

WELCOME
16th March, 2016
“DECISION MAKING
made easy by
COST MANAGEMENT”

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PRACTISING COST ACCOUNTANTS

FORMER: CHAIRMAN, NIRC of ICAI
DIRECTOR-FINANCE, CCI Ltd.
C.M.D., Triveni Structural Ltd.

STRATEGICAL NEEDS FOR BUSINESS GROWTH:

- IDENTIFICATION OF IDEAS**
- COUNTERACTING ADVERSE FEATURES**
- TURNING IT IN OUR FAVOUR**

CONTINUOUS MONITORING PERFORMANCES OF ALL FUNCTIONS OF BUSINESS:

- MANUFACTURING,**
- MARKETING,**
- HUMAN RELATIONS,**
- FINANCE,**
- METHODS/PROCESS**

- DETECTING SHORTCOMINGS and**
- REMEDYING DEFICIENCIES**

- **RAPID TECHNOLOGICAL CHANGES**
- **TOUGH GLOBAL COMPETITION**
- **PERFORMANCE PRESSURE**
- **STAKEHOLDERS' EXPECTATIONS**
- **CUSTOMERS' QUALITY NEEDS**

COST ACCOUNTING MEANS

FIXATION OF PRICE

INVENTORY VALUATION

**COMPUTATION OF PROFITABILITY OF
PRODUCTS / PROCESSES / SERVICES**

VARIANCE ANALYSIS- Budget / Standards

PARADIGM SHIFT IN METHODS, APPROACH AND FUNCTIONS OF COST ACCOUNTANTS

**THE COST ACCOUNTANT HAS NOW
TRANSFORMED AS
MANAGEMENT ACCOUNTANT
BY VALUE CREATION TO THE ORGANISATION**

MANAGEMENT ACCOUNTANT'S ROLE HAS ADVANCED TO

-COST ANALYSIS

-COST CONTROL

-COST REDUCTION / COST IMPROVEMENT

-BENCH MARKING

MANAGEMENT ACCOUNTING PROVIDES TECHNIQUES AND METHODS FOR:

- BREAKING VARIOUS ELEMENTS
OF COST IN SMALLER SEGMENTS**
- COMPARING WITH COMPETITORS'**
- COST OF OUTSOURCING**

DIFFERENT METHODS & TECHNIQUES OF COST MANAGEMENT

- MARGINAL COSTING**
- ACTIVITY BASED COSTING**
- BUDGETING/ STANDARDS/ BENCHMARKING**
- VARIANCE ANALYSIS**
- RATIO ANALYSIS**
- INTER FIRM COMPARISON**
- TARGET COSTING**
- COST REDUCTION**
- COST RE-ENGINEERING**

**IN A COMPETITIVE MARKET -
PRICES ARE FIXED BY MARKET**

**COMPROMISING NEEDS OF
CUSTOMERS,
OR SACRIFICING QUALITY.... is a no go**

EITHER RESTRICT THE PROFIT MARGIN ,

OR REDUCE THE COST

OBJECTIVES OF COST MANAGEMENT

- OPTIMUM UTILISATION OF RESOURCES**
- MINIMISATION OF WASTAGES**
- PROCESS COST RE-ENGINEERING**
- OUTSOURCING ACTIVITIES**
- ECONOMIC ANALYSIS OF ALL RELEVANT BUSINESS DATA IN VALUE AND QUANTITY TERMS**

- CONTINUOUS APPRAISAL**
- ACTION TO REMEDY DEFICIENCY**
- IMPROVING EFFICIENCY**
- MAXIMISING PRODUCTIVITY**
- REALISING GREATER PROFITABILITY**

**by TIMELY DECISIONS &
CORRECTIVE ACTIONS**

DECISION MAKING PROCESS

DECISION MAKING IS A PROCESS OF CHOOSING AMONGST COMPETING ALTERNATIVES

- Problem requiring management action
- Identify alternatives as possible solutions
- Eliminate unrelated alternatives
- Collecting relevant costs & benefits of each alternative
- Comparing
- Decision by selecting best alternative

