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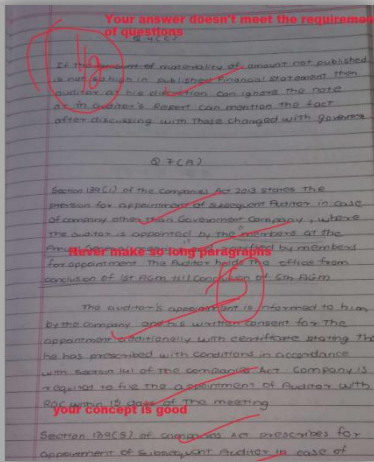
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**Rahul Singla** "It was hard for me to think of what to do since it was my 3<sup>rd</sup> attempt of Inter but thanks to catestseries.org and their team who helped me through this test series. Now I am positive for my results"

**Sima Bansal** "I want to give a big thanks to catestseries.org. I had cleared my Ipc 19 attempted. I have suggested all my friends about your test series and they are happy with their results."

**Vivek Pande** "My brother was old student of your website and he was the one who suggested me to join it. I had enough preparation But I was shocked when I saw where I had weak spots. Now I got passed with 37<sup>th</sup> rank is really makes me happy."

# OVERHEAD

**Concept Overheads meaning and Recovery Rates / Overhead absorption rate:-**

5 Methods

$$\text{Percentage of direct material cost} = \frac{\text{Amount of production of overheads}}{\text{Direct material cost}} \times 100$$

$$\text{Percentage of direct labour cost} = \frac{\text{Amount of production of overheads}}{\text{Direct labour cost}} \times 100$$

$$\text{c) Percentage of prime cost} = \frac{\text{Amount of production of overheads}}{\text{Prime cost}} \times 100$$

$$\text{d) Direct labour hours rate} = \frac{\text{Amount of production of overheads}}{\text{Direct labour cost}}$$

$$\text{e) Machine hour rate} = \frac{\text{Amount of production of overheads}}{\text{Machine hours}}$$

**Concept** : Allocation of overheads VS apportionment of overheads:-

**Allocation means** charging a full amount of overhead directly to a department for which this amount has been incurred.

**Apportionment** of overheads:- when separate identification of overhead department-wise is not possible then we have to divide cost of whole overheads among all departments on logical basis then it is called apportionment of overheads.

<b>Common Expenditure</b>	<b>Basis of Apportionment</b>
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1. (a) <b>Factory</b> Rent, Rates & Taxes (b) Repairs & Maintenance of <b>Factory</b> Building (c) Insurance of <b>Factory</b> Building (d) Depreciation of <b>Factory</b> Building (if <b>owned</b> )	Floor area occupied by each department
2. (a) Repairs & Maintenance of <b>Plant &amp; Machinery</b> (b) Insurance of <b>Plant &amp; Machinery</b> (c) Depreciation of <b>Plant &amp; Machinery</b>	Capital cost of plant & machinery of each department
3. (a) Supervision Salary (b) Canteen, Staff Welfare Expenses (c) Time Keeping & Personnel Office Expenses	No. of workers of each department
4. (a) Compensation to Workers (b) Employees' State Insurance Contribution (c) Provident Fund Contribution	Wages of workers of each department
5. Lighting & Heating	No. of light points <i>or</i> floor area occupied by each department
6. Power consumption	Horse power of machines <i>or</i> machine hours consumed in each department

<b>Common Expense, i.e. Overhead</b>	<b>Basis of Apportionment (Multiple Options)</b>
Rent of Factory Building	<ul style="list-style-type: none"> <li>• Area of Deptt. If Area Given</li> <li>• Equal if area not given</li> </ul>
Factory Lighting Expenses	<ul style="list-style-type: none"> <li>• Number of Light Points <i>or</i></li> <li>• Area if light points not given</li> </ul>

Depreciation of machines	<ul style="list-style-type: none"> <li>• Number of machines of each deptt if value not given</li> <li>• Value of machines</li> </ul>
Power for Machines	<ul style="list-style-type: none"> <li>• Horse Power (HP) Rating or</li> </ul>
	<ul style="list-style-type: none"> <li>• HP Rating × Machine Hours</li> <li>• Machine hours</li> </ul>
Indirect Wages	<ul style="list-style-type: none"> <li>• Direct Wages</li> </ul>

**Concept :-**Treatment of under/over absorption (Recovery) of overheads:-

Under absorption of OH means that amount of OH absorbed over products is less than the amount of actual OH incurred.

