



Strategic Cost Management and Performance Evaluation

For Students Preparing for Final Examinations of
The Institutes of Chartered Accountants and Cost Accountants of India

- Beyond Budgeting
- Lean System
- ERP
- Marginal Costing
- Standard Costing
- Six Sigma

V.K. Saxena

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Strategic Cost Management
and
Performance Evaluation

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9. Cost Audit and Management Audit for I.C.W.A. Final
10. Management Accounting—Decision Making



DEDICATED TO

LORD VENKATESHWARA

Strategic Cost Management and Performance Evaluation

**For Students Preparing for Final Examinations of the
Institutes of Chartered Accountants and
Cost Accountants of India**

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Preface

I am not new to the Cost Accounting Books published by M/s Sultan Chand & Sons. Old students of this subject still feel nostalgic about our celebrated editions on the subject. One of the editions has been in 19th print. I took a short hiatus from professional writing to write “Feel the Bhagavad Gita”, whose first edition (of four Chapters) has been published by M/s Archway, a wing of M/s Simon and Schuster.

I notice that there is an acute shortage of a book confirming to the requirements of the final examinations of the Institute of Chartered Accountants of India and the Institute of Cost Accountants of India. There is a sea change in the examination trends and a specific book is definitely required to meet the new requirements. There is strong feeling among the students of final level that examination questions are not repeated at this professional level. If a trend of questions of last 15 years is considered, it will be noticed that no problem is a new problem. Earlier questions used to be too lengthy. Now part of these questions are being asked with fresh look, fresh relevance and magnitude. This book is a book of confidence building for final level students of I.C.A.I.

The striking features of this book are summarised below:

- Language and approach used is simple, effective and informal. Approach in the book has been adapted considering the typical present examination requirements of the professional students preparing for the final examination under new syllabuses (Paper 5 of the Institute of Chartered Accountants and Paper 15 of the Institute of Cost Accountants of India).
- There is a glut of new terms in the market emanating from industrial revolution and intense cut-throat competition world-wide. Considering it in the light of weightage of questions asked, the scope of items discussed has been expanded to include such emerging issues as: Beyond Budgeting, Lean Systems, Six Sigma, Kaizen Costing, Throughput Accounting, Enterprise Resource Planning (ERP), Backflush Costing, Business Process Re-engineering, Total Quality Management, Socio-economic Costing, etc.
- All the recent practical problems, from the past examinations have been sectionalized, graded and presented according to level of difficulties. Each section of each Chapter ends with one of the celebrated problems of the past examinations, which has been the genesis of the recent examination problems.
- Questions have not been solved routinely. An effort has been made in each difficult situation to help the student to identify a methodology to solve the problems such as decision-making in situation of multiple key factors impacting each other with fixed costs differing at different levels.

- Every section, in each chapter, represents a particular topic under the overall discussion and every section contains almost all the problems, that have appeared during the past 15 to 20 years, making this book a reliable, unique and authentic problem–solution–textual discussion bank to qualify the examination.
- The readers can remain assured that this book adequately and effectively meets all the requirements of the professional students preparing for the above mentioned papers.
- As it contains all the category–wise graded problems relating to the above mentioned examinations, faced during the last 15 to 20 years in each category, the readers will fondly note that no problem is a new problem. The same difficulties are appearing and reappearing, at times with a tinge of slightly new colour hiding the route to be followed for the solution to the problems.
- Each heading in each Chapter contains numerous questions of about 15 years to expose the readers to the trend under the relevant heading.
- Special notes and diagrams have been included to make the contents lucid.

I am really indebted to my father and mother, who have given me inspiration to do the work with sincerity, dedication and determination. I am also grateful to my wife (Usha Saxena), son (Will Saxena) and daughter (Kanupriya) for allowing me a long and undisturbed spell to be constructively busy. I am also thankful to those numerous writers, who are too many to be specified and who have contributed substantially to add value to the efforts and imagination relating to the subject. The thoughts, like beyond budgeting, six sigmas are results of their original thinking and I feel obliged to be thankful to all these people.

There can be no claim for perfection in a book of this size. I request the students and teachers to bear with any errors, omissions or discrepancies, that might have crept in despite of my best efforts.

