper's Level I floor: only 12% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for the paper. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Introduction

L2P4-C14-T01

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 14, Marginal Costing — the meaning of marginal cost, contribution and the treatment of fixed cost.

NOTES

Marginal costing charges only the variable cost to the product and treats fixed cost as a period cost. The printed distinction states it in five limbs: the overhead absorption rate **includes only variable manufacturing overhead**; inventory is valued at **prime cost plus variable manufacturing overhead**; overheads are classified as **variable and fixed** (not as factory, administrative, selling and distribution); **fixed costs are regarded as period costs** and written off in full against the period; and the profitability of different products is judged **by their P/V ratio**.

The two lines that run the whole chapter: Marginal income or contribution = Net sales – variable manufacturing cost of goods sold – variable administrative, selling and distribution overhead, and Net operating profit = Contribution – fixed manufacturing overhead – fixed administrative overhead – fixed selling and distribution overhead. Every statement you build in this chapter is that pair of lines in some order, so learn the sequence rather than the arithmetic.

The technique rests on assumptions the answers themselves admit are imperfect. It assumes **all costs can be classified into fixed and variable**, that the **variable cost per unit stays constant** and that the **fixed cost stays constant in total** within a short span of time. The printed limitations say plainly that variable costs do not remain constant per unit once material prices, wage rates or bulk concessions change, and that fixed costs do not remain static from period to period. Say so if the question asks you to criticise the technique.

What the technique is actually used for, in the answers' own words: **short-term profit planning** by B.E.P charts; deciding **how much to produce** through break-even analysis; **more control over expenditure**, because segregating fixed from variable lets actual variable expense be compared with budgeted variable expense; and **decision making** — make or buy, discontinuance of a product, replacement of machines. Those four uses are the bridge into topics 3 to 7.

Topic 2: Advantages and Limitations of Marginal Costing

L2P4-C14-T02

Read first Read ICAI Study Material Chapter 14, Marginal Costing — the advantages and the limitations of the marginal costing technique.

NOTES

Seven advantages, each with the heading the answer prints: **Simplified pricing policy** — marginal cost per unit is constant from period to period within a short span, so firm pricing decisions can be taken; **proper recovery of overheads** — marginal costing avoids the under- or over-recovery that pre-determined fixed overhead rates create; **shows realistic profit** — stock and WIP are carried at marginal cost and fixed expenses are written off as period cost; **how much to produce** — it feeds break-even analysis; **more control over expenditure**; **helps in decision making** — make or buy, discontinuance, replacement of machines; and **short term profit planning** by B.E.P charts. Write the heading, then the one-line reason: the heading alone does not earn the mark.

The nine limitations, and the three the examiner keeps returning to. It is not useful for valuation of inventory; it cannot be applied in a cost plus contract unless a proper percentage over marginal cost is charged to cover fixed cost and profit; and it excludes fixed cost for decision making, which sometimes leads to a wrong conclusion — creating difficulty in inter-firm comparison, higher demand of salaries and large tax payment. Those three head the printed list and are the ones to lead with.

Two limitations carry an example in the printed answer — reproduce the example. It ignores the time factor and investment: the marginal cost of two jobs may be the same, but the job that takes longer and uses a costlier machine truly costs more, and marginal costing does not disclose this. And **the classification into fixed and variable is not always possible:** amenities provided to workers may bear no relation either to volume of production or to time.

The limitation that leads into the decision chapter: contribution of a product is not by itself a guide to optimum profitability unless it is linked with the key factor. This is the same rule that decides every limiting-factor question in topic 7, so it is worth quoting there as well.

The long-run and the WIP provisos. Fixed overheads of a fixed nature cannot altogether be excluded in large contracts while valuing work-in-progress — they have to be included to show the correct position. And **in the long run selling prices should be based on total cost;** a price below

total cost in the short run may lead customers to insist on the reduced price forever, and sales staff may mistake marginal cost for total cost and sell at a loss. The printed answer ends by saying sales staff should be cautioned when given the marginal cost.

Remembering reproduce what you have learnt · 1 question

- The question says 'enumerate' or 'discuss' and the answer is a numbered list. Five or six well-headed points with a line of explanation each will carry a 5-mark question; a continuous paragraph will not.

TQ 2.1 · PYQ 2019-May [6] (e) · DESC · 5M · Pg 760

LEVEL I
Remembering

Medium

Analysis break it down and examine the interrelationships · 1 question

- Give the advantages as **what marginal costing lets management do** — decide, plan, control — rather than as properties of the technique.
- If the question allows, close with one or two limitations. An answer that shows both sides reads as considered rather than recited.

TQ 2.2 · RTP 2025-Jan [19] (a) · DESC · Pg 761

LEVEL II
Analysis

Hard

Topic 3: Cost-Volume-Profit (CVP) Analysis

L2P4-C14-T03

Read first Read ICAI Study Material Chapter 14, Marginal Costing — cost-volume-profit analysis and its use in profit planning.

NOTES

The definition, in the four limbs the answer prints. CVP analysis is a managerial tool showing the relationship between the various ingredients of profit planning, viz., cost, selling price and volume of activity. It is **the analysis of three variables — cost, volume and profit**, it explores the relationship between costs, revenue, activity levels and the resulting profit, and it **aims at measuring variations in cost and volume**. Then list the four impacts on net profit it elucidates: changes in selling prices, changes in volume of sales, changes in variable cost, changes in fixed cost. Those four carry the marks in a 4-mark discussion.

The arithmetic the analysis runs on, in the order the answers set it out: **Contribution = Fixed cost + Profit**; **P/V ratio = (Contribution ÷ Sales) × 100**; **Break-even point = Fixed cost ÷ P/V ratio**; **Margin of safety = Actual sales – Break-even point**. Work down that list in order, because each line uses the answer of the one above it.

When the period shows a loss, contribution is fixed cost MINUS the loss. The printed answer

computes the first half-year as $\text{Contribution} = \text{Fixed cost} + \text{Profit} = ₹13,50,000 + ₹9,00,000 = ₹22,50,000$ and the loss-making second half as **Contribution = Fixed cost - Loss = ₹13,50,000 - ₹4,50,000 = ₹9,00,000**. Adding the loss instead of subtracting it is the single commonest slip on this question type.

Going backwards from contribution to sales: Expected sales volume = Contribution ÷ P/V ratio. In the printed answer the P/V ratio computed for the first half is carried into the second half because the question states that **selling price and fixed expenses remained unchanged** — say that in your working before you reuse the ratio, or you lose the reasoning mark.

Application use the rule - work the problem · 1 question

- Take the requirements in the order the question numbers them. The P/V ratio is always the first thing to establish; nothing else can be computed until it is on the page.

PQ 3.1 · MTP 2025-Jul S1 [1] (c) · 4M · Pg 763

LEVEL II
Application

Medium

Analysis break it down and examine the interrelationships · 1 question

- Two asks: **what CVP analysis is for**, and **the impact of changes in cost and volume on profit**. The second is the larger half — take price, variable cost, fixed cost and volume one at a time.
- For each change, say what happens to **contribution, the P/V ratio and the break-even point** in that order. That triple is the structure the marks follow.

TQ 3.1 · MTP 2026-Mar S1 [6] (Or) (c) · DESC · 4M · Pg 762

LEVEL II
Analysis

Medium

Topic 4: Methods of Break-Even Analysis

L2P4-C14-T04

Read first Read ICAI Study Material Chapter 14, Marginal Costing — break-even analysis, the P/V ratio and the break-even point by formula.

NOTES

The formula set, exactly as the printed answers use it. **Contribution = Sales - Variable cost** and **Contribution = Fixed cost + Profit**; **P/V Ratio = (Contribution ÷ Sales) × 100**; Break-even point (units) = Fixed cost ÷ Contribution per unit; Break-even point (value) = Fixed cost ÷ P/V ratio; Sales to earn a desired profit = (Fixed cost + Desired profit) ÷ P/V ratio; **Profit = Margin of safety × P/V ratio**. State the formula on its own line, then substitute — the answers do, and each line is marked separately.

Where the question gives two years of sales and profit, the ratio comes from the differences: **P/V**

Ratio = (Change in profit ÷ Change in sales) × 100. Then **Fixed cost = Sales × P/V ratio – Profit**, or where the year was a loss, **Fixed cost = Contribution + Loss**. Watch the sign: the printed answer writes the change as $[11,20,000 - (-3,80,000)] \div (2,40,00,000 - 1,80,00,000) = 25\%$. Treating the loss as a positive number is the recurring error corrected across three of these answers.

