UNIT 11 RECONCILIATION OF COST AND FINANCIAL ACCOUNTS

Structure

11.0 OBJECTIVES

After studying this unit, you should be able to:

- explain briefly the two methods of cost accounting
- explain the need for reconciliation of cost and financial accounts
- list the factors responsible for causing difference in profit or loss shown by cost and financial accounts
- prepare reconciliation statement
- prepare memorandum reconciliation account.

1 INTRODUCTION

You have learnt that cost accounts act as a check on financial accounts. It is achieved by comparing the profit/loss ascertained under cost accounts with profit/loss ascertained under financial accounts. Their amounts usually differ. But, these can be reconciled by preparing a reconciliation statement which explains the causes of difference. In this unit you learn about the various causes of difference between the profit/loss shown by cost accounts and the profit/loss shown by financial accounts, and the preparation of Reconciliation Statement.

11.2 METHODS OF COST ACCOUNTING

Large manufacturing firms often maintain their cost accounts on double entry system. For this purpose, they adopt one of the following two methods:

1) Integral or Integrated Accounting

2) Non-integral or Independent Accounting

It is important to decide whether cost and financial transactions are to be unified or kept separate, for an appropriate method of cost accounting. Where cost and financial transactions are to be unified, the method to be adopted is called 'Integral/Integrated Accounting'. On the other hand, if cost and financial transactions are to be kept separate, the method followed is called 'Non-integral' or 'Independent Accounting.' The problem of reconciliation of cost and financial accounts arises only when non-integral accounting method is followed. Let us, therefore, discuss these two methods briefly before we take up the problem of reconciliation.

11.2.1 Integral Accounting

The term 'Integral/Integrated Accounting' means the merger of financial and cost accounts and maintenance of a single set of bodks to record both financial and cost transactions. In other words, **it refers to the unified method which serves the purpose of both financial and cost accounts.** Under this method, book-keeping procedure followed is very much similar to the procedure involved in financial accounting. In addition to the General Ledger, Sales Ledger and Bought Ledger in financial accounting, a Cost Ledger and three subsidiary ledgers viz., Stores Ledger, Work-in-progress Ledger and Finished Stock Ledger are also maintained.

Cost Ledger : It refers to the principal ledger in cost accounting which contains all the nominal accounts. It also contains a control account for each subsidiary ledger i.e., Stores Ledger Control Account, Work-in-progress Ledger Cbntrol Account and Finished Stock 'Ledger Control Account if non-integral accounting is followed. In case of integral accounting, however, these control accounts appear in the General ledger.

Stores ledger : It refers to a subsidiary ledger which contains an account for each item of stores and its movement. This account is debited with purchases of materials and credited with issues of materials to jobs.

Work-in-progress ledger : It refers to a subsidiary ledger which contains an account for each job, process or operation which is pending on the shop floor. This account is debited with the cost of materials, labour and overheads, and is credited with the cost of goods transferred to Finished Stock Ledger as and when they are completed.

Finished Stock Ledger : It refers to a subsidiary ledger which contains an account for each item of finished product manufactured or job completed. Each such completed product or job account is debited with the cost of production and credited with the cost of goods transferred to Cost of Sales Account.

Since only one set of accounts is maintained **under this method, no Costing Profit and Loss Account is prepared. Thus there is only one figure of profit or loss and, as such, there is no need for reconciliation of costing and financial profit or loss.**

11.2.2 Non-integral Accounting

When independent cost accounts are maintained, the subsidiary ledgers and the cost ledger are inter-locked through control accounts maintained in each ledger. These control accounts cross-check the accuracy of ledgws and also make each ledger seif-balanced-so that a separate trial balance may be prepared for each ledger without reference to the other ledgers. Besides these control accounts, a General Ledger Adjustment Account is opened in the cost ledger for all items of incomeand expenditure. The account is also known as 'Cost Ledger Control Account'. The cost ledger also contains control accounts such as Wages Control Account. Production Overheads Control Account. Administrative Overheads Control Account, Selling and Distribution Overheads Control Account, etc. Thus, **under non-integral accounting, the double entry is completed through control accounts.** Hence, this system has also been termed as 'Control Accounts System'.

Costing Profit and Loss Account : When cost accounts are maintained independent of financial accounts, a separate Costing Profit and Loss Account is prepared for determining the profit or loss of a particular period. This account is debited with the cost of sales and credited with the sales value. It is also debited with items like abnormal losses, under-absorption of overheads, loss or sale of special jobs etc., and credited with items like abnormal gains, overabsorption of overheads, profit on sale of special jobs, etc. The balance of this account will indicate the profit or loss as per cost records which should be reconciled with the profit or loss as per financial records.