DECISION MAKING

**ALL DECISION MAKING RELATES
TO FUTURE**

**ONLY DIFFERENTIAL FUTURE COST
AND REVENUES ARE RELEVANT**

**THAT LEADS TO CASH FLOW
(INFLOW OR OUTFLOW)**

RELEVANT COSTS/REVENUE

- COST AFTER SPILT OFF POINT
- INCREMENTAL REVENUE AFTER FURTHER PROCESSING
- OPPORTUNITY COST i.e. BENEFIT FORGONE
- COST OF NEW ASSET
- DISPOSAL VALUE OF EXISTING ASSET
- TAX IMPACT ON DEPRECIATION
- CHANGE IN WORKING CAPITAL NEEDS

IRRRELEVANT COSTS

- DEPRECIATION ON FIXED ASSETS
- PAST COMMITTED COST
- SALE OF OBSOLETE INVENTORY

DECISIONS

- PROCESSING OF JOINT PRODUCTS**
- INTRODUCTION OF NEW PRODUCT**
- MARGIN OF SAFETY AT DIFFERENT SALES VOLUME**
- SALES TO ATTAIN TARGET PROFIT**
- MARKET EXPANSION**
- TRADE RECESSION**

DECISIONS

- TENDERING EXPORT ORDER
- ACCEPT OR REJECT NEW ORDER
- DROPPING A LINE OF PRODUCTION
- PRODUCT MIX DECISION
- MAKE OR BUY / OUTSOURCING OF COMMERCIAL PROCESSES
- SUB CONTRACTING
- TRANSFER PRICING

**ONCE THE DECISION IS
IDENTIFIED**

**DETERMINATION OF RELEVANT
COSTS AND REVENUES IS EASY
IN ORDER TO ACCEPT OR REJECT
ALTERNATE DECISION**

MARGINAL COSTING

**COST OF PRODUCING MARGINAL
PRODUCT**

VARIABLE COST

FIXED COST

CONTRIBUTION

SALES-VARIABLE COST

FIXED COST+PROFIT

**SELL THE JOINT PRODUCTS AT
SPLIT OFF POINT, OR
PROCESS FURTHER**

IGNORE JOINT COSTS.

**PROCESS FURTHER
THAT JOINT PRODUCT, WHOSE
INCREMENTAL REVENUE EXCEEDS
INCREMENTAL COSTS**

**NEW ORDER AT DISCOUNT,
IF IDLE CAPACITY IS AVAILABLE**

**IF REGULAR SALES ARE NOT
AFFECTED,**

**ACCEPT ORDER AT
ANYTHING ABOVE MARGINAL COST**

**EXPORT ORDER AT
LOWER PRICES
IF IDLE CAPACITY IS AVAILABLE**

**ACCEPT ORDER AT
ANYTHING ABOVE MARGINAL COST**

INTRODUCING A NEW PRODUCT

**COMPARE ADDITIONAL
CONTRIBUTION MARGIN
FROM THE NEW PRODUCT**

**ANY INCREASE IN
FUTURE FIXED COSTS**

DROPPING A PRODUCT LINE

**COMPARE EXISTING
CONTRIBUTION MARGIN
OF PRODUCT LINE GOING TO BE
DROPPED**

**CONSIDER ANY REDUCTION IN
FUTURE FIXED COSTS**

MARKET EXPANSION-AREA

**COMPUTE INCREMENTAL
CONTRIBUTION MARGIN FROM
THE SALES IN NEW
AREA.**

**ANY INCREASE IN
FIXED COSTS**

PRODUCT MIX TO MAXIMISE PROFITS

COMPUTE THE CONTRIBUTION OF EACH PRODUCT AS PER AVAILABLE CAPACITY,

SELECT PRODUCT MIX WHICH GIVES HIGHEST CONTRIBUTION WITHIN KEY FACTOR

SELL OBSOLETE INVENTORY OR REWORK

COST OF STOCK IS IGNORED.