You cannot start until the cost is split into fixed and variable, and there are two printed routes to the split. From two activity levels, **Variable cost per unit = Difference in total cost ÷ Difference in units** — but where the question gives **average** cost per unit, convert to total cost first ($4,000 \times ₹3.75 = ₹15,000$ and $5,000 \times ₹3.50 = ₹17,500$, so variable cost is ₹2.50 per unit), then **Fixed cost = Total cost – Variable cost = ₹15,000 – ₹10,000 = ₹5,000**; differencing the averages instead of the totals gives a wrong answer that looks plausible. Where instead the cost elements are given as **percentages of cost of goods sold or of cost of sales**, solve by algebra: **COGS = 0.57 COGS + ₹4,51,500** gives ₹10,50,000, and **COS = COGS + (0.04 COS + ₹1,02,000)** gives ₹12,00,000. Selling and distribution overhead is a percentage of **cost of sales**, not of COGS — the two bases are deliberately different.

A desired profit expressed as a percentage of sales must be set up as an equation, not divided. The answers write **18S = 3,75,000 + 9S (20% of 45S)** and solve, or **Sales Value (S) = 0.7S + 12,60,000 + 0.2S**, so **S = 12,60,000 ÷ 0.10**. A profit of 20% **on sales** and a return of 20% **on an investment** are different animals: the second is a fixed rupee figure added to fixed cost, the first is a proportion of the unknown.

When the selling price or a cost changes, recompute contribution per unit and the P/V ratio before you touch the break-even formula. The printed answer goes: revised selling price ₹24 – 10% = ₹21.60; revised contribution ₹21.60 – ₹16 = ₹5.60; revised P/V ratio 25.926%; revised BEP = Fixed cost ÷ revised P/V ratio. The same answer shows the value route and the unit route giving ₹30,85,705 and ₹30,85,711 — a rounding difference, not an error; both are accepted, so say which route you used.

Reading the question backwards from the margin of safety. Given margin of safety in units and in rupees, **Selling price per unit = MOS value ÷ MOS units**; Total sales units = MOS units + Break-even units; **Profit = Total sales – Total cost**; **P/V Ratio = (Profit ÷ Margin of safety) × 100**; **Fixed cost = Break-even sales value × P/V ratio**. Where the margin of safety is given as a percentage, its complement is the break-even ratio: Break-even sales ratio = 100% – margin of safety %, so a 40% margin of safety means break-even sales are 60% of sales.

Choosing between two methods, plants or machines. Build a comparative statement — selling price, less variable cost, contribution per unit, × capacity, total contribution, less fixed cost, profit — and read the recommendation off it. The **cost indifference point** is where the two total costs are equal (a difference in fixed cost of ₹2,00,000 over a difference in variable cost of ₹5 per unit gives 40,000 units), and the printed interpretation is the part that carries the marks: at an activity level below the indifference point, the alternative with lower fixed costs and higher variable costs should be used; above it, the alternative with higher fixed costs and lower variable costs. For equal profit between two companies, write one contribution equation per company — **0.20S = 1,72,000**

+ P and $0.40S = 5,80,000 + P$ — and solve the pair.

Remembering reproduce what you have learnt · 1 question

- Write the formula before the figures on every part. A correct number with no formula above it does not earn the method mark.

PQ 4.11 · RTP 2023-May [13] · Pg 778

LEVEL I
Remembering

Medium

Application use the rule - work the problem · 13 questions

- Answer part by part, in the question's own numbering, and label each part. The examiner marks (i) to (iv) separately, so a wrong fixed cost in (i) does not have to cost you (iii) if your formula and substitution are shown.
- State your P/V ratio to the decimals the answer uses (53.41%, 25.926%, 21.67%) and carry that figure through. Rounding it to a whole number early throws every later line out.

PQ 4.4 · PYQ 2019-Nov [1] (d) {C} · 5M · Pg 769	LEVEL II Application	Easy
PQ 4.5 · PYQ 2021-Jan [1] (a) {C} · 5M · Pg 770	LEVEL II Application	Easy
PQ 4.12 · MTP 2024-Mar [4] (b) · 4M · Pg 780	LEVEL II Application	Easy
PQ 4.6 · PYQ 2021-Jul [1] (d) {C} · 5M · Pg 771	LEVEL II Application	Medium
PQ 4.7 · MTP 2021-Oct [5] (a) · 10M · Pg 772	LEVEL II Application	Medium
PQ 4.10 · MTP 2023-Mar [3] (b) · 10M · Pg 776	LEVEL II Application	Medium
PQ 4.13 · PYQ 2024-May [5] (b) · 4M · Pg 781	LEVEL II Application	Medium
PQ 4.1 · PYQ 2018-Nov [2] (b) · 10M · Pg 764	LEVEL II Application	Hard
PQ 4.2 · MTP 2019-Mar [1] (a) {C} · 5M · Pg 766	LEVEL II Application	Hard
PQ 4.3 · PYQ 2019-May [5] (a) · 5M · Pg 767	LEVEL II Application	Hard
PQ 4.8 · PYQ 2021-Dec [2] (b) · 10M · Pg 774	LEVEL II Application	Hard
PQ 4.9 · PYQ 2022-May [4] (b) · 5M · Pg 775	LEVEL II Application	Hard
PQ 4.14 · PYQ 2026-May [5] (b) · 4M · Pg 783	LEVEL II Application	Hard

Topic 5: Margin of Safety

L2P4-C14-T05

Read first Read ICAI Study Material Chapter 14, Marginal Costing — the margin of safety and the cash break-even point.

NOTES

The definition, as printed: the margin of safety is **the difference between the expected level of sale and the breakeven sales**, and a large margin of safety indicates that there is a higher chance of making profits. Both limbs are asked together in the theory question, so give the definition and the inference.

Three ways to compute it, all used in the printed answers: **Margin of safety = Actual sales – Break-even sales**; **Margin of safety = Profit ÷ P/V ratio**; and in units, **Margin of safety (units) = Profit ÷ Contribution per unit**. Read the other way round, **Profit = Margin of safety × P/V ratio**. As a percentage, **Margin of safety (%) = (Margin of safety ÷ Actual sales) × 100**. Use whichever the data supports and say which you used.

The margin of safety and the break-even point are complements — use that to unlock the sales figure. Where the question gives the margin of safety as a percentage of sales and the fixed cost, the answers write **Sales (S) = Break-even sales + Margin of safety**, so $S = 42,00,000 + 0.25S$ and $S = 42,00,000 \div 0.75 = ₹56,00,000$. Where the margin of safety is 40% of revised sales, the **break-even sales ratio is 60%** and **Revised fixed cost = Revised break-even sales × revised contribution to sales ratio**.

Cash break-even point. **Cash fixed cost = Total fixed cost – Depreciation**, and **Cash BEP (units) = Cash fixed cost ÷ Contribution per unit** — in the printed answer, $(₹10,50,000 - ₹1,90,000) \div ₹50 = 17,200$ units against a normal break-even of 21,000 units. Only the non-cash item named in the question comes out; do not strip anything else out of fixed cost.

Where fixed cost steps up beyond a capacity level, test the step before you compute. The printed answer says in terms: to earn the target profit **the company must exceed 80% capacity, requiring additional fixed costs**, so the new fixed cost is $₹10,50,000 + ₹1,50,000 = ₹12,00,000$, and only then **Required units = (New fixed cost + Desired profit) ÷ Contribution per unit**. **Capacity utilisation = (Required units ÷ Units at 100% capacity) × 100**, and the new margin of safety is required units less the new break-even units — both recomputed on the stepped-up fixed cost.

Building the per-unit figures from a semi-variable cost. The answers take **Variable cost per unit = Direct material + Direct wages + the variable component of the semi-variable cost**; the fixed part of the semi-variable cost = **Total semi-variable cost at that level – (variable rate × units)**; **Total fixed cost = that fixed part + the fixed overheads**; and **Selling price = Variable cost per unit + Contribution per unit**. Do this block as a numbered working note before part (i) — it is where most of the method marks sit.

