***B.COM 4th SEMESTER (NON-CBCS)***

***COST AND MANAGEMENT ACCOUNTING (MANAGEMENT MAJOR)***

***PAPER - 405***

***GROUP- A: COST ACCOUNTING***

***UNIT – III***

***STANDARD COSTING***

Q.1 **Explain the significance of Variance analysis**

***OR***

**Explain Variance Analysis**

**Answer:** ICMA defines variance as “The different between a standard cost and comparable actual incurred during a given period. The purpose qI’variance is, to enable the management to have control over cost.”

Variance may be favourable or unfavourable. Again it may be controllable or uncontrollable.

**Favourable Variance**:

When actual cost is less than the standard cost or actual result is better than the standard, the difference is known as favourable variance. It is sign of efficiency.

**Unfavourable Variance:**

When actual cost exceeds standard cost or result is less than the standard, it is known as unfavorable or adverse variance. It is a sign of inefficiency or wastage.

The term favourable and unfavourable variance indicates a trend of variance of variance from standard cost. This trend will give correct indicate if the standards are accurately set and timely revised with the change situations, otherwise this give distorted results and will lead to wrong managerial decision.

Q.2 **What are the advantages of standard** **costing?**

**Answer:** Following are the various advantages of standard cost:

1. **Effective Cost Control** – Standard set act as yardsticks against which actual are compared. Thus it facilitates effective cost control and provides information for cost reduction.
2. **Helping in Formulating Policies and Planning** – It provides a valuable guidance to the management in their function of formulating policies, in determining pricing and planning.
3. **Provides Incentives** – Standard provides incentives and motivate worker to work with greater efforts for appropriate rewards.
4. **Determination of Cause for Inefficiency** - Measurement and analysis of variances help in detecting mistakes and inefficiencies. It enables the management to investigate their cause.
5. **Delegation of Authority -** It delegates authority and establishes responsibility of each executive for his performance.
6. **Facilities Co-ordination -** It enforces co-ordination between different departments by establishing standards for the performance of each department.
7. **Cost Consciousness -** It infuses the cost consciousness among the labour force and thus productivity is improved.
8. **Valuation of Closing Stock -** It simplifies the valuation of closing stock because it is valued at standard’ cost.
9. **Standardizing of Business activity –** It sets standards for various business activities. Thus it enables the use of standards materials, standard methods of production, etc.

1. **Management by Exception** - Reporting variances is bases on the principle of Management by Exception. Only variances beyond a pre-determined limit may be considered by the management for corrective action.
2. **Prompt preparation of Profit and Loss Account -** This will help the management for prompt preparation Profit and Loss Account for a short period.

Q3. **Define standard and standard cost?**

**Answer:** **Standard -** The term standard may be used to refer to the pre-determined rate or a pre-determined amount against which performance is judged. As for example. For an output of 1000 units, standard material cost is Rs. 5,000. Therefore, the standard rate per unit is Rs. 5.

Pre-determined rate is fixed on the basis of past experience, study and analysis of prevailing conditions and expected future changes.

**Standard Cost** - Standard cost is a predetermined cost which determines in advances what each product or services should cost under given circumstances. It is determined on the basis of technical estimate of for material, labour and overheads for a selected period of time and for a prescribed set of working conditions.

CIMA London defines standard cost as “a pre determined cost which is calculated from management standard efficient operations and the relevant necessary expenditure.”

Q4. **What are the limitations of Standard Costing?**

**Answer**: Following are the limitations of standard costing –

1. It is difficult to establish standard in practice.
2. Standard require constant revisions in view of changing costs. Revision involves cost and creates problem.
3. Inaccurate and unreliable standards cause misleading results.
4. Installation of standard costing is a costly affair.
5. It is expensive and unsuitable in job-order industries, manufacturing non-standard products.
6. It is unsuitable for service industries.

Q5. **What is meant by Standard Costing?**

**Answer**: ICMA, London, defines Standard Costing as “The preparation and the use of standard costs, their comparison which actual costs and analysis of variances of their causes and points of incidence.”

Thus when standard costs are used, the technique is known Standard Costing. Standard costs have defines by Lucey “As pre-determined calculation of how much cost should be under specified working conditions.”