11.3 NEED FOR RECONCILIATION OF COST AND FINANCIAL ACCOUNTS

When cost accounts and financial accounts are maintained independent of each other, the profit or loss as disclosed by the two sets of books is bound to differ from each other. This non-agreement of profit or loss shown by the two sets of books necessitates the preparation of a reconciliation statement which shows the causes leading to the difference between the two figures. The preparation of this statement is a must in order to establish the accuracy of cost accounts. Not only that, it also helps in cross-checking the arithmetical accuracy of operating results shown by the financial accounts.

11.4 CAUSES OF DIFFERENCE

The factors responsible for the difference between the profit or loss shown by the two sets of books can be broadly summarised as follows :

Items shown only in the financial accounts and not in the cost accounts : There are quite a few items which appear in the financial accounts and not in the cost accounts. All such items of expenses and losses reduce the financial profit while all such items of incomes and gains increase the financial profit.

This items can be classified as under :

a) Financial Charges
   i) Cash discount allowed
   ii) Interest paid on debentures, bank loans, mortgages, etc.
   iii) Penalties and fines paid
   iv) Income-tax paid
   v) Loss on sale of fixed assets
   vi) Loss on sate of investments
   vii) Obsolescence loss
   viii) Expenses on issue of shares/debentures
   ix) Discount on issue of shares/debentures
   x) Goodwill, Preliminary Expenses, etc. written off.

b) Financial Incomes
   i) Interest received on investments, bank deposits, etc.
   ii) Dividend received on investments
   iii) Share transfer fees received
   iv) Rent received
   v) Profit on sale of fixed assets
   vi) Profit on sale of investments
   vii) Cash discount received

c) Items of Appropriation of Profits
   i) Transfer of profits to reserves
   ii) Dividend paid
   iii) Proposed dividend

Items shown only in the cost accounts and not in'the financial accounts : There are very a few items which appear in the cost accounts and not in the financial accounts. Such items are as follows:

a) Interest on capital employed : Sometimes, it is the policy of the management to charge interest on capital employed for costing purposes. But, in reality, no such interest is paid. As such, it is excluded from the financial accounts.

b) Charges in lieu of rent : It is also the policy of the management to charge notional rent for the premises owned so as to enable comparison between the cost of production in a factory owned by a company and the cost of production in a leasehold or rented factory. However. in reality, no such rent is actually paid and, as such, it is exlcuded from financial accounts.

Under/Over absorption of overheads : The recovery of overheads in cost accounts is always based on estimates while the financial accounts are based on actuals. Hence, the amount of overheads recovered in cost accounts and the amount of expenditure actually incurred and recorded in financial accounts will invariably disagree.

The overheads charged in cost accounts may either fall short of or exceed the actual amount of expenses incurred and recorded in the financial accounts. If overheads are not fully recovered in cost accounts the shortfall is known as 'underabsorbed overheads. On the other hand, if overheads recovered in cost accounts are in excess of the actual expenditure, the excess amount is known as 'overabsorbed overheads'.

Different basis of stock valuation : Quite often, the stock figures shown in cost accounts differ from the figures shown in financial accounts. This may be due to the different bases followed for stock valuation in the two sets of books. The conventional method of stock valuation in financial accounts is based on the principle of 'cost price or market price whichever is lower'. However, in cost accounts, the basis of stock valuation is invariably the actual cost of production and this may even include the administration overheads.

11.5 PREPARATION OF RECONCILIATION STATEMENT

The preparation of a statement to reconcile the profits shown by the cost accounts with the profits shown by the financial accounts is similar to the preparation of bank reconciliation statement. It may provide for two amount columns, the first (plus column) for showing the amounts of items to be added and the second (minus column) for showing the amounts of items to be subtracted. You can take profits as per cost accounts as the starting point and arrive at profits as per financial accounts by making the necessary adjustments, or vice versa. In case you start with profits as **per** cost accounts as the base, take the following steps to arrive at the profit as per financial accounts.

1) Show the profit as per cost accounts in the plus column. In case of loss, the amount may be shown in minus column.
2) Look at the debit side of the Profit and Loss Account and as certain the items such as interest, income tax, discount, etc. which are not shown in cost accounts. Had these items of expenses or appropriations been shown in cost accounts, the amount of profit would have been lower. Hence, these amounts should be deducted.
3) Look at the credit side of the Profit and Loss Account and ascertain the items such as income received on investments, rent received, etc. which are not shown in cost accounts. Had these items of income been shown in cost accounts, amount of profit would have been higher. Hence, these amounts should be added.
4) Look at the cost accounts and ascertain whether any amount of notional rent, proprietor's salary, interest on capital, etc. has been shown as expense. If so, add these amounts because they have resulted in lower profits in cost accounts.
5) Compare the amounts of all indirect costs (factory overheads, administration overheads, and selling and distribution overheads) charged in cost accounts with their actual amounts as recorded in the financial accounts. Add overabsorption and deduct underabsorption of various overheads.
6) Compare the values of stock shown in cost accounts with those shown in financial accounts. in all probability, the stock values shown in cost accounts will be higher. Hence, the difference in closing stock shall be deducted and the difference in opening stock will be added.
7) Take the totals of both plus and minus columns and work out the difference between the two totals. If the total of plus column is higher than the total of the minus column, the excess represents the profit as per the financial accounts. If, however, the total of the minus column is higher than the total of the plus column, the excess shall represent the loss as per the financial accounts.