**CHOOSE ALTERNATIVE WITH
GREATER EXCESS OF
FUTURE REVENUE
OVER FUTURE COSTS**

MAKE OR BUY / OUTSOURCING OF SERVICES

**COMPARE MARGINAL COST
WITH PURCHASE PRICE
(LANDED COST)**

SUB- CONTRACTING

**COMPARE INCREMENTAL COST
WITH TOTAL COST PAYABLE TO
SUB-CONTRACTOR**

RECESSIONARY PERIOD

**TO CHECK FALL IN SALES VOLUME
WHERE NO LOSS SHALL BE INCURRED**

**COMPUTE CONTRIBUTION AND OPERATE
WHERE CONTRIBUTION IS EQUAL TO
FIXED COSTS**

**PRODUCT TO BE EMPHASIZED,
WHEN CAPACITY IS LIMITED BY
SCARCE RESOURCES**

**DETERMINE THE SCARCE
RESOURCE, WHICH IS THE KEY
FACTOR.**

**EMPHASIZE THE PRODUCT WITH
LARGER CONTRIBUTION**

RESOURCE OPTIMISATION

MAN

MACHINE

MONEY

MATERIAL

METHODS

**AVAILABILITY OR SCARCITY IS THE BASIC
FEATURE OF RESOURCES**

KEY FACTOR ANALYSIS

Machine capacity

Raw material

Specific labour

Power

Working capital

Seasonal fluctuation in Demand

Trade depression

There may be

more than one key factors

BREAK EVEN ANALYSIS
- NO PROFIT – NO LOSS

&

SENSITIVITY
ANALYSIS
-SALES TO ATTAIN TARGET PROFITS

SENSITIVITY ANALYSIS

Sales (MT)	ACTUAL		Sales Qty. up_ 10%		Sales Qty. up_ 20%		Sales Qty. Budgeted		Sales Qty. less_ 10%	
	5000		5500		6000		7000		4500	
	Rs. Lacs	Rs. per MT	Rs. Lacs	Rs. per MT	Rs. Lacs	Rs. per MT	Rs. Lacs	Rs. per MT	Rs. Lacs	Rs. per MT
Gross Sales	3964	79283	4339	78900	4734	78900	5523	78900	3550	78900
Less Freight	149	2978	164	2978	179	2978	208	2978	134	2978
Less Sales Comm.	19	383								
Net Sales	3796	75922	4176	75922	4555	75922	5315	75922	3416	75922
RM Consumption	2559	51182	2815	51182	3071	51182	3583	51182	2303	51182
NVA	1237	24740	1361	24740	1484	24740	1732	24740	1113	24740
Variable Cost	350	7003	385	7003	420	7003	490	7003	315	7003.2
Contribution	887	17737	976	17737	1064	17737	1242	17737	798	17737
Fixed Cost	604	12083	604	10985	604	10069	604	8631	604	13426
OPERATING PROFIT	283	5654	371		460		637		194	
	0	0	0		0		0		0	
PBDIT	283	5654	371		460		637		194	
Depreciation	65	1291	65	1174	65	1076	65		65	
Interest	5	98	5	89	5	82	5		5	
PBT	213	4265	302	6039	391	7812	568	11360	125	2491
Increase in PBT (%)			42	42	83	83	166	166	-42	-42
Break even NVA	1024	20475	1059	19251	1094	18230	1164	16626	989	21972
BEP for Operating Profit (MT)		3406		3406		3406		3406		3406
BEP for Net Profit (MT)		3798		3798		3798		3798		3798

Note: 1. Sales has been adjusted by sales commission for further analysis.