Q.6 **Indicate the industries where Standard Costing system is suitably applied?**

**Answer**: Standard Costing can be applied in all industries but it is more useful in those industries, which produce standardized products and which are repetitive in nature. Examples of such industries are –

Cement, Textile, Fertilizers, Sugar, Steel, etc.

In job-order industries, it is not worthwhile to develop and employ a full system of standard costing because each undertaken may be different from another and settings standards for each job may prove to be difficult and expensive.

**Q7. State the steps involved in Standard Costing?**

**Answer:** The technique of standard costing involves the determination of cost beforehand. The cost is based on technical information after considering the impact on current conditions. Cost ascertainment is not based on a guess work. The impact of possible factors on cost is studied before setting the standard. The standards are set as per existing conditions of work. With the change of conditions, the standard cost too can be modified so as to make it more realistic. The standard may be divided according to the elements of cost. The cost is divided into standard for materials, labour and overheads. The sub-division of standard will be more useful for cost control purposes. The actual cost is recorded when incurred. The standard cost is compared to the actual cost. The difference between the two costs is known as variance. The variance re-calculated element-wise. The management can take corrective measures to set the things right.

From the above discussion it is clear that standard costing involves the following steps:

1. The determination of standard cost.
2. The recording of actual cost.
3. The comparison between the standard cost and actual cost.
4. The finding out variance.
5. The reporting of variance so as to find out inefficiency and take corrective measures.

The technique of standard costing is complementary to the ordinary system. The standard cost will be of no use if they are not compared with actual cost. The basic purpose of standard costing is to efficiency or inefficiency in manufacturing a particular product. This will be possible only if both standard costs and actual costs are giving side by side. Though standard costing system will be useful for all types of commercial and industrial undertaking but it will be more useful in those undertaking where production is standardized. It will be of less use in job costing system because every job has different specifications and it will be difficult to determine standard costs for every job.

**Q8. Discuss “Standard Costs” Vs “Target Costs”.**

**Answer:** Standard cost is the predetermined cost based on technical estimate of material, labour and overhead for a selected period of time and for a specified set of working conditions, whereas the target cost is the estimated cost of a product based upon the customer’s value perception. The target cost is the difference between target price which the potential customers are willing to pay and the reasonable profit. Target costing is defined as a “cost management tool for reducing the overall cost of a product over its entire life cycle with the help of the production, engineering and R&D.” The purpose of target costing is to enable a firm to remain and compete in the market in the long run. Thus, standard cost technique may be used to control costs to the extent possible within a given operational framework ; whereas target costing is a powerful tool for reducing cost not only at the production stage but also at the planning and design stages of the product life-cycle. Target costing as a new technique of controlling cost has been developed by Japanese in the 1970s.

**Q9. State the limitations of Standard Costing .**

**Answer**: Standard costing is an important tool for management control. It is helpful in fixing standards and finding out variances. It enables the management to pinpoint inefficient spots. Besides all the benefits derived from this system, it has a number of limitations. These limitations are discussed as follows:

1. Standard costing cannot be used in those concerns where non-standard products are produced. If the production is undertaken according to the customer’s specifications then each job will involve different amount of expenditures. Under such circumstances it is not possible to set up standards for every job. Standard costing can be used only in those concerns where standardized products are manufactured.
2. The process of setting up standards is a difficult task as it requires technical skill. The time and motion study is required to be undertaken for this purpose. These studies require a lot of time and money.
3. There are no inset circumstances to be considered for fixing standards. The conditions under which standards are fixed do not remain static. With the change in circumstances the standards are also to be revised. The revision of standard is a costly process. In case the standards are not revised the same become impracticable.
4. This system is expensive and small concerns may not afford to bear the cost. For small concerns the utility from this system may be less than the cost involved in it.
5. The fixing of responsibility is not an easy task. The variances are to be classified into controllable and uncontrollable variances. The responsibility can be fixed only for controllable variances. The determination of controllable and uncontrollable variances will be a problem. The variances may be controllable at one point of time and may become uncontrollable at another time. The problem is faced whenever a responsibility is to be fixed.
6. The industries liable for frequent technological changes will not be suitable for standard costing system. The change in production process will requires a revision of standard. A frequent revision of standard will be costly. So this system will not be useful for industries where methods and techniques of production are fast changing.