   Based on the above analysis, we can draw the lists of items to be added to the profits shown by cost accounts and the items to be deducted there from.

Items **to** be Added

1) Incomes not shown in cost accounts
2) Notional costs shown in cost accounts
3) Overabsorption (overcharge) of any indirect cost in cost accounts
4) Overvaluation **of** opening stock

Items to **be** Deducted

1) Charges not shown **in** cost accounts

2) Underabsorption (undercharge) of any indirect cost in cost accounts
3) Overvaluation of closing stock

In case the figure of profit or loss as per cost accounts, is not given, you have to start with the profit or loss as per financial accounts. In that case, the items listed above for addition shall be deducted and shown in minus column, and the items listed above for deduction shall be added and shown in plus column. In other words, the whole treatment will be reversed.

Look at Illustration 1 and study how Reconciliation Statement is prepared a) when you take profits as per cost accounts as the base, and b) when you take profits as per financial accounts as the base.

Illustration 1

The net profit of a manufacturing company appeared at Rs. 60,500 as per financial records for the year ended 31st March, 1990. The cost accounts, however, showed a net profit of Rs. 1,19,400 for the same period. A detailed comparison of the figures contained in both sets of books revealed the following factors responsible for their disagreement:

Directors Fees not charged in cost accounts	7.500
Works Overheads under-recovered in costs	1,500
Loss due to Obsolescence charged in financial accounts	3,500
Administrative overheads over-recovered in costs	1,800
Depreciation charged in financial accounts	10,000
Depreciation recovered in costs	12,000
Income Tax provided in financial accounts	54,500
Interest on Investments not included in costs	5,000
Transfer Fees credited in financial accounts	2,500
Fines paid not included in costs	1,200
Discount on issue of debentures written off in financial accounts	2,000

Prepare a Reconciliation Statement showing reconciliation of profit between the two sets of books.

Solution

Reconciliation Statement

	Plus Column	Minus Column
	Rs.	Rs.
Net Profit as per Cost Accounts	1,19,400	
Directors' Fees not charged in costs		7,500
Works Overheads under-recovered in costs		1,500
Loss due to Obsolescence not charged in costs		3,500
Administrative Overheads over-recovered in costs	1,800	
Depreciation overcharged in costs (12,000 − 10,000)	2,000	
Income Tax provided in financial accounts		54,500
Interest on Investments not included in costs	5,000	
Transfer Fees credited in financial accounts	2,500	
Fines paid not included in casts		1,200
Discount on Issue of Debentures not shown in costs		2,000
	1,30,700	70,200
Net Profit as per Financial Accounts	60,500	

Alternatively

Reconciliation Statement

	Plus Column	Minus Column
	Rs.	Rs.
Net Profit as per Financial Accounts	60,500	
Director's Fees not charged in costs	7,500	
Works Overheads under-recovered in costs	1,500	
Loss due to Obsolescence not considered in costs	3,500	
Administrative Overheads over-recovered in costs		1,800
Excess depreciation charged in costs (12,000 – 10,000)		2,000
Income Tax provided in financial accounts	54,500	
Interest on Investments credited in financial accounts		5,000
Transfer Fees credited in financial accounts		2,500
Fines paid charged in financial accounts	1,200	
Discount on Issue of Debentures written off in financial accounts	2,000	
	1,30,700	11,300
Net Profit as per Cost Accounts	1,19,400	

Check Your Progress A

1 Fill in the blanks:

a) If cost and financial transactions are maintained in a single set of books, the method is called ....

b) If cost and financial records are kept separate, the method is called ....

c) Cost ledger is the .... ledger in cost accounting which contains all the nominal accounts.

d) Stores ledger is a .... ledger which records separate account for each item of stores.

e) Object of preparing Costing Profit or Loss Account is to determine ....

f) Preparation of reconciliation statement is necessitated because of ....

2 Tick the correct answer:

a) Under-recovery of works overheads should be added to the net profit as per financial records in order to arrive at the net profit as per costing records.

b) Obsolescence loss should be deducted from the net profit as per financial records in order to arrive at the net profit as per costing records.

c) Dividend on investments should be added to the net profit as per financial records in order to arrive at the net profit as per costing records.

d) Overabsorption of selling and distribution overheads in costs should be deducted from the net profit as per costing records in order to arrive at the net profit as per financial records.

