Standard costing

Standard costing is the preparation of standard cost and applying them to measure the variance from actual cost and also analyse the causes of variance with the view to achieve maximum efficiency in production.

In other word, we can say that it is a technique which uses standards for costs and revenue for the purpose of control through variance analysis.

Technique of Standard Costing

The technique of Standard Costing thus involves the following steps:

a. The ascertainment of Standard cost.
b. The use of Standard cost.
c. Their comparision with Actual cost.
d. Measurement of Variances.
e. The analysis of variances for ascertaining the reason for the same.
f. The location of responsibility for the variances and the corrective action to be taken.

Need for standards in Cost Accounting

a) Cost Control
b) Pricing Decision
c) Performance Appraisal
d) Cost Awareness
e) Management by Objective

Management by objective – This is a concept in which manager establish specific objectives for all business activities. When such activities are under the desired performance level, little or no management action is necessary. However, when performance is at wide variance with desired levels, management take suitable actions.

For this purpose, standards provide quick, ready reference for identifying and reporting variances for acceptable performance level.

Difficulties/ Limitations of Standards

I. Setting the standard is a difficult task as it involves technical skills.

II. Accounts are not unanimous regarding the circumstances to be taken as the basis for setting standard cost. Even if, standard to be used is well-defined, since condition do not remain static.
Thus, continuous revision of standard is a difficult task to be performed.

III. The fixation of inaccurate standards especially those that are incapable of achievement adversely affect the morale of the employees and act as a hindrance to achieve efficiency.

IV. For localising deviations and fixing responsibilities, it becomes necessary to distinguish between controllable and uncontrollable variance but such a distinction may not be always possible.

Difference between Budgetary Control and Standard Costing

Budgetary Control	**Standard Costing**
➢ Budgetary control is concerned with the operation of business as a whole.	➢ Standard costing is related with the control of cost mainly. Hence, budgetary control is broader than standard costing.
➢ Budgets are prepared based on past actual data adjusted to future trends.	➢ Standard costs are fixed based on technical assessment.
➢ Budgets set up maximum limits of expenses, which the actual expenditure should not normally exceed.	➢ Standards are minimum targets which are to be attained by actual performance at specific efficiency level.
➢ Budget is a projection of financial accounts.	➢ Standard cost is the projection of cost accounts.
➢ Budgets can be adopted without standard costing.	➢ Standard costing cannot exist without budgeting.

Objective

The objective of both standard costing and budgetary control is to achieve maximum efficiency and cost reduction by establishing pre-determined standards, comparing actual performances with the pre-determined standards and taking corrective actions, where necessary.

Reason for difference between actual performance and standard performance

- Measurement errors
- Outdated standards
- Out of control operations

1) Measurement Errors – The recorded amount for actual cost or actual uses may differ from actual incurred amount. For e.g. – Labour hours for a particular operations may be incorrectly added up or indirect labour cost may be incorrectly classified as direct labour cost.
2) Outdated standards – Standards become outdated because of change in production conditions like where frequently changes in prices of input occurred, there is danger that standard price may be outdated.

   Standards can also become outdated where operations are subject to frequent technological changes.
3) Out of control operations – Variances may result from inefficient operation due to a failure to follow prescribed procedure, faulty machinery or faulty human force.

Type of variances

1. Cost variance
2. Sales variance

1. Cost variance
    a. Material Variance
    b. Labour Variance
    c. Overhead Variance
        I. Variable overhead variance
        II. Fixed overhead variance