Application use the rule - work the problem · 5 questions

- Where the question gives the margin of safety and asks for fixed cost or profit, start from Profit = Margin of safety $\times$ P/V ratio. It is the shortest route and the one the answers take.
- Present each requirement under its own numbered head, and show the units answer and the value answer separately when both are asked.

TQ 5.1 · PYQ 2021-Jul [6] (b) · DESC · 5M · Pg 784	LEVEL II Application	Medium
PQ 5.1 · PYQ 2018-May [1] (c) {C} · 5M · Pg 784	LEVEL II Application	Hard
PQ 5.2 · PYQ 2022-Nov [1] (d) {C} · 5M · Pg 786	LEVEL II Application	Hard
PQ 5.3 · PYQ 2023-May [1] (c) {C} · 5M · Pg 787	LEVEL II Application	Hard
PQ 5.4 · PYQ 2026-May [2] (b) · 7M · Pg 788	LEVEL II Application	Hard

Topic 6: Angle of Incidence

L2P4-C14-T06

Read first Read ICAI Study Material Chapter 14, Marginal Costing — the break-even chart and the angle of incidence.

NOTES

The definition is one line and it must name both lines and the point: the angle of incidence is formed by the intersection of the sales line and the total cost line at the break-even point. Anything that does not mention the break-even point has missed the definition.

What the angle measures: it shows the rate at which profits are being earned once the break-even point has been reached, and **the wider the angle the greater is the rate of earning profits**. It is a rate, not an amount — do not describe it as the quantum of profit.

Read it together with the margin of safety. The printed answer closes with the sentence that earns the second mark: a large angle of incidence with a high margin of safety indicates an extremely favourable position. In a two-mark short note give the three bullets in this order — what forms it, what it shows, what a large angle with a high margin of safety indicates.

Remembering reproduce what you have learnt · 1 question

- This is printed as a 2-mark short note. Three short bullets, no introduction — the marks are in the words 'intersection of sales line and total cost line', 'rate at which profits are earned' and 'with a high margin of safety'.

TQ 6.1 · PYQ 2012-May [7] (c) (ii) · SN · 2M · Pg 790

LEVEL I
Remembering

Easy

Topic 7: Application of CVP Analysis in Decision Making

L2P4-C14-T07

Read first Read ICAI Study Material Chapter 14, Marginal Costing — the application of CVP analysis to decisions: make or buy, key factor, accept or reject, shut down and pricing.

NOTES

Identify the relevant costs before you compute anything. The printed answer gives the two principles of estimation: **Variability** — by how much a cost or benefit increases or decreases because of the choice of the option, variable costs differing with volume while fixed costs remain the same irrespective of volume; and **Traceability** — the degree of relationship between the cost and the choice, direct costs being assigned to the option and indirect costs apportioned on some reasonable basis. The working rule that follows: a fixed cost enters the decision only if it is specific to the option and therefore avoidable. Where a question labels some fixed expenses as 'incurred only if this product is manufactured' and another as 'incurred whether any product is made or not', the first two belong to the decision and the third cannot change the answer. In the same way, where the budgeted sales are already achieved all fixed overheads are recovered, so no fixed overhead is chargeable to a special order, and a direct order carries **no sales commission**.

Key factor: rank on contribution per unit of the limiting factor, never on contribution per unit of product. The steps the answers run, in order: compute **contribution per unit**; divide by the units of the scarce resource each product consumes to get **contribution per kg / per litre / per machine hour / per labour hour**; rank; then allocate the resource to rank I up to its demand or capacity ceiling and give the balance to rank II. The trap is printed twice over: one answer has contribution per bottle of ₹160 and ₹190 but contribution per litre of material of ₹20 and ₹19, so the product with the **lower** contribution per bottle wins; another has contribution per unit of ₹17 and ₹16 but contribution per machine hour of ₹8.50 and ₹16. Ranking on contribution per unit is the classic wrong answer.

Make or buy: compare the relevant cost of making with the purchase price. Relevant in-house cost = Direct labour + Direct material + Variable overhead — fixed overhead is excluded, because it is incurred either way; **Saving = Purchase price – Relevant in-house cost**. Where a component's in-house cost exceeds the purchase price, outsource it entirely. Where labour or another resource is scarce, rank the components by **saving per labour hour** and make in the order of that ranking until the hours run out. Where making more requires a machine and a step in fixed overhead, the step has to be earned: **minimum additional quantity = Additional fixed overhead ÷ Saving per unit** — ₹7,500 ÷ ₹0.0375 = 2,00,000 cans in the printed answer.

Accept or reject a special order: the test is incremental contribution, and then capacity. Build a statement of contribution on the order alone — order revenue less the variable costs the order

actually causes (including any batch-level cost at the order's own batch configuration, and any additional shipping or packaging cost). With spare capacity and no increase in fixed cost, accept if contribution is positive. Where capacity is short, deduct the contribution lost on the regular sales displaced: the printed answer gains ₹1,12,500 on the order but loses ₹1,74,000 of regular contribution, a net loss of ₹61,500, so it rejects. Two qualitative points recur and both are marks: an order at a discount to a **local** customer may damage the existing market at the full price, where an export customer would not; and the offer price is judged against the **relevant** cost, not the total cost struck under the company's normal absorption policy.

Shut down: compare the loss if you continue with the loss if you close. Set the two columns side by side — contribution earned if continued against nil, and against each the fixed cost that will actually be borne, which on shutdown is **fixed cost – fixed cost avoided + additional shut-down costs** (₹4,20,000 – ₹2,50,000 + ₹25,000 = ₹1,95,000 in the printed answer). Shut down if the loss is lower. Shut-down point (units) = (Fixed cost if continued – Fixed cost if shut down) ÷ Contribution per unit — (₹4,20,000 – ₹1,95,000) ÷ ₹3 = 75,000 units. Close with the printed caveat: the company **should consider many other factors before finally deciding**.

Minimum price and relevant cost quotations. The rules the minimum-price answer applies, in the order it applies them: **costs already incurred and progress payments already received are ignored** — they are sunk; **material already in stock is charged at its replacement value** if it would otherwise be used elsewhere; labour in a department that is extremely busy carries the contribution forgone as well as its wage, at the rate the question gives (₹3 of contribution per rupee of direct wages); **opportunity costs of alternatives given up are added** (the scrap realisation and the sale value of the drawings); and **savings from an alternative use of a part removed are deducted**, net of the cost of dismantling it. Fixed overhead absorbed at a percentage of direct wages is not part of a minimum price.

Sales mix and the choice between capacity levels. For a fixed mix, the answers strike a composite contribution per unit = Σ (contribution per unit $\times$ that product's fraction of the mix) — (₹40 $\times$ 5/8) + (₹50 $\times$ 3/8) = ₹43.75 — then **Break-even units = Fixed cost $\div$ composite contribution**, split back in the mix ratio. For a choice of capacity level or of process, prepare a comparative profitability statement at each level: contribution per unit $\times$ units, less fixed cost, profit — and note that the answer to 'which process' changes when the capacities change, so answer on the capacity the question actually gives in that part.

Remembering reproduce what you have learnt · 2 questions

- Decision questions turn on **relevant cost**. State the test — the cost must differ between the alternatives and must be a future cash cost — before you compute anything.
- Where the question says SUGGEST or STATE, a recommendation is required. Give the figure, then the recommendation in a separate sentence, so the examiner can find it.

PQ 7.2 · MTP 2018-Aug [1] (c) {C} · 5M · Pg 793

LEVEL I
Remembering**Easy****Understanding** explain it, and place it in context · 2 questions

- State the decision rule before the figures — 'accept if incremental contribution is positive and capacity is spare', 'rank by contribution per unit of the key factor'. The rule is a mark on its own.

PQ 7.6 · PYQ 2022-May [1] (c) {C} · 5M · Pg 799

LEVEL I
Understanding**Medium**

PQ 7.25 · MTP 2026-Apr S2 [2] (a) · 7M · Pg 834

LEVEL I
Understanding**Medium****Application** use the rule - work the problem · 20 questions

- Lay the answer out as a statement with the alternatives as columns, not as loose arithmetic. Contribution per unit, units, total contribution, fixed cost, profit — in that order.
- Show the working note that derives the per-unit variable rates (direct material per unit, direct labour per unit) before the main statement. Several printed answers mark that note separately.