3) What is the purpose of preparing reconciliation statement?

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11.6 MEMORANDUM RECONCILIATION ACCOUNT

The reconciliation of profits shown by the two sets of books can also be presented in the form of a ledger account called 'Memorandum Reconciliation Account'. This method is simple. The amounts which are to be added to profits shall be shown on its credit side **while** the amounts to be deducted from profits shall be shown on its debit side. In this case also, you can take either **profit/loss** as per cost accounts as the base or **profit/loss** as per financial **accounts** as the base. Based on data given in Lllustration 1, the Memorandum Reconciliation Account shall be prepared as follows:

Memorandum **Reconciliation Account**

Dr.	Rs.		Cr. Rs.
To Directors Fees not charged in costs	7,500	By Net Profit as per Cost Accounts	1,19,400
To Works Overheads under-recovered in costs	1,500	By Administrative Overheads over-recovered in costs	1,800
To Loss due to Obsolescence not charged in costs	3,500	By Depreciation over-recovered in costs	2,000
To Income Tax charged in financial accounts	54,500	By Interest on Investments not included in costs	5,000
To Fines paid not included in costs	1,200		
To Discount on Issue of Debentures not shown in costs	2,000	By Transfer Fees credited in financial accounts	2,500
To Net Profit as per Financial Accounts	60,500		
	1,30,700		1,30,700

Alternatively

Memorandum Reconciliation Account

Dr.	Rs.		Cr. Rs.
To Administration Overheads over-recovered in costs	1,800	By Net Profit as per Financial Accounts	60,500
To Excess Depreciation charged in costs	2,000	By Directors Fees not charged in cost accounts	7,500
To Interest on Investments credited in financial accounts	5,000	By Works Overheads under-recovered in costs	1,500
To Transfer Fees credited in financial accounts	2,500	By Loss due to Obsolescence charged in financial accounts	3,500
To Net Profit as per Cost Accounts	119,400	By Income Tax provided in financial accounts	54,500
		By Fines paid charged in financial accounts	1,200
		By Discount on Issue of Debentures written off in financial accounts	2,000
	1,30,700		1,30,700

11.7 COMPREHENSIVE ILLUSTRATIONS

Illustration 2

From the following figures prepare a Reconciliation Statement.

	Rs.
Net Profit as per Financial Records	25,751
Net Profit as per Costing Records	34,480
Works Overheads under-recovered in costs	624
Administration Overheads recovered in excess in costs	340
Depreciation charged in financial records	2,240
Depreciation recovered in costing	2,500
Interest on Investments received but not included in costs	1,600
Obsolescence loss charged in financial records	1,140
Income Tax provided in financial accounts	8,060
Bank Interest credited in financial accounts	150
Store Adjustments credited in financial accounts	95
Loss of Stock due to Spoilage charged in financial accounts	1,350

Solution

Reconciliation Statement

	(+) Rs.	(–) Rs.
Net Profit as per Financial Accounts	25,751	
Works Overheads under-recovered in excess in costs	624	
Administration Overheads recovered in excess in costs		340
Excess Depreciation recovered in costs		260
Interest on Investment not included in cost		1,600
Obsolescence loss charged in financial records but not in cost	1,140	
Income Tax provided in financial but not in cost	8,060	
Bank interest credited in financial books, but not in cost		150
Stores Adjustments credited in financial books, but not in cost		95
Loss of Stock due to Spoilage charged in financial books but not in cost	1,350	
	36,925	2,445
Net Profit as per Cost Accounts	34,480	

Illustration 3

The Net Loss shown by financial accounts of a company amounted to Rs. 57,320 while the Net Loss disclosed by company's cost accounts for that period amounted to Rs. 37,100. Scrutiny of figures from both the sets of books revealed the following facts:

i) Directors Fees not charged in cost Rs. 1,300
ii) A Provision for Bad and Doubtful Debts made in financial accounts Rs. 1,140
iii) Bank Interest credited in financial accounts Rs. 60
iv) Obsolescence Loss charged in financial accounts Rs. 16,600
v) Overheads in the cost accounts were estimated at Rs. 17,000. The charge shown by the financial accounts was Rs. 16,640
vi) Depreciation charged in financial accounts was Rs. 9,600 while depreciation recovered in costs amounted to Rs. 8,000.

Prepare a statement reconciling the figures shown by the financial and cost accounts.

Solution

Reconciliation Statement

	(+) Rs.	(–) Rs.
Net Loss as per Financial ~~counts		57,320
Directors Fees not charged in costs	1,300	
Provision for Bad and Doubtful Debts made in financial accounts but not in costs	1,140	
Bank Interest credited in financial accounts, but not credited in costs		60
Obsolescence loss charged in financial accounts, but not in costs	16,600	
Overabsorption of overheads in costs (17,000—16,640)		360
Excess depreciation chnrged in financial accounts (9,600—8,000)	1,600	
	20,640	57,740
Net Loss as per Cost Accounts		37,100

Illustration 4

From the following Profit and Loss Account draw up a Memorandum Reconciliation Account showing the profit as per Cost accounts.