	ACTUAL		Selling rate up_5%		Selling rate less_5%		RM consumed less_5% (qty./rate)		RM consumed up_5% (qty./rate)		Selling rate up_2% & RM less_2%	
Sales (MT)	5000		5000		5000		5000		5000		5000	
	Rs. Lacs	Rs. per MT	Rs. Lacs	Rs. per MT	Rs. Lacs	Rs. per MT	Rs. Lacs	Rs. per MT	Rs. Lacs	Rs. per MT	Rs. Lacs	Rs. per MT
Gross Sales	3964	79283	4142	82845	3748	74955	3945	78900	3945	78900	4024	80478
Less Freight	149	2978	149	2978	149	2978	149	2978	149	2978	149	2978
Less Sales Comm.	19	383										
Net Sales	3796	75922	3993	79867	3599	71977	3796	75922	3796	75922	3875	77500
RM Consumption	2559	51182	2559	51182	2559	51182	2431	48623	2687	53741	2508	50158
NVA	1237	24740	1434	28685	1040	20795	1365	27299	1109	22181	1367	27342
Variable Cost	350	7003	350		350		350		350		350	
Contribution	887	17737	1084	21682	690	13792	1015	20296	759	15178	1017	20339
Fixed Cost	604	12083	604		604		604		604		604	
OPERATING PROFIT	283	5654	480		85		411		155		413	
	0	0	0		0		0		0		0	
PBDIT	283	5654	480		85		411		155		413	
Depreciation	65	1291	65		65		65		65		65	
Interest & Exch rate	5	98	5		5		5		5		5	
PBT	213	4265	410	8210	16	320	341	6824	85	1706	343	6866
Increase in PBT (%)			93	93	-93	-93	60	60	-60	-60	61	61
Break even NVA	1024	20475	1024	20475	1024	20475	1024	20475	1024	20475	1024	20475
BEP for Operating Profit (MT)		3406		2786		4380		2977		3980		2970
BEP for Net Profit (MT)		3798		3107		4884		3319		4438		3312

Note: 1. Sales has been adjusted by sales commission for further analysis.

SENSITIVITY ANALYSIS

	ACTUAL IN Q-2 (2010-11)		Sales Qty. up_ 25%		Sales Qty. up_50%		Sales Qty. up_75%		Selling rate up_5%		RM consumed less_5% (qty./rate)		Selling rate up_2% & RM less_2%	
Sales (MT)	4028		5000		6000		7000		4028		4028		4028	
	Lacs	per MT	Lacs	per MT	Lacs	per MT	Lacs	per MT	Lacs	per MT	Lacs	per MT	Lacs	per MT
Sales incl Frt.	2886	71648	3543	70854	4251	70854	4960	70854	2997	74397	2854	70854	2911	72271
Less Freight	130	3227	161	3227	194	3227	226	3227	130	3227	130	3227	130	3227
Less Sales Comm	32	794												
Net Sales	2724	67627	3381	67627	4058	67627	4734	67627	2860	71008	2724	67627	2781	69044
RM Consumption	1969	48883	2444	48883	2933	48883	3422	48883	1969	48883	1871	46439	1930	47905
NVA	755	18744	937	18744	1125	18744	1312	18744	891	22125	853	21188	851	21139
Variable Cost	289	7175	359		430		502		289		289		289	
Contribution	466	11569	578	11569	694	11569	810	11569	602	14950	564	14013	562	13964
Fixed Cost	384	9533	384	7680	384	6400	422	6034	384		384		384	
OPERATING PROFIT	82	2036	194		310		387		218		180		178	
Depreciation	66	1639	66	1320	66		66		66		66		66	
Interest	11	273	14	275	17		19		11		11		11	
Other Income	50	1241												
Erection Loss/Profit	-71	-1763												
Net Profit	-16	-397	115		228		302		141		103		101	
BEP for Operating Profit (MT)	3319		3319		3319		3651		2569		2740		2750	
BEP for Net Profit (MT)	4166		4190		4214		4570		3084		3290		3301	

Note: 1. Sales has been adjusted by sales commission for further analysis.



THANKS

Subhash Agrawal