PQ 7.15 · PYQ 2025-May [1] (a) {C} · 5M · Pg 815

LEVEL II
Application**Easy**

PQ 7.18 · PYQ 2025-Sep [1] (a) {C} · 5M · Pg 822

LEVEL II
Application**Easy**

PQ 7.22 · PYQ 2026-Jan [5] (c) · 3M · Pg 827

LEVEL II
Application**Easy**

PQ 7.1 · PYQ 2018-May [5] (b) · 10M · Pg 791

LEVEL II
Application**Medium**

PQ 7.3 · PYQ 2019-Nov [5] (a) · 10M · Pg 794

LEVEL II
Application**Medium**

PQ 7.4 · PYQ 2021-Jan [3] (a) · 10M · Pg 796

LEVEL II
Application**Medium**

PQ 7.8 · PYQ 2024-May [3] (a) · 7M · Pg 801

LEVEL II
Application**Medium**

PQ 7.10 · PYQ 2024-Sep [5] (b) · 7M · Pg 804

LEVEL II
Application**Medium**

PQ 7.11 · RTP 2024-Sep [17] · Pg 808

LEVEL II
Application**Medium**

PQ 7.12 · PYQ 2025-Jan [1] (a) (i) (ii) {C} · 5M · Pg 810

LEVEL II
Application**Medium**

PQ 7.13 · PYQ 2025-Jan [3] (b) · 6M · Pg 811

LEVEL II
Application**Medium**

PQ 7.14 · RTP 2025-Jan [17] · Pg 812

LEVEL II
Application**Medium**

PQ 7.17 · MTP 2025-Jul S1 [4] (a) · 6M · Pg 820

LEVEL II**Medium**

	Application	
PQ 7.19 • PYQ 2025-Sep [3] (b) • 6M • Pg 823	LEVEL II Application	Medium
PQ 7.24 • MTP 2026-Mar S1 [4] (a) • 7M • Pg 831	LEVEL II Application	Medium
PQ 7.26 • PYQ 2026-Sep [1] (a) {C} • 7M • Pg 836	LEVEL II Application	Medium
PQ 7.5 • PYQ 2021-Jan [3] (b) • 10M • Pg 797	LEVEL II Application	Hard
PQ 7.16 • RTP 2025-May [18] • Pg 817	LEVEL II Application	Hard
PQ 7.20 • RTP 2025-Sep [16] • Pg 824	LEVEL II Application	Hard
PQ 7.21 • PYQ 2026-Jan [1] (a) {C} • 5M • Pg 826	LEVEL II Application	Hard

Analysis break it down and examine the interrelationships • 1 question

- Where there are two products or two plants, take them one at a time and say in a sentence why each is or is not chosen, then give the combined figure.

PQ 7.9 • PYQ 2024-Sep [1] (c) {C} • 4M • Pg 803	LEVEL II Analysis	Hard
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Evaluation judge it against the standard • 2 questions

- Finish with the recommendation in words — accept, reject, make, buy, shut down — and add the qualitative caveat the answers add (effect on the local market, other factors before closing a plant). A page of correct figures with no conclusion loses the decision mark.

PQ 7.7 • PYQ 2023-Nov [4] (b) • 5M • Pg 800	LEVEL II Evaluation	Medium
PQ 7.23 • RTP 2026-Jan [17] • Pg 828	LEVEL II Evaluation	Hard

Topic 8: Distinction Between Marginal and Absorption Costing

L2P4-C14-T08

Read first Read ICAI Study Material Chapter 14, Marginal Costing — the distinction between marginal and absorption costing and the reconciliation of the two profits.

NOTES

Eight bases of distinction, and the examiner wants them tabulated. Manufacturing overhead rate — absorption includes both fixed and variable, marginal only variable; **valuation of inventory**

— prime cost plus applied fixed and variable manufacturing overheads against prime cost plus variable manufacturing overhead; **classification of overhead** — factory, administrative, selling and distribution against variable and fixed; **operating profit** — gross profit against contribution; **net operating profit**; **effect of stock valuation** — the magnitude of opening and closing stock affects the unit cost of production under absorption but **does not** under marginal; **decision making** — absorption **distorts** it, marginal **aids** it; and **profitability** — under absorption each product bears a share of fixed cost so profitability is influenced by the apportionment, under marginal fixed costs are period costs and profitability is judged by the **P/V ratio**. Write it as a three-column table: basis, absorption, marginal.

Build the full production cost per unit first — both statements depend on it. Direct material + direct labour + variable production overhead = **total variable cost** (₹480 + ₹360 + ₹540 = ₹1,380), then + fixed production overhead per unit = **full production cost** (₹1,480). The fixed rate comes from the budget, not the actual: **Absorption rate = Budgeted fixed production overhead ÷ Budgeted normal output** = ₹60,00,000 ÷ 60,000 units = ₹100 per unit. Using actual output to set the rate is the commonest error here.

The absorption costing statement, in the order the answer prints its rows: Sales units × selling price = **Sales value (A)**; then cost of goods sold — Opening stock at ₹1,480 + Production cost at ₹1,480 – Closing stock at ₹1,480; then **Under/(over) absorption**; then **Add: fixed selling overheads**; = **Cost of sales (B)**; **Profit = A – B**. Stock is valued at the **full** production cost including the fixed element.

Under- or over-absorption is a separate line and it must be signed correctly. Under/(over) absorption = Actual fixed production overhead – Overhead absorbed (units produced × rate per unit). Under-absorption is **added** to cost of sales; over-absorption is **deducted** and the answers show it in brackets. Note that it is driven by **production** units, not sales units.

The marginal costing statement is shorter and its rows are fixed: Sales value, **less variable production cost at ₹1,380**, = **Contribution**, **less fixed production overheads** (the whole actual figure, ₹5,00,000 a month — no absorption rate, no under-recovery), **less fixed selling overheads**, = **Profit**. Because the whole period's fixed production overhead is written off, there is no under- or over-absorption line at all.

The reconciliation is a three-line statement and only the fixed production overhead in stock moves. Profit under absorption costing + (Opening stock units × fixed overhead per unit) – (Closing stock units × fixed overhead per unit) = Profit under marginal costing. In the printed answer April adds nil and deducts 400 × ₹100; May adds 400 × ₹100 and deducts 300 × ₹100. The stock figures come from a separate working: **Opening stock + Production – Sales = Closing stock**, carried month to month.

The rule the reconciliation demonstrates, which is what a theory follow-up asks for: when **production exceeds sales** stock rises, fixed overhead is carried forward in that stock, and **absorption profit is higher**; when sales exceed production the reverse. **Fixed selling overhead never enters stock under either method** — only fixed **production** overhead does, so it is the only

figure that appears in the reconciliation.

Understanding explain it, and place it in context · 1 question

- A distinguish question: **answer in matched pairs or a two-column table**, the same point of comparison on both sides of each row.
- Cover the treatment of fixed cost, stock valuation, the effect on profit when stock changes, and the purpose each serves. The stock-valuation row is the one that carries the reconciliation mark.

TQ 8.1 · PYQ 2020-Nov [6] (e) · DB · 5M · Pg 838

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 1 question

- Do the three requirements in the order asked and keep one column per month. The reconciliation in (iii) must tie to the figures you produced in (i) and (ii); if they do not tie, say so and show which stock line caused it.
- Put the full production cost per unit, the stock movement and the under/over absorption in numbered working notes before the statements. Each is separately marked.

PQ 8.1 · MTP 2024-Mar [4] (a) · 10M · Pg 840

LEVEL II
Application

Hard

CHAPTER 15

Budgets and Budgetary Control

9 Topics · 43 Classified Questions · Importance: B

ICAI SKILL PROFILE ICAI band for this paper: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge **15.7%** 42 of 268 marks

Level II — Analysis & Application **84.3%** 226 of 268 marks

Below the paper's Level I floor: only 16% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for the paper. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Essential Characteristics of Budget

L2P4-C15-T01

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 15, Budgets and Budgetary Control — what a budget is, the budget period and the budget manual.

NOTES

A budget is a plan, and the printed answers define it by what it contains. It is 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, drawn up to achieve objectives determined in advance and the policies adopted for them. Two things make it a budget rather than a forecast: it is **prior to** the period it covers, and it is expressed in **both** quantity and money.