Profit & Loss Account for the Year ended 31st December, 1989

Dr.	Rs.		Cr. Rs.
To Office Salaries	22,564	By Gross Profit b/d	1,09,236
To Office Expenses	16,540	By Dividend received on investments	2,400
To Sales Expenses	28,452		
To Distribution Expenses	5,980	By Interest on Bank Deposits	360
To Loss of Sale of Machinery	3,900		
To Fines & Penalties	500		
To Discount on Debentures	1,000		
To Goodwill written off	10,000		
To Provision for Income Tax	10,000		
To Net Profit	13,060		
	1,11,996		1,11,996

Solution

Memorandum Reconciliation Accounts

Dr.	Rs.		Cr. Rs.
To Dividend received on Investments	2,400	By Net Profit as per Financial Accounts	13,060
To Interest on Bank De osits	360	By Lou on sale of machinery	3,900
To Net Profit as per Cost Accounts	35,700	By Fines & Penalties	500
		By Discount on Debentures	1,000
		By Goodwill written off	10,000
		By Provision for Income Tax	10,000
	38,460		38,640

Illustration 5

The following figures are extracted from the financial accounts of Selwel Ltd. for the year ending 31-12-1989.

		Rs.
Sales (20,000 units)		50,00,000
Materials		20,00,000
Wages		10,00,000
Factory Overheads		9,00,000
Administration Overheads		5,20,000
Selling and Distribution Overhends		3,60,000
Finished Goods (1,230 units)		3,00,000
Work-in-process		
Materials	Rs. 60,000	
Labour	Rs. 40,000	
Factory Overheads	Rs.40,000	1,40,000
Interest paid on capital		40,000
Goodwill written off		4,00,000

In the costing records, factory overheads are charged at 100% of wages, administration overheads at 10% of factory cost, and Selling and Distribution'overheads at the rate of Rs. 20 per unit sold.

Prepare a statement reconciling the profit as per financial records with the profit as per cost records.

Solution

Trading and Profit & Loss Account of Selwel Ltd. for the Year ending 31st December, 1989

Dr.	Rs.			Cr. Rs.
To Materials	20,00,000	By Sales		50,00,000
To Wages	10,00,000	By Closing Stock Finished Goods		3,00,000
		Work-in-process		
To Factory Overheads	9,00,000	Materials	60,000	
To Gross Profit c/d	15,40,000	Labour	40,000	
		Factory Overhead	40,000	1,40,000
	54,40,000			54,40,000
To Administration Overheads	5,20,000	By Gross Profit b/d		15,40,000
To Selling and Distribution Overheads	3,60,000			
To Goodwill Written off	4,00,000			
To Interest paid on Capital	40,000			
To Net Profit	2,20,000			
	15,40,000			15,40,000

Cost Sheet of Selwel Etd. for the Year ending 31st December, 1989

Outpur: 21,230 units

	Rs.	Rs.
Cost of Direct Materials used	20,00,000	
Less : Cost of Materials in Work-in-process	60,000	19,40,000
Cost of Direct Labour used	10,00,000	
Less : Cost of Direct Labour in Work-in-process	40,000	9,60,000
PRIME COST		29,00,000
Factory Overheads @ 100% of wages		9,60,000
FACTORY COST		38,60,000
Administration Overheads @ 10% of Factory Cost		3,86,000
COST OF PRODUCTION (21,230 units)		42,46,000
Less : Cost of closing stock of finished goods (1,230 units)		2,46,000
COST OF GOODS SOLD (20,000 units)		40,00,000
Selling and Distribution Overheads (20,000 × Rs. 20)		4,00,000
COST OF SALES		44,00,000
Profit (balancing figure)		6,00,000
SALES		50,00,000

Reconciliation Statement

	(+) Rs.	( ) Rs.
Profit as per Cost Accounts	6,00,000	
Overabsorption of Factory Overheads in costs (9,60,000—8,60,000)	1,00,000	
Overvaluation of closing stock of Finished Goods in financial accounts (3,00,000—2,46,000)	54,000	
Underabsorption of Administration Overheads in costs (5,20,000 - 3,86,000)		1,34,000
Overabsorption of Selling and Distribution Overheads in costs (4,00,000—3,60,000)	40,000	
Goodwill written off in financial accounts, but not considered in cost accounts		4,00,000
Interest aid on Capital charged in financial accounts, but not considered in cost accounts		40,000
	7,94,000	5.74.000
Net Profit as per Financial Accounts	2,20,000	

Working Notes

i) *Total no. of units produced during the year*

= No, of units sold + No, of units remaining unsold

= 20,000 + 1230 = 21,230 units

ii) *Value of Closing Stock of Finished Goods*

$$= \frac{\text{Cost of Production}}{\text{Total No. of units produced}} \times \text{No. of Units remaining unsold}$$

$$= \frac{42,46,000}{21,230} \times 1230 = \text{Rs. } 2,46,000$$

iii) *Actual expenditure incurred on factory overheads in financial accounts*
Total amount – Amount spent on work-in-process
= Rs. (9,00,000 –40,000) = Rs. 8,60,000.