Over absorption of OH means that amount of OH absorbed over products is more than the amount of actual OH incurred.

**Accounting Treatment:-** Under or over absorbed overheads are disposed off by any of following methods:-

- a. One method suggest that the **under or over absorbed overheads should be charged to costing profit & loss account as loss or profit. – Modern Break-up method**
  
- b. Second method suggest that **unabsorbed / over-absorbed** overheads should be charged to WIP, Finished goods- stock and units sold (**Traditional break-up method**)

- by using supplementary rate

**OR**

- in the ratio of their value in case units are not given in question.

**Note 1:-** supplementary rate =  $\frac{\text{Unabsorbed or over absorbed OH}}{\text{Total production in units including equivalent units of WIP}}$

Absorbed OH = absorption OH = Recovered OH = Applied OH

**Note 2:-** The **under absorbed overhead** relating to **inefficiency or defective planning or defective production policy** is abnormal loss hence it is charged to profit and loss account as loss.

**Note 3:-** For calculation of unabsorbed / over absorption OH, **Actual overhead incurred** should not include non- recurring expenses

- amount paid to worker as per court order
- previous years' expenses booked to current year
- wages paid in strike period
- obsolete stores written off.

**Concept** Re-distribution of overheads

There are 2 kinds of departments – first is production departments and second is service departments.

4 methods are used for re-distribution

1. Repeated / continuous distribution method:- Following steps shall be applied under this method assuming 3 production deptt. As P1, P2, P3 and 3 service deptt. S1, S2 and S3.

**S.1 Original Cost** of S1 is distributed among P1, P2, P3, S2 and S3 in given %.(**1:5**)

**S.2 Original Cost** of S2 Plus **shared cost** from S1 is distributed among P1, P2, P3, S1, S3 in

given %.(1:5)

**S.3 Original cost** of S3 plus **shared cost** from S1 & S2 is distributed among P1, P2, P3, S1 and S2 in given %.(1:5)

**S.4** Repeat the above step -1, step – 2 and then step - 3 until cost of S1, S2 and S3 becomes small figure.

(Rs. 1 or Rs. 2). Now distribute this small figure over P1, P2 and P3

### “Gadha method”

2. Trial and error method:-Following steps are applied under this method assuming 3 production deptt. As P1, P2, P3 and 3 service deptt. S1, S2 and S3.

**S.1 Original Cost** of S1 is distributed among S2 and S3 in given %.(1:2) **(No amount shall be reduced from S1)**

**S.2 Original Cost** of S2 along with **shared cost from S1** is distributed among S1 & S3 in given %.(1:2)**(No amount shall be reduced from S2)**

**S.3 Original Cost** of S3 along with **shared cost from S1 & S2** is distributed among S1 & S2 in given %.(1:2)**(No amount shall be reduced from S3)**

**S.4** Repeat the process of distribution again beginning with S1 until the **additional amount** becomes small amount (Rs.1 or Rs.2)

**Note:-** Original cost is shared only once and additional cost is shared again and again.

**S.5** Now distribute the [**100% - Share of other Service Deptt.**] cost of S1, S2 and S3 among P1, P2 and P3 **only once.**

### “Galti ka Putla method”

3. Simultaneous equation method:-



Following steps are applied under this method assuming 3 production deptt.

As P1, P2, P3 and 2 service deptt. S1 and S2.

**S.1** Make 2 equations to show the total cost of S1 & S2 including its share (%) in S2 & S1 respectively.

**S.2** Solve these 2 equations to find out the cost of S1 and S2. (**Called Calculated Cost**)

**S.3** This calculated cost of S1 and S2 is then distributed **only once** over production deptt and service deptt. in given %.