The budget period is the period covered by the budget. The answers are explicit that **there is no general rule governing the selection of the budget period**: a calendar or financial year budget is often divided into shorter periods — monthly or quarterly, or for such periods as coincide with a period of trading activity of the business. Quote that last phrase; it is the part students drop.

The budget for the business as a whole and the budgets that make it up. The policy of a business for a defined period is represented by the Master Budget, and its detailed components are presented through a number of individual budgets known as Functional Budgets. That sentence is the hinge between this topic and topic 6, and it is worth opening any budgeting theory answer with it.

The budget manual is the document that makes the system work. It is a document which sets out the responsibility of the persons engaged in, the routine, and the forms and records required for budgetary control. Where a question asks what a budget is in a wider sense, the manual, the

budget period and the master/functional split are the three things the printed answers actually supply.

Topic 2: Essential Steps for Preparing Budget

L2P4-C15-T02

Read first Read ICAI Study Material Chapter 15, Budgets and Budgetary Control — the steps in establishing a budgetary control system.

NOTES

Five steps, and the question is marked on the sequence. (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.

The order runs objectives → activities → plan → comparison → corrective action. Steps 1 to 3 are the **design** of the system, step 4 is **implementation** of the reporting, step 5 is **monitoring**. When the question is framed as a consultant asked to 'design, implement and monitor', map your five steps onto those three words explicitly — it is the same list, and the mapping shows you have read the question.

Step 4 carries the responsibility idea and step 5 the control idea. The comparison is **by each person or department**, not for the business as a whole, and the **causes** of variation must be determined, not merely the amounts. Step 5 has two limbs and both are marked: corrective action first, and **revision of the plan** only if corrective action is not possible.

Answer as a numbered list, not as prose. The printed answer is five numbered sentences, and a 5-mark question is one mark a step. Do not pad the answer with the advantages of budgeting — that is a different question.

Synthesis integrate the material and construct · 1 question

- The question asks you to **design a system**, so the answer must be a sequence — define the centres, fix the budget period and the key factor, prepare the budgets, then compare, report and act.
- End with the monitoring loop. A design that stops at preparation has answered only half the question.

Topic 3: Budgetary Control

L2P4-C15-T03

Read first Read ICAI Study Material Chapter 15, Budgets and Budgetary Control — the budgetary control system, its components, its limitations and feedback versus feedforward control.

NOTES

The definition, verbatim: a budgetary control system is a system of management control and accounting under which all operations are forecasted and planned in advance, to the extent possible, and the actual results are compared with the forecasted and planned results. Note the three elements — forecast, plan in advance, compare with actual.

Four components, asked twice in the printed papers and answered the same way both times.

Physical budgets — information in quantitative terms, such as quantity of sales, quantity of production, inventories and manpower. **Cost budgets** — cost information for manufacturing, administration, selling and distribution, and research and development. **Profit budgets** — those that enable ascertainment of profit, such as the sales budget and the profit and loss budget.

Financial budgets — those that facilitate ascertaining the financial position, such as the cash budget, the capital expenditure budget and the budgeted balance sheet. Give the head, then an example; the examples are where the marks are.

Six limitations, each with a one-line head. Based on estimates — budgets rest on conditions prevailing or expected when the budget was established and need revision if conditions change.

Time factor — budgets cannot be executed automatically and management must not expect too much during the initial development period. **Co-operation required** — staff co-operation is usually not available at the start, and in a decentralised organisation each unit has its own objective.

Expensive — it consumes qualified manpower and equipment. **Not a substitute for management** — it is only a managerial tool. **Rigid document** — budgets are sometimes treated as rigid, but a budget should be **flexible enough to incorporate ongoing developments** in the internal and external factors affecting it.

Feedback and feedforward are distinguished by timing, and the two Latin tags are the marks.

Feedback control collects the actual results for the budgeted period and compares them with the budgeted figures; **variances are identified after completion of the budget period**; it is an **ex-post corrective control system**, common where the MIS is not very robust and data comes only after the books are finalised, and **inexpensive to maintain**. **Feedforward control** is its opposite: an **ex-ante preventive control mechanism** in which budgets are set at the beginning and **actual results are continuously monitored** against them, targets kept realistic and reset if necessary; it **requires a robust MIS supported by an integrated ERP system** and, though **expensive**, suits an organisation in a **dynamic business environment**.

Do not confuse the four components with the classifications in topics 5 and 6. The components question is answered with physical / cost / profit / financial; the capacity question with fixed / variable / flexible; the functions question with sales, production, material, labour, overhead, cash and master. Three different lists, three different questions — the printed papers ask all three.

Remembering reproduce what you have learnt · 1 question

- Learn the four components with one example each. The 4-mark and 5-mark versions of this question differ only in how much you write about each head, not in the heads themselves.

TQ 3.1 · PYQ 2021-Jan [6] (b) · DESC · 5M · Pg 848

LEVEL I
Remembering

Medium

Analysis break it down and examine the interrelationships · 3 questions

- Name the **components** before describing them, and keep the count the question asks for. Where it asks for four, give four.
- On feedback and feedforward, the distinction is **when** the comparison is made — after the event against actuals, or before it against a forecast. Lead with that, then illustrate each.

TQ 3.3 · PYQ 2024-May [5] (c) · DESC · 4M · Pg 850

LEVEL II
Analysis

Easy

TQ 3.4 · PYQ 2026-Jan [6] (Or) (c) · DESC · 4M · Pg 851

LEVEL II
Analysis

Easy

TQ 3.2 · PYQ 2021-Dec [6] (d) · DESC · 5M · Pg 849

LEVEL II
Analysis

Medium

Topic 4: Preparation of Budget

L2P4-C15-T04

Read first Read ICAI Study Material Chapter 15, Budgets and Budgetary Control — the budget manual, the budget period and the preparation of the functional budgets.

NOTES

Budget manual — give the formal definition first, then the contents. It is a document which sets out the responsibilities of the persons engaged in, the routine of, and the forms and records required for, budgetary control; it is also described as a collection of documents that contains key information for those involved in the planning process. Salient features to list: a statement of the **objectives** of the organisation and how budgetary control will achieve them; the **functions and responsibility of each executive** for preparation and execution; the **procedure for obtaining approval** and who may grant it; an **organisation chart** showing who prepares each functional budget and how the budgets interrelate; a **timetable** for the preparation of each budget; the

manner of **scrutiny** and who carries it out; the **reports, statements and forms** to be maintained; the **accounts classification**, which must be identical in the accounts department and the budget department; the **reporting of remedial action**; the manner of **revision or amendment** after acceptance; and a list of **account codes**. The timetable exists to **prevent a bottleneck where one late budget holds up all the others**.

Budget period — the period covered by the budget, with **no general rule governing its selection**, commonly broken into monthly or quarterly sub-periods or periods coinciding with a period of trading activity. It is set as a 2-mark definition, so two sentences are enough.

The practical questions here are functional-budget builds, and they run in a fixed chain. Sales → production → material consumption → material purchases → wages. The two anchor formulae: **Production (units) = Sales + Closing stock – Opening stock** and **Purchases = Consumption + Closing stock – Opening stock**. Prove the annual total in a working note before you split it by quarter — the printed answer computes total production as Sales for four quarters + closing balance – opening balance and then checks that the four quarterly figures add back to it.

Where the question gives a production pattern, the pattern replaces the stock formula — do not apply both. Production in the current quarter = 75% of the current quarter's sales + 25% of the next quarter's sales, and the **closing stock of the current quarter is that 25% of the next quarter's sales**. For the last quarter, the "25% of next quarter" line is the given closing stock of finished goods at the year end. Set the two component lines out separately and total them; the marks follow the two lines.

Closing stock expressed in days must be converted before it can be used. Budgeted period in days = weeks × days per week (13 weeks × 5 days = 65 days); Closing stock = (Period sales ÷ days in period) × the stated number of days, **rounded up**; the same for material, using daily consumption = total consumption ÷ days in period. The printed answers round up to the next whole unit or kilogram and say so.