11.8 LET US SUM UP

Broadly speaking, there are two methods of maintaining cost accounts on double entry system : 1) Integral Accounting, and 2) Non-Integral Accounting. Under the second method of cost accounting (also known as control accounts system) cost records are maintained as an independent set of accounts. A separate Costing Profit and Loss Account is prepared to ascertain the profit or loss. The amount of profit or loss so ascertained is invariably different from the profit or loss as per financial accounts. This necessitates the preparation of a statement reconciling the amounts of profit or loss shown by the two sets of accounts.

The profit or loss shown by the two sets of books differs on account of four major factors. They are:

i) Items shown only in the financial accounts and not in the cost accounts

ii) Items shown only in the cost accounts and not in the financial accounts

iii) Under/Overabsorption of Overheads

iv) Different basis of Stock valuation

The reconciliation statement can be prepared either with profit/loss as per cost accounts as the starting point or with profit/loss as per financial amounts as the starting point. In both cases, the amount of profit/loss as per the other set of books is arrived at by making adjustments in respect of all items responsible for the difference. The reconciliation of two figures of profit can also be done by preparing a Memorandum Reconciliation Account. The preparation of Reconciliation Statement or Memorandum Reconciliation Account helps in cross-checking the arithmetical accuracy of both sets of accounting records and thus makes them more reliable.

11.9 KEY WORDS

Cost Control Accounts System : A method of maintaining accounts where the cost transactions are recorded in a completely separate set of books.

Cost Ledger : The principle ledger in cost accounting which contains all nominal accounts and all control accounts for the subsidiary ledgers.

Costing Profit and Loss Account : An amount prepared for determining the profit/loss as per costing books maintained under non-integral accounting.

Finished Stock Ledger : A subsidiary ledger which contains accounts of all items of finished products manufactured or the jobs completed.

Integrated Accounting : A method of maintaining accounts where both the cost and financial transactions are recqrded in a single set of books.

Memorandum Reconciliation Account : The formal way of reconciling the profit/loss shown by the two sets of books in the form of a ledger account.

Overabsorption of Overheads : The recovery of overheads in excess of the actual expenditure.

Reconciliation Statement : The formal way of reconciling the profit/loss shown by the two sets of books in the form of a statement.

Stores Ledger : A subsidiary ledger which contains accounts for items of stores and shows the movement of stores.

Underabsorption of Overheads : The short-fall in recovery of overheads.

Work-in-progress Ledger : A subsidiary ledger which contains accounts for all jobs, processes or operations pending on the shop floor.

10.10 ANSWERS TO CHECK YOUR PROGRESS

A 1 a) Integral Accounting, b) Non-integral Accounting, c) principal, d) subsidiary, c) Profit/loss as per costing records, f) Non-agreement of profit/loss as per two sets of books

2 a) True, b) False, c) False, d) False

11.11 TERMINAL QUESTIONS/EXERCISES

Questions

1) What are control accounts? Describe their advantages.
2) What do you understand by 'Integrated Accounting"?
3) Explain the need for reconciliation of cost and financial accounts.
4) It has been stated that the results worked out from the costing records and those worked out from the financial accounts may not necessarily agree. Why?
5) Give reasons as to why it is necessary to reconcile cost accounts and financial accounts. What is the accounting procedure to be adopted for their reconciliation?
6) State briefly the causes of difference between profits shown by Financial Accounts and the profits shown by Cost Accounts.

Exercises

1) From the following figures prepare a Reconciliation Statement.

	Rs.
Net Profit as per financial records	1,28,755
Net profit as per costing records	1,72,400
Works Overheads under-recovered in costing	3,120
Administrative Overheads recovered in excess in costing	1,700
Depreciation charged in financial records	11,200
Depreciation recovered in costing	12,500
Interest received but not included in costing	8,000
Obsolescence Loss charged in financial records	5,700
Income Tax provided in financial records	40,300
Bank Interest credited in financial books	750
Stores Adjustments credited in financial books	6,750

2) From the following particulars prepare

i) Statement of Cost of Manufacture for the year 1988.

ii) Statement of Profit as per cost accounts, and

iii) Profit & Loss account in the financial books and show how you would attribute the difference in the profit as shown by (ii) and (iii).