4. Step ladder method :- following steps are applied under this method assuming 3 production deptt. As P1, P2, P3 and 4 service deptt. S1, S2, S3 & S4.

✓ S1 provide services to P1, P2, P3, S2, S3 & S4.

**(1:6)**

✓ S2 provide services to P1, P2, P3, S3 & S4. **(1:5)**

✓ S3 provides services to P1, P2, P3 and S4. **(1:4)**

✓ S4 provides services to P1, P2 & P3. **(1:3)**

**S.1 Original Cost** of S1 is distributed among P1, P2, P3, S2, S3 & S4.

**S. 2 Original Cost** of S2 along with **shared cost from S1** is distributed among P1, P2, P3, S3 & S4.

**S. 3 Original Cost** of S3 along with **shared cost from S1 & S2** is distributed among P1, P2, P3 and S4.

**S. 4 Original Cost** of S4 along with **shared cost from S1, S2 & S3** is distributed among P1, P2 & P3.

**Concept Different capacity :-**

<b>Meaning</b>	Capacity of a factory refers to its ability to produce with the available resources and facilities. It is expressed in terms of Units of product <i>e.g.</i> 100 cars per day Production Hours <i>e.g.</i> 8 hours per day
<b>Types 1. Maximum / Rated Capacity</b>	It refers to the maximum possible production capacity of a factory which can never be achieved practically and it is only a theoretical capacity.
<b>2. Practical Capacity</b>	It refers to the maximum capacity of a factory <b>reduced</b> by capacity lost due to Normal repairs & maintenance, Sundays, Holidays, etc. Thus, <b>Practical capacity = Maximum capacity – Normal loss of capacity</b>
<b>3. Normal Capacity / Average Capacity</b>	It refers to average of capacity utilised of factory during <b>one full business cycle</b> which may extend over 3 to 5 years ignoring the abnormal year of highest and lowest utilisation.
<b>4. Actual Capacity</b>	It refers to the capacity actually utilized during a given period.

**Concept Machine hour rate:-** while calculating machine hour rate,

$$\text{Machine hour rate} = \frac{\text{Amount of production overheads}}{\text{Effective machine hours}}$$

- All expenses related to **operating of machine** are divided into fixed/standing charges and running/machine expenses.
- Comprehensive machine hour rate = Simple machine hour rate + **direct wages per machine**

$$\left( \frac{\text{Total direct wages}}{\text{Total machine hours}} \right)$$

**STATEMENT SHOWING THE COMPUTATION OF MACHINE HOUR RATE**

Particulars	Amount (Rs.)
<b>A. Fixed/Standing Charges:</b>	
(a) Rent & Rates	XXX

(b) Heating & lighting cost	XXX
(c) Supervision cost	XXX
(d) Insurance cost	XXX
(e) Department & general overheads	XXX
(f) Sundry Shop Supplies	XXX
(g) Depreciation of factory - building	
Total Fixed/Standing Charges	<b>XXX</b>
<b>B. Machine Expenses per hour:</b>	
(a) Depreciation = $\frac{\text{Original cost + Installation Exp. - Scrap value}}{\text{Effective useful life (in hours)}}$	
(b) Power consumed cost / Electricity	
(c) Repair & Maintenance	
(d) Lubricating oil & Consumable stores	
(e) Other running expenses	
<b>C. Machine Hour Rate</b>	

#### Calculation of Effective machine hours

Particulars	Hours
Maximum Capacity (365 days x 8 hours in a day)	XXX
Less:- Hours spent on holidays, festivals, Sundays, repair & maintenance	(XXX)
Practical capacity (In hours)	XXX
Less:- Set up time (If unproductive)	(XXX)
Effective machine hours	XXX

**Note:-** if set-up time is considered productive then it shall not be reduced.

**Note:-** Depreciation of machine shall be fixed exp. if life of machine is based on Time

**OR**

Depreciation of machine shall be variable exp. if life of machine is based on machine hours.

Depreciation of factory building shall always be fixed.