The wages budget has four steps and the order of the last two decides the answer. (1) Total standard hours for budgeted production = units to be produced × standard hours allowed per unit. (2) **Productive hours = Standard hours ÷ efficiency (productivity) ratio** — $25,562 \div 0.85 = 30,072.94$. (3) Add non-productive downtime at the stated percentage of the productive hours worked — $15\% \times 30,072.94$ — to get total labour hours required. (4) Overtime hours = Total labour hours required – Normal hours (workers × weeks × days × 8 hours), and **Wages = Normal hours × basic rate + Overtime hours × (basic rate + premium)** — ₹9 plus a 60% premium is ₹14.40. Downtime is a percentage of productive hours **worked**, so it is added **after** the efficiency gross-up, never built into it.

An expense budget at other volumes is a split-and-flex exercise. Convert each stated percentage into a per-unit fixed and a per-unit variable amount **at the budgeted volume** — selling expenses ₹15 per unit at 20% fixed gives fixed ₹3 × 20,000 = ₹60,000 and variable ₹12 per unit; distribution ₹12 per unit at 85% variable gives fixed ₹1.80 × 20,000 = ₹36,000 and variable ₹10.20. Then hold the fixed total constant across all volumes and flex only the variable per-unit figure, and show the

fixed and variable halves of a mixed expense on two separate lines.

Remembering reproduce what you have learnt · 2 questions

- For the budget manual, ten listed features will carry a 5-mark question; give the definition first, then the list. For the 2-mark definitions, two sentences and stop.

TQ 4.2 · PYQ 2024-Sep [6] (b) · DESC · 2M · Pg 852

LEVEL I
Remembering

Easy

TQ 4.1 · PYQ 2022-Nov [6] (d) · DESC · 5M · Pg 851

LEVEL I
Remembering

Medium

Application use the rule - work the problem · 4 questions

- Label each budget with its own heading and state the unit of measure — 'Production Budget (in units)', 'Raw material purchase budget (in quantity)', '(in value)'. The question asks for them separately and they are marked separately.
- Put the days conversion, the closing stock computation and the production budget in numbered working notes. Every printed answer does, and the purchases and wages budgets both draw on them.

PQ 4.2 · MTP 2025-Dec S2 [3] (a) · 9M · Pg 856

LEVEL II
Application

Medium

PQ 4.3 · RTP 2026-Jan [18] · Pg 859

LEVEL II
Application

Medium

PQ 4.4 · MTP 2026-Mar S1 [2] (b) · 6M · Pg 862

LEVEL II
Application

Medium

PQ 4.1 · RTP 2025-Sep [17] · Pg 853

LEVEL II
Application

Hard

Topic 5: Classification on the Basis of Capacity or Flexibility

L2P4-C15-T05

Read first Read ICAI Study Material Chapter 15, Budgets and Budgetary Control — classification by capacity: fixed, variable and flexible budgets.

NOTES

Definition of a flexible budget, in the two forms the answers print. It is a budget which, by recognising the difference in behaviour between fixed and variable costs in relation to fluctuations in output, turnover or other variable factors, is designed to change appropriately with such fluctuations; and per CIMA, a budget which, by recognizing the difference between fixed, semi-variable and variable costs, is designed to change in relation to the level of activity attained. The contrast that follows is the mark: unlike static (fixed) budgets, flexible budgets show the expected

results of a responsibility centre for different activity levels.

Fixed versus flexible — four points of difference, tabulated. (1) A fixed budget **operates on one level of activity and under one set of conditions** and assumes no change in prevailing conditions, **which is unrealistic**; a flexible budget **consists of various budgets for different levels of activity**. (2) Under a fixed budget all costs relate to one activity level, so **variance analysis does not give useful information**; under a flexible budget **each cost is analysed according to its behaviour**. (3) If budgeted and actual activity levels differ significantly, a fixed budget gives a wrong picture for **cost ascertainment and price fixation**; flexible budgeting facilitates ascertainment of cost, fixation of selling price and tendering of quotations. (4) Comparison of actual with budget is **meaningless** under a fixed budget when the two activity levels differ; a flexible budget **provides a meaningful basis of comparison**.

When flexible budgeting is resorted to, and where it is suitable — two separate lists, and questions ask for either. **Situations:** a **new business venture** where demand cannot be forecast accurately; a business **dependent upon the mercy of nature**, where demand depends on climatic conditions; a **labour-intensive industry** where production depends on the availability of labour. **Suitability:** **seasonal fluctuations in sales and/or production** (soft drinks); a company that **frequently introduces new products or changes their design**; **make-to-order** industries (shipbuilding); an industry **influenced by changes in fashion**; and **general changes in sales**. Name the industry given against each — the printed answers do.

Four advantages, where the question asks you to recommend flexible budgeting to management. Sales, costs and profit can be **calculated easily at various levels of production capacity**; **adjustment is simple as business conditions change**; it **helps determine the production level**, since budgeted costs are shown by behaviour at various activity levels alongside sales, so management can select the level that yields the predetermined profit; and it **shows the quantity to be produced to earn a determined profit**.

The format: activity levels across the columns, behaviour down the rows. Production (units); Sales at the selling price; **Variable cost** at the variable rate per unit; **Contribution (A)**; then the fixed costs listed one by one — including the **fixed part of any semi-variable cost on its own line**; **Total fixed cost (B)**; **Operating profit (A – B)**. Where the question asks only for total cost, drop the contribution line but keep the variable and fixed blocks separate.

Stepped fixed costs are the trap in nearly every printed answer. A fixed expense 'estimated to increase by 25% **at and above** 80% capacity' stays at ₹1,00,000 for 60% and becomes ₹1,25,000 at **both** 80% and 100%; an advertising cost incurred only **above** 80% capacity appears at 90% and nowhere else. Other costs step by slab: transport at ₹4,000 per truck of 4,000 units capacity, bus hire per bus of 50 usable seats, block entrance fees and prize money that change at stated bands of numbers. Read the band wording — 'at and above', 'above', 'upto 300', '301–900' — and apply the band the level falls in. Flexing a step cost proportionately is the classic wrong answer.

Splitting a semi-variable cost from period data: **Variable cost per unit = Change in cost ÷ Change in activity**, and **Fixed cost = Total cost at a level – (variable rate × units at that level)**. Two

cautions from the printed answers: use a pair of periods whose only difference is volume; and where the variable rate itself changes above a threshold (labour cost 50% higher above 19,000 units), show the **overtime premium on the excess units as a separate line** rather than rebuilding the rate — $2,000 \text{ units} \times ₹9 \times 0.50 = ₹9,000$. Where the variable element of a cost is a function of **sales** and the rest a function of **production**, split them on their own bases.

Remembering reproduce what you have learnt • 1 question

- The ask is **when a flexible budget is suitable**, so every point must be a circumstance of the business, not a property of the budget.
- Seasonal demand, a new product with uncertain volume, output governed by an outside factor, and a business whose costs are largely variable are the cases the printed answers give.

TQ 5.1 • PYQ 2019-May [6] (b) • DESC • 5M • Pg 863

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context • 1 question

- Where the question describes a company whose actuals overshoot a fixed budget, name flexible budgeting, define it, and then give at least three advantages. The definition before the advantages — the marks are allocated that way.

TQ 5.4 • MTP 2025-Dec S2 [6] (Or) (c) • DESC • 4M • Pg 866

LEVEL I
Understanding

Easy

Application use the rule - work the problem • 19 questions

- Write the activity levels as column headings in the order the question asks for them, even if that is 80%, 60%, 100%. Convert the percentage into units first and show the conversion.
- Show the per-unit variable rate beside each variable line and the basis beside each fixed line. An unlabelled column of figures cannot be given method marks.