	Rs.
Opening stock of raw materials	30,000
Opening stock of finished goods	60,000
Purchase of raw materials	1,80,000
Stock of raw materials at the end	45,000
Stock of finished goods at the end	15,000
Wages	75,000

Calculate the factory overheads at 25% on prime cost and office overheads at 75% on factory overheads.

Actual works expenses amounted to Rs. 58,125 and actual office expenses amounted to Rs. 45,750. The selling price was fixed at a profit of 25% on cost.

(Answer: Profit as per Statement of Cost Rs. 97,500; Profit as per Financial Amounts Rs. 98,625)

3) The following information has been obtained from the records of Freezer Ltd., a manufacturer of one tonne air-conditioners.:

	Rs.
a) Materials per machine	1,500
Wages	900
Number of machines manufactured and sold	80
Selling price per machine	4,250

b) Works overheads to be charged @ 60% of the wages

c) Office overheads to be charged 20% of works cost

d) There were no stock of machines or work-in-progress at the beginning or at the end of the period.

Prepare a statement showing the profit per machine sold. Also prepare a slatement showing the actual profit if work expenses were Rs. 43,000 and office expenses were Rs. 48,000 as per the financial records; and shown how you will reconcile the profits shown by two statements.

(Answer: Profit as per cost statement Rs. 57,760; Profit as per financial records **Rs. 57,000)**

4) The following is the summarised version of Trading and Profit & Loss Account of Continental Enterprises Limited for the year ended 31st March, 1990.

	Rs.			Rs.
To Materials	48,000	By Sales		96,000
To Wages	36,000	By Closing Stock Finished Goods		20,400
To Works Expenses	24,000	By Work-in-progress		
To Gross Profit c/d	14,400	Materials	3,000	
		Wages	1,800	
		Work Expenses	1,200	6,000
	1,22,400			1,22,400
To Administration Expenses	6,000	By Gross Profit b/d		14,400
To Net Profit	8,400			
	14,400			14,400

During the year 6,000 units were manufactured and 4,800 of them were sold.

The costing records show that works overheads have been estimated at Rs. 3 per unit produced and administration overheads at Rs. 1.50 per unit produced. The costing books show a profit of Rs. 11,040.

You are required to prepare a Reconciliation Statement.

(Answer: Valuation of Closing Stock of Finished Goods in Cost Rs. 21,240 **(Overvaluation** by Rs. **840).** Under-recovery of Works Overheads Rs. 4,800 and Over-recovery of Administration Overheads Rs. 3,000)

5) Modern Company Limited furnishes the summary of Trading and Profit & Loss Account for the year ended 31st March, **1990.**

	Rs.		Rs.
To Raw Materials	1,39,600	By Sales (1,200 units)	4,80,000
To Direct Wages	76,200	By Finished Stock (200 units)	8,000

To Production Overheads	42,600	By Work-in-progress		
To Administration Overheads	39,100	Materials	28,200	
To Selling & Distribution		Wages	11,976	
Overheads	42,700	Production Overheads	7,999	47,995
To Preliminary Expenses written off	2,200	By Interest on Securities		6,000
To Goodwill written off	2,501			
To Dividends	3,000			
To Income Tax	4,100			
To Net Profit	1,89,944			
	5,41,995			5,41,995

The company manufactures a standard unit, scrutiny of cost records for the same period shows that

i) Factory overheads have been allotted to the production at 20% on prime cost.

ii) Administration overheads have been charged at Rs. 3 per unit on units produced,

iii) Selling and Distribution expenses have been charged at Rs. 4 per unit on units sold.

You are required to prepare a Statement of Cost to work out profit as per cost accounts and to reconcile the same with that shown in the financial accounts.

(Answer : Profit as per costing records : Rs. 1,88,493; 'Valuation of Closting Stock of Finished Goods in Cost Rs. 4,058 (under-valuation by Rs. 3,942); Overabsorption of production overheads Rs. 560; Underabsorption of administrative overheads Rs. 2,500 and overabsorption of selling & distribution overheads Rs. 5,300)

6) The financial profit and loss account of a manufacturing company for the year ended 31st March, 1990.

	Rs.		Rs.
To Opening Stock of Finished Goods	38,500	By Sales	2,50,000
To Purchases of Materials	60,000	By Closing Stock of Finished Goods	35,000
To Wages	48,000		
To Works Overheads	38,000		
To Gross Profit c/d	1,00,500		
	2,85,000		2,85,000
To Administrative Expenses	20,000	By Sales	2,50,000
To Selling & Distribution Expenses	24,000	By Closing Stock Finished Goods	35,000
To Bad Debts	7,200		
To' Provision for Bad Debts	5,000		
To Net Profit	65,300		
	1,21,500		1,21,500

It is found that the Costing Profit and Loss Account has been prepared on the basis of figures furnished below:

Opening Stock of Finished Goods	Rs. 45,000
Closing Stock of Finished Goods	Rs. 31,500
Works Overheads recovered in costs	Rs. 36,000
Administrative Overheads recovered in Costs	Rs. 22,000
Selling & Distribution Overheads recovered in Costs	Rs. 20,000

You are required to prepare a Memorandum Reconciliation Account and determine the profit as per cost accounts.

