**Strategic Cost Management**

**April 2025 Examination**

**1. New Era Corp., a mid-sized manufacturing company, has been struggling with inefficiencies in its budget allocations. For years, the company relied on incremental budgeting, where previous year’s expenses were carried forward with minor adjustments. Over time, this led to certain departments hoarding funds they didn’t necessarily need, while other critical areas remained underfunded.**

**Facing increasing competition and pressure to improve profitability, the management decided to overhaul their budgeting process. They proposed shifting to a zero-based budgeting (ZBB) system, where every expense would have to be justified from scratch for each new budgeting cycle. The finance team welcomed the opportunity to streamline spending but raised concerns about the time and resources required to implement ZBB. Department heads expressed mixed reactions—some saw it as a chance to highlight their real needs, while others worried about the effort involved in preparing detailed justifications for every cost. After a six-month trial run with ZBB, the company observed some significant changes. Now, the management must decide whether to fully adopt ZBB across the organization or return to the traditional budgeting approach. What are the advantages and disadvantages of adopting a zero-based budgeting system as observed in this case? (10 Marks)**

**Ans 1.**

**Introduction**

Budgeting plays a crucial role in financial planning and resource allocation for any organization. New Era Corp., a mid-sized manufacturing company, faced inefficiencies due to its reliance on incremental budgeting, which led to misallocation of funds and reduced financial agility. To address this issue, the company considered implementing Zero-Based Budgeting (ZBB), a process where each department must justify every expense for each budgeting cycle. The shift aimed to eliminate wasteful spending and allocate resources more effectively. However, this change brought mixed reactions from employees—while some saw it as an opportunity to optimize funds, others found the process cumbersome. After a six-month trial,

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**2. Mindset Ltd., a manufacturing company producing Product A and Product B, is facing challenges in accurately allocating overhead costs using the traditional costing system. To address this, the management has decided to implement an Activity-Based Costing (ABC) system to ensure a fair allocation of costs and better decision-making. The following data is available:**

**Overhead Costs and Activity Drivers:**

|  |  |  |  |
| --- | --- | --- | --- |
| **Activity** | **Total Overhead Cost** | **Activity Driver** | **Total Activity** |
| **Machine Setup** | **₹50,000** | **Number of setups** | **100 setups** |
| **Quality Inspection** | **₹60,000** | **Number of inspections** | **120 inspections** |
| **Material Handling** | **₹40,000** | **Number of material movements** | **80 movements** |

**Activity Driver Usage by Products:**

|  |  |  |
| --- | --- | --- |
| **Activity Driver** | **Product A** | **Product B** |
| **Number of setups** | **60 setups** | **40 setups** |
| **Number of inspections** | **80 inspections** | **40 inspections** |
| **Number of material movements** | **50 movements** | **30 movements** |

**Allocate overhead costs to Product A and Product B using activity-based costing. Calculate the overhead cost per unit for each product if units produced of product A are 1000 and that of product B are 500. What insights do the results share? (10 Marks)**

#### **Ans 2.**

#### **Introduction**

Accurate allocation of overhead costs is crucial for manufacturing firms to ensure fair pricing and effective decision-making. Mindset Ltd., which produces Product A and Product B, faced inefficiencies using the traditional costing system. This method often assigns overheads arbitrarily, leading to inaccurate product costing and potential profitability issues. To improve cost allocation accuracy, the company decided to adopt Activity-Based Costing (ABC). ABC assigns overhead costs based on actual resource consumption through activity drivers such as machine setups, quality inspections, and material handling. By implementing ABC, Mindset

**3. Delta Ltd. is a mid-sized manufacturing company specializing in high-quality kitchen appliances. Their flagship product, the ‘SmartCook Pro’, is gaining popularity, but the management team is concerned about fluctuating profit margins due to rising raw material costs and competitive pricing pressures.**

**To address these challenges, DEF Ltd. wants to use Cost-Volume-Profit (CVP) analysis to better understand the relationship between their costs, production volume, and profit. They need insights into the breakeven point, the sales volume required to meet a target profit, and how changes in variable costs or selling prices might impact their financial performance. The company has set a selling price of ₹2,000 per unit, incurs variable costs of ₹1,200 per unit, and has total fixed costs of ₹8,00,000.**

**The management also plans to introduce a discount strategy, reducing the selling price to ₹1,800 per unit to boost sales, and they wish to evaluate its impact on profitability. Using CVP analysis, they aim to make informed decisions on production levels and pricing strategies.**

**a. Based on the current pricing strategy, calculate the breakeven point in units. What is break-even analysis and what does these number of units signify? (5 Marks)**

**Ans 3a.**

#### **Introduction**

Break-even analysis is a financial tool used by businesses to determine the level of sales required to cover total costs, where no profit or loss occurs. Delta Ltd., a manufacturer of kitchen appliances, seeks to understand its breakeven point for the ‘SmartCook Pro’ to navigate rising material costs and competitive pricing pressures. By calculating the breakeven point, the

**b. If Delta Ltd. reduces the selling price to ₹1,800 per unit to achieve a target profit of ₹4,00,000, calculate the number of units they need to sell? (5 Marks)**

**Ans 3b.**

#### **Introduction**

Delta Ltd. plans to reduce the selling price of the ‘SmartCook Pro’ to ₹1,800 per unit to attract more customers. However, the management wants to determine how many units they need to sell to achieve a target profit of ₹4,00,000. Using Cost-Volume-Profit (CVP) analysis, we can calculate the required sales volume to ensure profitability under the new pricing strategy.

#### **Concept and Analysis**

The key concept in CVP analysis for target profit calculations is the contribution margin, which r