PQ 5.1 • PYQ 2020-Nov [1] (a) {C} • 5M • Pg 866

LEVEL II
Application

Easy

PQ 5.2 • PYQ 2021-Dec [1] (b) {C} • 5M • Pg 867

LEVEL II
Application

Medium

PQ 5.3 • RTP 2022-May [13] • Pg 869

LEVEL II
Application

Medium

PQ 5.4 • PYQ 2024-Sep [3] (b) • 6M • Pg 872

LEVEL II
Application

Medium

PQ 5.5 • RTP 2025-Jan [18] • Pg 873

LEVEL II
Application

Medium

PQ 5.6 • PYQ 2025-May [5] (c) • 7M • Pg 874

LEVEL II
Application

Medium

PQ 5.7 • RTP 2025-May [19] • Pg 876	LEVEL II Application	Medium
PQ 6.4 • PYQ 2023-May [3] (a) • 10M • Pg 887	LEVEL II Application	Medium
PQ 6.6 • PYQ 2023-Nov [2] (b) • 10M • Pg 892	LEVEL II Application	Medium
PQ 6.7 • MTP 2024-Jul [5] (a) • 7M • Pg 894	LEVEL II Application	Medium
PQ 6.8 • RTP 2024-Sep [18] • Pg 897	LEVEL II Application	Medium
PQ 6.9 • MTP 2024-Nov [4] (b) • 8M • Pg 899	LEVEL II Application	Medium
PQ 6.12 • PYQ 2026-Sep [2] (a) • 7M • Pg 905	LEVEL II Application	Medium
PQ 6.1 • PYQ 2018-Nov [5] (a) • 10M • Pg 881	LEVEL II Application	Hard
PQ 6.2 • PYQ 2021-Jul [5] (b) • 10M • Pg 883	LEVEL II Application	Hard
PQ 6.3 • PYQ 2022-May [3] (a) • 10M • Pg 884	LEVEL II Application	Hard
PQ 6.5 • MTP 2023-Sep [3] (b) • 10M • Pg 890	LEVEL II Application	Hard
PQ 6.10 • PYQ 2025-Sep [4] (a) • 9M • Pg 902	LEVEL II Application	Hard
PQ 6.11 • PYQ 2026-May [4] (a) • 9M • Pg 903	LEVEL II Application	Hard

Analysis break it down and examine the interrelationships • 1 question

- A distinguish question between fixed and flexible budgets. **Set them side by side on the same points** — the level of activity assumed, whether it is re-cast, what it can be used to control, and when each is useful.
- Do not open by defining both at length. The marks are in the contrast, so get to the pairs quickly.

TQ 5.3 • RTP 2025-Sep [18] (c) • DESC • Pg 865	LEVEL II Analysis	Medium
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Evaluation judge it against the standard • 1 question

- The facts describe a fixed budget failing, and the ask is what to do about it. **Diagnose first, then recommend** — say why a fixed budget could not absorb the change before you propose the flexible one.
- Support the recommendation with the mechanism: costs split into fixed, variable and semi-variable, and the budget re-cast at the level actually achieved. A recommendation with no mechanism behind it is an opinion.

Topic 6: Classification on the Basis of Functions

L2P4-C15-T06

CONCEPT BASE — no exam question asked yet · essential for full preparation**Read first** Read ICAI Study Material Chapter 15, Budgets and Budgetary Control — classification by function: the sales, production, material, labour, overhead, cash and master budgets.

NOTES

The functional budgets are the detailed components of the master budget, and every printed answer builds them in the same chain. Sales budget → production budget → material consumption budget → material purchase budget → wages budget → cash budget. Sales comes first because the sales quantity drives production; the only time it does not is when the question names another constraint — limited labour hours or limited material — in which case the **limiting factor fixes the production mix first** and the sales budget is built on what can be made.

Sales budget = quantity × selling price per unit, set out product by product and month by month (or channel by channel), with a total column. Two things to watch: where the goods are **sold through dealers at a discount**, the sales budget uses the **net price** — ₹2,000 less 15% = ₹1,700; and where the question gives a price change and a percentage growth and an additional campaign volume, apply them in the order stated — **budgeted units × (1 + growth %) + additional campaign units**, at the **revised price**.

Production budget (units) = Sales quantity + Closing stock – Opening stock, one column per month or quarter. Where the closing stock is a percentage of the next period's sales, that percentage **is** the closing stock line, and **each month's closing stock becomes the next month's opening stock** — which is why the last month needs the year-end figure the question gives. Where instead a **production pattern** is given (80% of the current quarter's sales plus 20% of the next quarter's), show the two components on separate lines and total them.

Rejection and wastage are divided, not multiplied. Good units required = Sales + increase in finished stock; Units to be produced = Good units ÷ (1 – post-production rejection rate) — $28,320 \div 0.96 = 29,500$. On material, **Material needed for production = units to be produced × usage per completed unit (net of wastage)**, then **Material to be purchased = Material needed ÷ (1 – wastage %)** — $1,47,500 \div 0.90 = 1,63,889$ kg. Grossing up by multiplying by 1.04 or 1.10 is the classic wrong answer and it is wrong by the whole of the second-order effect.

Material budgets in two stages, and the examiner asks for them separately. Consumption budget (quantity) = units to be produced × material per unit, quarter by quarter. **Purchase budget (quantity) = Consumption + Closing stock of material – Opening stock of material. Purchase budget**

(value) = quantity × rate per kg — and where the question buys stated percentages of the annual requirement in different quarters at different prices, apportion the **purchase** quantity by those percentages and value each slice at its own rate. Do not value the consumption quantity.

Wages budget: Total standard hours = units to be produced × standard hours allowed per unit;
Productive hours required = Standard hours ÷ efficiency ratio; add non-productive downtime at the stated percentage of productive hours worked; **Overtime hours = Total hours to be paid – Normal hours**, where normal hours are **workers × weeks × hours per week** at the threshold the question states (40 hours a week, or 45); **Wages = Normal hours × rate + Overtime hours × rate × (1 + premium)** — at ₹25 with a 50% premium the overtime rate is ₹37.50. The overtime threshold is a **weekly** figure, so multiply it by the number of weeks, not by the days.

The cash budget is a receipts-and-payments statement and nothing else goes in it. Rows: receipts (collections from debtors by their lag — 50% one month after sale and 50% two months after — plus capital receipts such as the sale of a property in the month received); payments (creditors for materials at their lag, variable overheads in the month following production, wages split 75% in the month of production and 25% the following month, capital payments and tax in the month of payment); then **Net cash flow**, **Balance b/f** and **Cumulative cash flow**. **Depreciation never appears in a cash budget** — the printed question gives a depreciation figure and the printed answer has no line for it. Build the debtor collections, the overhead payments and the wage payments as three separate working tables before the budget itself; the lags are what the marks are for.

Topic 7: Zero Based Budgeting (ZBB)

L2P4-C15-T07

Read first Read ICAI Study Material Chapter 15, Budgets and Budgetary Control — zero based budgeting, its stages and its advantages.

NOTES

Definition, verbatim: zero-based budgeting is a method of budgeting which requires each cost element to be specifically justified, although the activities to which the budget relates are being taken for the first time without approval, the budget allowance is zero. The operative idea is that budgets are prepared as if for the first time, without reference to previous budgets — no line carries forward simply because it was there last year.

Four stages, in this order, and each needs its sentence of description. (1) **Identification and description of decision packages** — decision packages are the programmes or activities for which a decision is required, described for technical specification, financial impact by cost benefit analysis and other issues such as environmental, regulatory and social. (2) **Evaluation of decision packages** — against synchronisation with organisational objectives, availability of funds and regulatory requirements. (3) **Ranking (prioritisation) of the decision packages** — on the basis of the priority

of the activities. (4) **Allocation of resources** to the ranked packages.

Because of the prioritisation stage, ZBB is also known as Priority-based Budgeting. That alternative name is printed in the answer and is an easy mark in a definition question.

Why it is considered superior to traditional budgeting — six points. It provides a systematic base for evaluation of different activities; it lets management **allocate resources after a proper cost benefit analysis**; it ensures the functions undertaken are critical for the achievement of the objectives; it provides **a base for a system of management by objectives**; it creates a close relationship between the departmental budget and corporate objectives; and it helps **identify wastage and then eliminate it**.

The advantages question adds one limb the superiority question does not — use it. Because resources are allocated only after a thorough cost-benefit analysis, **the chances of arbitrary cuts and enhancements are avoided**, and the technique ranks activities **in order of preference for the allocation of scarce resources**. Note also that ZBB **can be used for the introduction and implementation of management by objectives** and so serves purposes beyond those of traditional budgeting.

Remembering reproduce what you have learnt · 2 questions

- Name the four stages before describing them, then describe each in one sentence. A 5-mark answer is the definition plus the four stages.

TQ 7.2 · PYQ 2019-Nov [6] (e) · DESC · 5M · Pg 907

LEVEL I
Remembering

Medium

TQ 7.3 · MTP 2023-Mar [6] (a) · DESC · 5M · Pg 908

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 1 question

- 'Why is ZBB superior to traditional budgeting' and 'state the advantages of ZBB' are the same list written twice. Answer either with six headed points; do not write about the disadvantages unless asked.