(Answer : Profit as per cost accounts : Rs. 50,500;
Overvaluation of Opening Stock in cost Rs. 6,500;
Undervaluation of Closing Stock in cost Rs. 3,500;
Under-resovery of Works overheads in cost Rs. 2,000

Note : These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

UNIT 12 JOB AND CONTRACT COSTING

Structure

12.0 OBJECTIVES

After studying this unit. you should be able to:

- define job costing and describe its special features
- explain the procedure adopted for costing purposes in case of job costing
- evaluate job costing as a method of cost ascertainment
- prepare a job cost sheet
- define contract costing and describe its special features
- prepare contract account and ascertain the notional profit on uncompleted contracts
- explain how profit taken to profit and loss account is determined
- explain how work in progress is shown in balance sheet.

12.1 INTRODUCTION

If a firm is engaged in producing homogeneous product, it uses unit costing method about which you studied in Unit 2. But, where a firm is engaged in undertaking small jobs involving different amount of material, labopr and overhead costs such as automobile repair shop, interior decorators, furniture makers, etc., unit costing method cannot be applied. The method of costing used by them is known as 'job costing' which treats each job as a separate unit of cost. Under this method, costs are accumulated and analysed job-wise. When, however, a firm undertakes big jobs like constructing a building, road, bridge, etc., which involve huge sums and long duration, it stops contract costing method of ascertaining cost and profit. The special feature of such jobs is that they may remain incomplete by the end of the accounting year. Hence, ascertainment of profit or loss has many complexities.

In this unit, you will learn about both the methods in detail and study how cost and profit of small jobs and big projects (contracts) are ascertained. To be more specific, you will learn about the preparation of Job Cost Sheet and Contract Account.

12.2 JOB COSTING

Job Costing refers to the method of ascertaining costs where product is manufactured or service is provided against specific order, as distinct from continuous production for stock and sale. Under this method, costs are collected and recorded for each job. or a batch of similar jobs, under a separate production order number. Each job has its own characteristics and needs special treatment. Take the example of a machine tool manufacturer or an automobile repair shop. Each order of machine or each repair job involves dtfferent amount of materials, labour and overheads. Hence, it is necessary to accumulate the costs for each order or job so that its total cost can be determined and proper matching of costs and revenues can be made.

12.2.1 Definition and Characteristics

The ICMA Terminology provides an excellent description of job costing which defines it as "that form of specific order costing which applies where work is undertaken to customers' special requirements and each order is of comparatively short duration. The work is usually carried out within a factory or work shop and moves through processes and operations as a continuously identifiable unit".

Thus, the special features relating to production and cost ascertainment in industries where job costing can be applied are :

i) Each job is unique, specific and dissimilar.

ii) Each job is undertaken to customer's special requirements and not for stock.

iii) Each job is comparatively of a short duration.

iv) Each job is capable of identification at all stages of production.

v) Each job order is separately identified by a job order number.

vi) There is no uniformity in the flow of production from department to department.

vii) Direct costs of labour, materials and expenses are booked directly against the job order.

viii) Overheads are charged on the basis of predetermined rates.

12.2.2 Applicability

Keeping in view the above features, job costing may be usefully employed in the following organisations :

Printing Press : Each item to be printed, whether it is a handout, a book or an advertising flyer, is a separate job.

Garage : Each car to be repaired or tuned up becomes a separate job.

Furniture Manufacturer : Each order for furniture is treated as an individual job. For example, several units of one style of chairs will be produced in one batch.

Service Organisation stations : A firm of Chartered Accountants is an example of a service Organisation. Each work-order assigned by the client is treated as a separate job and fees charged accordingly.

Construction Companies : Each building is a separate job because each building has different covered area and a different design.

12.2.3 Procedure

Job Costing involves considerable amount of recording and analysis. It requires reliable production control records which must show material issued to various jobs, labour time spent on different jobs and the appropriate allocation of overheads as work on each job passes through production cost centres. A concern using job costing usually adopts the following procedure for costing purposes.

1) Estimating the job costs : Estimating is an essential requirement of a job costing procedure. It is useful for submission of tenders and price quotations. The Costing Department has to prepare an estimate of the total cost for each job before it is undertaken. This forms the basis for quoting the price to the customer.

2) Allocating job order number : As soon as an order is received and accepted, it must be assigned a separate job order number. This facilitates reference for production as well as for costing purposes.