Any suggestion in this regard will be thankfully acknowledged and incorporated in future editions.

V. K. Saxena

Syllabus

The Institute of Chartered Accountants of India Paper–5: Strategic Cost Management and Performance Evaluation

Part A–Strategic Cost Management and Decision Making (Sub Part: Strategic Cost Management)

1. Introduction to Strategic Cost Management
 - (i) Concept of Strategic Cost Management
 - (ii) Limitations of Traditional Cost Management
 - (iii) Traditional vs. Strategic Cost Management
2. Modern Business Environment
 - (i) Introduction/ Characteristics of the Modern Business Environment
 - (ii) Cost of Quality, Total Quality Management, Business Excellence Model
 - (iii) Throughput Accounting and Theory of Constraints
 - (iv) Supply Chain Management (SCM)
 - (v) Gain Sharing Arrangements
 - (vi) Outsourcing
3. Lean System and Innovation
 - (i) Introduction to Lean System
 - (a) Just-in-Time (JIT)
 - (b) Kaizen Costing
 - (c) 5 Ss
 - (d) Total Productive Maintenance (TPM)
 - (e) Cellular Manufacturing/ One-Piece Flow Production Systems
 - (f) Six Sigma (SS)
 - (ii) Introduction to Process Innovation and Business Process Re-engineering (BPR)
4. Cost Management Techniques
 - (i) Cost Control/ Waste Control, Cost Reduction
 - (ii) Target Costing
 - (iii) Value Analysis/ Value Engineering
 - (iv) Pareto Analysis
 - (v) Life Cycle Costing
 - (vi) Environmental Management Accounting
5. Cost Management for Specific Sectors
 - (i) Agricultural Sector
 - (ii) Information Technology Sector
 - (iii) Power Sector

(Sub Part: II Strategic Decision Making)

1. Decision Making
 - (i) Decision Making using CVP Analysis
 - (ii) Decision Making using Relevant Cost Concepts
 - (iii) Decision Making using Activity Based Costing
 - (iv) Ethical and Non-Financial Considerations Relevant to Decision Making
2. Pricing Strategies/ Decisions
 - (i) Theory & Principles of Product Pricing
 - (ii) Pricing–New Product, Finished Products & Pricing of Services
 - (iii) Sensitivity Analysis in Pricing Decisions
 - (iv) Pricing Decision under Special Circumstances
 - (v) Pricing Strategies

Part–B Performance Evaluation and Control

(Sub Part: I Performance Evaluation and Reporting)

1. Performance Measurement and Evaluation
 - (i) Responsibility Accounting
 - (ii) Linking Critical Success Factors (CSFs) to Key Performance Indicators (KPIs) and Corporate Strategy; Performance Measurement Models; The Balanced Scorecard, The Performance Pyramid, The Performance Prism and The Building Block Model; Divisional Performance Measures; Benchmarking Schemes
 - (iii) Performance Measurement in the Not-for-Profit Sector
 - (iv) Preparation of Performance Reports
2. Divisional Transfer Pricing
 - (i) Meaning, Purpose and Principles of Transfer Pricing
 - (ii) Methods of Transfer Pricing
 - (iii) The Behavioural Consequences arising from Divisional Structures
 - (iv) International Transfer Pricing
3. Strategic Analysis of Operating Income
 - (i) Operating Profit Analysis
 - (ii) Advanced Activity Based Costing, Activity Based Management (ABM), Activity Based Budgeting (ABB)

(Sub Part–II Managerial Control)

1. Budgetary Control
 - (i) The Concept of Feedback and Feed Forward Control
 - (ii) Behavioural Aspects of Budgeting–Imposed Style, Participative Budget
 - (iii) Behavioural Aspects of Budgetary Control
 - (iv) Beyond Budgeting
2. Standard Costing
 - (i) Analysis of Advanced Variances
 - (ii) Integration of Standard Costing with Marginal Cost Accounting
 - (iii) Reconciliation of Profit
 - (iv) Variance Investigation Techniques, Interpretation of Variances, Possible Interdependence Between Variances and Reporting
 - (v) Behavioural Aspects of Standard Costing, Limitation of Standard Costing (including its use in the contemporary business environment)

Part–C Case Study

1. Case Study (covering Course Concepts)

General Note:

Applications of the following Quantitative Techniques are required to be studied for linkage to the course concept:

- (a) Linear Programming
- (b) Learning Curve/Experience Curve

The Institute of Cost & Works Accountants of India

Section A: Cost Management [20 Marks]

1. Cost Management
 - (a) Developments in Cost Management:
 - (i) Life Cycle costing
 - (ii) Target costing
 - (iii) Kaizen Costing
 - (iv) Value Analysis and Value Engineering
 - (v) Throughput Costing
 - (vi) Business Process Re-engineering
 - (vii) Back-flush Accounting
 - (viii) Lean Accounting
 - (ix) Socio Economic Costing
 - (b) Cost Control and Cost Reduction—Basics, Process, Methods and Techniques of Cost Reduction programme.

Section B: Strategic Cost Management Tools and Techniques [50 Marks]

2. Decision Making Techniques
 - (a) Marginal Costing–Differential Costing–CVP Analysis–Profit Volume Graphs–Contribution Approach
 - (b) Decisions involving alternative choices–Optimum utilization of resources–Make or Buy–Evaluation of Orders–Multiple scarce resource problems—Product sales pricing..... etc
 - (c) Pricing Decisions and Strategies–New Product Pricing, Use of Costs in Pricing, Sensitivity Analysis in Pricing Decisions; Monopoly Pricing vs. Competitive Pricing; Bottom Line Pricing
 - (d) Costing of Service Sector–methods, pricing, performance measurement
 - (e) Transfer Pricing–Objectives, Methods (Cost Based, Market Price Based, Negotiated Pricing), Advantages and Disadvantages, Criteria for setting Transfer Prices, Transfer Price in different situations, Situations causing Conflicts and resolving the Conflicts;
 - (f) Relevant Cost Analysis: Relevant Cost, Irrelevant Costs – Sunk or Historical Cost, Committed Cost, Absorbed Cost, Situations where Fixed Costs become relevant for decision–making and its related implications
 - (g) Profitability Analysis–Product wise/Segment wise/Customer wise
3. Standard Costing in Profit Planning
 - (a) Variance Analysis—Investigation of Variances, Planning and Operating Variances, Controllable/ Non-controllable Variances, Relevant Cost Approach to Variance Analysis; Variance analysis under marginal costing and absorption costing; Activity Ratios; Application of budgetary control and Standard Costing in Profit planning, Standard Costing Vs Budgetary Control, Reconciliation of Actual Profit with Standard Profit and /or Budgeted Profit.
 - (b) Uniform Costing and Inter-firm comparison.
4. Activity Based Cost Management–JIT and ERP
 - (a) Activity Based Cost Management—Concept, purpose, benefits, stages, relevance in decision-making and its application in Budgeting, Responsibility accounting, Traditional vs. ABC System–comparative analysis
 - (b) JIT — Introduction, Benefits, Use of JIT in Measuring the Performance
 - (c) ERP and its applications in strategic cost management
 - (d) Bench Marking
5. Cost of Quality and Total Quality Management
 - (a) TQM- Basics Stages, Principles, Control, Corrective actions
 - (b) PRAISE-Steps, Problems, Implementation
 - (c) PARETO Analysis
 - (d) Quality Costs

Section C: Strategic Cost Management — Application of Statistical Techniques in Business Decisions (30 Marks)

6. Application of Operation Research and Statistical tools in Strategic Decision Making
 - (a) Learning Curve
 - (b) Linear Programming (Formulation only)
 - (c) Assignment
 - (d) Transportation
 - (e) Simulation
 - (f) Network Analysis – CPM/PERT

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Vijay Kumar Saxena is a post-graduate in Commerce and a fellow of the Institute of Cost Accountants of India. He took voluntary retirement as Deputy General Manager, from M/s Bharat Heavy Electricals, an undisputed leader amongst the Indian power plant equipment manufacturers. He has written numerous books on Cost Accounting, Financial Accounting, Management Accounting, Cost Audit and Management Audit. None of the books written by him remained confined to first edition only. One of his book has been in the 19th Edition. His contributions to add value to the students' efforts to their objectives have been profound, substantial and obviously effective. His very name makes the old students of the subject nostalgic.

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