TQ 7.1 · PYQ 2018-May [6] (c) · DESC · 5M · Pg 907

LEVEL I
Understanding

Medium

Topic 8: Performance Budgeting (PB)

L2P4-C15-T08

Read first Read ICAI Study Material Chapter 15, Budgets and Budgetary Control — performance budgeting.

NOTES

Definition: performance budgeting involves the evaluation of the performance of an organisation in the context of both specific as well as overall objectives of the organisation, and requires complete clarity about both the short-term and the long-term organisational objectives. Both limbs — specific and overall, short-term and long-term — are printed, and the question is set for as little as one mark, so this sentence is the whole answer.

Five things an organisation must have in place before it can adopt performance budgeting. (1)

Objectives are clearly defined — spelt out in concrete terms. (2) **Objectives are translated into activities** — into specific functions, programmes, activities and tasks. (3) **Performance standards are established** — realistic and acceptable norms, yardsticks or standards and performance indicators evolved. (4) **Responsibility is decentralised** — a style of management based on a decentralised responsibility structure. (5) **Accounting and reporting system is developed** — to facilitate monitoring, analysis and review of actual performance in relation to budgets.

The five run in a chain — objectives, activities, standards, responsibility, reporting — and the chain is the answer's logic. You cannot set a standard for an activity you have not defined, and you cannot fix responsibility without a reporting system to measure it. Say this in a line if the question asks you to explain rather than list.

Watch the length the question asks for. It is printed once as a 5-mark descriptive ('what important points should an organisation consider' — answer with the five headed points) and once as a 1-mark definition (answer with the definition sentence only). Writing the five points for one mark wastes time you need elsewhere.

Remembering reproduce what you have learnt · 2 questions

- Learn the five heads as five words — objectives, activities, standards, decentralisation, reporting — then expand each into the printed sentence.

TQ 8.2 · PYQ 2024-Sep [6] (b) (iv) · DESC · 1M · Pg 910

LEVEL I
Remembering

Easy

TQ 8.1 · PYQ 2020-Nov [6] (b) · DESC · 5M · Pg 909

LEVEL I
Remembering

Medium

Topic 9: Budget Ratio

L2P4-C15-T09

Read first Read ICAI Study Material Chapter 15, Budgets and Budgetary Control — the budget ratios: efficiency, activity, capacity usage and actual usage of budgeted capacity.

NOTES

The five ratios, exactly as the printed answers write them. Efficiency Ratio = (Standard hours for actual output ÷ Actual hours worked) × 100. Activity Ratio = (Standard hours for actual output ÷

Budgeted hours) $\times 100$. Standard Capacity Usage Ratio = (Budgeted hours $\div$ Maximum possible hours in the budget period) $\times 100$. Actual Capacity Usage Ratio = (Actual hours worked $\div$ Maximum possible hours in the budget period) $\times 100$. Actual Usage of Budgeted Capacity Ratio = (Actual hours worked $\div$ Budgeted hours) $\times 100$ — this last one is also printed simply as the **Capacity Ratio**. Every one is a ratio of hours to hours; if your numerator or denominator is in units, you have not finished converting.

Everything turns on getting the three hour figures right, so compute them first as working notes. Maximum capacity in the budget period = Maximum number of employees $\times$ hours per day $\times$ days per week $\times$ weeks — $60 \times 8 \times 5 \times 4 = 9,600$ hours. Budgeted hours = Employees actually working (the budgeted strength) $\times$ hours per day $\times$ days per week $\times$ weeks — $50 \times 8 \times 5 \times 4 = 8,000$ hours. **Actual hours worked** is given, or is backed out of a ratio. Using the maximum number of employees where the budgeted strength is meant, or forgetting to multiply by the number of weeks, is the recurring error.

Where the data is in units rather than hours, convert with the standard hours per unit before you start. **Budgeted hours** = **Budgeted production** $\times$ **standard hours per unit** ($88,000 \times 10 = 8,80,000$) and **Standard hours for actual output** = **Actual production** $\times$ **standard hours per unit** ($75,000 \times 10 = 7,50,000$). The same answer then gives efficiency 125%, activity 85.23% and capacity 68.18% from those two figures and the actual hours worked.

The reverse question gives you the ratios and asks for the hours — write the ratio as an equation and substitute. **86%** = (**Actual hours worked** $\div$ **24,000**) $\times 100$, so actual hours = 20,640; then **110%** = (**Standard hours for actual output** $\div$ **20,640**) $\times 100$, so standard hours = 22,704. Take the parts in the order that makes each one feed the next — the printed answers always solve the capacity ratio first to get actual hours, then the efficiency ratio to get standard hours, and only then the activity and standard capacity usage ratios.

The printed answers use alternative names for the same ratios — recognise them in the question. **Efficiency / Productivity Ratio**; **Volume / Activity Ratio**, which one answer expresses as (**Actual output** $\div$ **Budgeted output**) $\times 100$ measured in standard hours; and **Standard Capacity Usage Ratio**, expressed in the same answer as (**Normal capacity** $\div$ **Practical capacity**) $\times 100$. They are the same computations under different words; do not invent a sixth ratio because the question used a different name.

A check worth running before you hand the answer in: in both fully worked printed answers, the activity ratio equals the efficiency ratio multiplied by the actual-usage-of-budgeted-capacity ratio — $117.33\% \times 93.75\% = 110\%$, and $125\% \times 68.18\% = 85.23\%$. If your three figures do not satisfy that, one of the three hour bases is wrong, and it is almost always the budgeted hours.

Application use the rule - work the problem - 4 questions

- Start with a short working note giving maximum capacity hours, budgeted hours, actual hours and standard hours for actual output. Every part then becomes one line.

- Give the percentages to two decimals as the answers do (117.33%, 78.125%, 92.86%). Rounding to whole percentages will not match the printed answer.

PQ 9.1 · PYQ 2019-May [1] (a) {C} · 5M · Pg 910	LEVEL II Application	Easy
PQ 9.2 · MTP 2019-Oct [1] (b) {C} · 5M · Pg 912	LEVEL II Application	Easy
PQ 9.4 · PYQ 2026-Jan [5] (b) · 5M · Pg 914	LEVEL II Application	Easy
PQ 9.3 · PYQ 2024-May [1] (c) {C} · 4M · Pg 913	LEVEL II Application	Hard

AT THE END OF THE BOOK

Corrigendum

Every printed Topic-Wise Question Frequency table in this Scanner was reconciled against the questions printed under it — topic by topic, on each of the PYQ, RTP and MTP columns separately, counting a question once for the sitting it was set in and once more for every repeat and every "Or" alternative printed on its head. Ninety-eight of the hundred examined topics reconcile exactly. The two that do not are below.

A topic block that is not printed

Chapter 15, Budgets and Budgetary Control — topic 06 has no block head

Printed: The frequency table declares 06 Classification on the Basis of Functions with 8 PYQ + 4 RTP + 4 MTP = 16 appearances, but the body runs from block 05 (page 863) straight to block 07 (page 906) with no 06 head between them.

Read: The questions are printed and are correctly numbered for topic 6 — block 05 runs TQ 5.1 to PQ 5.7 and then continues PQ 6.1 to PQ 6.12 with no heading between.

Proof: counting blocks 05 and 06 together, with their repeats, gives exactly 13 PYQ / 9 RTP / 6 MTP — exactly what the table declares for topics 5 and 6 added together. Nothing is lost; only the heading is. These notes set the two topics apart as the table declares them.

A count that does not reconcile

Chapter 3, Employee Cost and Direct Expenses — topic 11, Employee (Labour) Turnover

Printed: The table declares 7 PYQ / 3 RTP / 6 MTP.

Read: The twelve questions printed under the topic, with their repeats, come to 7 PYQ / 3 RTP / 5 MTP.

One MTP appearance short. Reported as arithmetic, not as a verdict: it needs a reading of the topic to decide whether the table over-counts or a repeat line is missing from a question head.

Counted afresh on this edition: 533 questions across 120 declared topics, of which 100 carry questions and 20 are declared but not yet examined. 3,317 marks are printed on the question heads, and ten questions carry an "Or" alternative — the same answer, set again in a different sitting. Questions from the September 2026 paper carry the Scanner's own answer key and solution hints rather than a worked answer, as the Front Matter explains.