

VIVEKANANDA COLLEGE

THAKURPUKUR

KOLKATA-700063

NAAC ACCREDITED 'A' GRADE



Topic: SHORT TERM DECISION MAKING [CHAPTER-5]

Course Title: CC 4.2.ch

Paper: COST AND MANAGEMENT ACCOUNTING-II

Unit:05

Semester: IV

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Name of the department: COMMERCE

COST AND MANAGEMENT ACCOUNTING-II

SHORT TERM DECISION MAKING [CHAPTER-5]

DR. SARBAPRIYA RAY

I have already completed entirely 'Budget and Budgetary control'[chapter-2] before closure of college where production ,sales budget, specially cash budget and flexible budget have been discussed with several problems-solution.

Now, I need to discuss chapter-5.

Short-term Decision Making [10 marks/ 15 hours teaching]

[**Coverage:** Marginal Cost and decision relating Product Pricing; Product Mix; Make or Buy; Choosing among alternatives and closing down or suspending an activity. (with simple type of problems)]

Decision Making is futuristic in nature. It involves a choice between available alternatives. There are always two alternatives for any decision. The decision maker tries to choose the best alternative. It is necessary to evaluate all available alternatives for selecting the best one. This requires the analysis of both quantitative and qualitative information.

Cost data constitute a major part of quantitative information. All cost data may not be relevant to a particular decision making. So, relevant cost plays a very vital role in decision making process .Relevant cost in relation to decision making must be **future cost** and **differential variable cost**.

Marginal costing and short term decision making:

Short term decision making involves the selection of the best alternative that can be implemented within one accounting period. Marginal costing is an important managerial tool for short run decision making. Special areas of decision making where marginal costing proves its worth are as follows:

- (1) Make or buy decision*
- (2) selection of most profitable product mix*
- (3) Fixation of selling price(i.e product pricing)*

Direct Expenses	Rs 3,50,000
Factory overhead(variable)	Rs 5,50,000
Factory overhead(fixed)	Rs 7,50,000

The company considers purchasing of automobile parts from outside suppliers at a price of Rs 24 per unit.

Should the company make or buy the automobile parts?

Solution:

Marginal (variable) cost of making 1,00,000 units of automobile parts:

Direct material cost	Rs 7,00,000
Direct labour cost	Rs 5,00,000
Direct Expenses	Rs 3,50,000
Factory overhead(variable)	<u>Rs 5,50,000</u>
	<u>Rs 21,00,000</u>

Marginal(variable) cost per unit= Rs 21,00,000/1,00,000=Rs 21 per unit.

Decision:

Marginal cost of making (Rs 21 per unit) is lower than the purchase price(Rs 24 per unit). Therefore, it is recommended to make the automobile parts.

Problem:2:

The production manager of a company SR Ltd wants to arrive at a decision whether to continue making of its existing product-A or buy it from an outside supplier. The annual requirement of product-A is 15000 units. The following costs are incurred. in making product-A within the organization:

Direct material cost: Rs 1,60,000;

Indirect material cost-Rs 10,000,

Direct wages:-Rs 2,00,000;

Indirect wages-Rs 25,000

Power and fuel-Rs45,000

Repair and maintenance-Rs30, 000

Other variable overhead: Rs10,000

Depreciation (fixed): Rs 30,000

Rent and insurance (fixed): Rs 75,000

Other fixed overhead: Rs25,000

The lowest quotation received from an outside supplier to buy the same product is Rs 26 per unit.

The following additional expenses will be incurred if the product is bought in from outside sources:

Transportation cost: Rs 4 per unit, storage cost-Rs 3 per unit, Inspection charges:- Rs 30,000.

Would you recommend for making the product internally or buying it from an outside suppliers?

Solution :

Marginal(variable) cost of making product-A:

Direct material cost:	Rs 1,60,000;
Indirect material cost-	Rs 10,000,
Direct wages:-	Rs 2,00,000
Indirect wages-	Rs 25,000
Power and fuel-	Rs45,000
Repair and maintenance-	Rs30, 000
Other variable overhead:	<u>Rs10,000</u>
Total	<u>Rs 4,80,000</u>

Marginal cost per unit:Rs 4,80,000/15,000 unit=Rs32 per unit

Relevant cost of buying product:

	<i>Cost per unit (Rs)</i>
Purchase price	26
Transportation cost	4
Storage cost	3
Inspection cost (Rs30000/15000unit)	<u>2</u>
Total	<u>35 per unit</u>

DECISION:

Therefore, the marginal cost of making (Rs32 per unit) is lower than relevant cost of buying (35 per unit). Therefore, it is recommended to manufacture the product-A IN THE FACTORY.

[NOTE: Fixed cost remains the same whether the product is manufactured or bought. So, this cost is to be ignored in managerial decision making]

Date : 03/04/2020 time: 9-15 p.m