UNIT-III
STANDARD COSTING

1. What is Standard Cost?

Ans. The word 'standard' means a bench-mark or yardstick. The standard cost is a predetermined cost which determines in advance what each product or service should cost under given circumstances.
The costing terminology of I.C.M.A., defines standard cost as "a predetermined cost which is calculated from management's standards of efficient operation and the relevant necessary expenditure. It may be used as a basis for price-fixing and for cost control through variance analysis".
A standard cost is a planned cost for a unit of product or service rendered.

2. Distinguish between standard cost and standard costing.

Ans.

Standard Cost	Estimated Cost
1. It gives an emphasis on What should be the Cost.	1. It presumes that what will be the cost.
2. It uses the parameter of efficiency.	2. It uses the perception of efficiency applied.
3. It is revised at frequent intervals	3. It cannot be revised since there is no need of revision.
4. It is a reliable tool of cost control.	4. It cannot be used as a cost control.
5. It is more stable in nature.	5. It is more flexible and changed at every change of situation.

3. What is Standard Costing? State its features.

Ans. The technique of using standard costs for the purposes of cost control is known as standard costing.
Standard Costing is defined by I.C.M.A. Terminology as, "The preparation and use of standard costs, their comparison with actual costs and the analysis of variances to their causes and points of incidence".

Characteristics/Features of Standard Costing:

(i)Cost determination. Standard costing is designed to know cost of output based on past experience and future trend.

(ii)Cost comparison. When actual costs are known these are compared to budgeted costs.

(iii) Control on variances. The comparison between standard and actual cost is made to know the variances.

(iv) Verification of variances. Once the variances are known the effective study is made to check the future variances.

(v) Reporting. For the benefit of top management, reports are prepared and despatched specifying who is responsible for variances.

(vi) Revision. The management gives corrective suggestions for variances.

4. Explain the advantages and disadvantages of standard costing.

Ans. Advantages of Standard Costing:

(i)Cost Control: Standard costing is universally recognised as a powerful cost control system. Controlling and reducing costs becomes a systematic practice under standard costing.

(ii)Elimination of Wastage and Inefficiency: Wastage and inefficiency in all aspects of the manufacturing process are curtailed, reduced and eliminated over a period of time if standard costing is in continuous operation.

(iii)Norms: Standard costing provides the norms and yard sticks with which the actual performance can be measured and assessed.

(iv)Locates Sources of Inefficiency: It pin points the areas where operational inefficiency exists. It also measures the extent of the inefficiency.

(v) Fixing Responsibility: Variance analysis can determine the persons responsible for each variance. Shifting or evading responsibility is not easy under this system.

(vi)Management by Exception: The principle of 'management by exception can be easily followed because problem areas are highlighted by negative variances.

(vii) Improvement in Methods and Operations: Standards are set on the basis of systematic study of the methods and operations. As a consequence, cost reduction is possible through improved methods and operations.

(viii)Guidance for Production and Pricing Policies: Standards are valuable guides to the management in the formulation of pricing policies and production decisions.

(ix)Planning and Budgeting: Budgetary control is far more effective in conjunction with standard costing. Being predetermined costs on scientific basis, standard costs are also useful in planning the operations.

(x)Inventory Valuation: Valuation of stocks becomes a simple process by valuing them at standard cost.

Limitations of Standard Costing:

(i) Variation in Price: One of the chief problems faced in the operation of the standard costing system is the precise estimation of likely prices or rate to be paid.

(ii) Varying Levels of Output: If the standard level of output set for pre-determination of standard costs is not achieved, the standard costs are said to be not realised.

(iii)Changing Standard of Technology: In case of industries that have frequent technological changes affecting the conditions of production, standard costing may not be suitable.

(iv)Applicability: It cannot be used in those organizations where non-standard products are produced. If the production is undertaken according to the customer specifications, then each job will involve different amount of expenditures.

(v)Difficult to set Standard: The process of setting standard is a difficult task, as it requires technical skills. The time and motion study is required to be undertaken for this purpose. These studies require a lot of time and money.

(vi) Problem in fixing Responsibility: The fixing of responsibility is not an easy task. The variances are to be classified into controllable and uncontrollable variances. Standard costing is applicable only for controllable variances.

5. Distinguish between Standard Costing and Budgetary Control.

Ans. The following are the major differences between standard costing and budgetary control:

Basis	Standard Costing	Budgetary Control
1.Meaning	Standard Costing is a cost accounting system, in which performance is measured by comparing the actual and standard costs.	Budgetary Control is a control system in which actual and budgeted results are compared continuously in order to achieve the desired result.
2. Relationship	Standard Costing is limited to, cost data.	Budgetary Control is related to cost as well as economic data of the enterprise.
3.Concept	Standard costing is a unit concept.	Budgetary control is a total concept.
4.Scope	Standard Costing has a restricted scope, limited to production costs only.	Budgetary Control has a comparatively wider scope as it covers all the operations of the whole organization.
5. Reporting of Variances	In Standard Costing variances are revealed and reported.	In budgetary control, as the controls are being exercised at the same time, the variances are not disclosed.
6. Comparison	In Standard Costing the comparison is made between actual cost and standard cost of actual output.	On the other hand, in Budgetary Control the comparison is made between the actual and budgeted performance.
7. Effects of temporary changes in conditions	Standard costs do not change due to short-term changes in the conditions.	Budgeted costs may change due to short-term changes in the conditions.
8.Applicability	Standard Costing applies to manufacturing concerns.	Budgetary Control applies to all the organizations.

6. What is variance analysis? Explain its importance or managerial uses of variance analysis.

Ans. Variance Analysis deals with an analysis of deviations in the budgeted and actual financial performance of a company. The causes of the difference between the actual outcome and the budgeted numbers are analyzed to showcase the areas of improvement for the company.

In other words, variance analysis is a process of identifying causes of variation in the income and expenses of the current year from the budgeted values. It helps to understand why fluctuations happen and what can / should be done to reduce the adverse variance. This eventually helps in better budgeting activity.

Importance or managerial uses of variance analysis: The variance analyses are important tools of cost control and cost reduction and they generate an atmosphere of cost consciousness in the organisation. In short, the uses of variances are:

(i) Comparison of actual with standard cost which reveals the efficiency or inefficiency of performance. The inefficiency or unfavourable variance is analysed and immediate action is taken. Thus variance is like a barometer.

(ii) It is a tool of cost control and cost reduction.

(iii)It helps the management to apply the principle of management by exception.

(iv)It helps the management to maximise the profits by analysing the variances into controllable and uncontrollable; the controllable variances are further analysed so as to bring a cost reduction, indirectly more profit.

(v)Future planning and programmes are based on the variance analysis, because standard costing and variance analysis need a complete study of the organisation. Thus, the factors of profits can be known and future plan made.

(vi) Within the organisation, a cost consciousness is created along with the team spirit.

The variance analysis and fact finding further boost the profits of the organisation.

7. What is disposition of variances? What are the ways/methods of disposing of variances?

Ans. When financial statements contain actual cost figures only then there will be no variances. When standard costing system is followed then accounting records contain both standard costs and actual costs. The question of variances arises at the end of the accounting period. The process of adjusting the variances is known as disposition of variances.

There is difference of opinion among accountants as regards disposal of cost variance. However, the following methods are usually used to close the Standard Cost Variances:

(i)Transfer to Profit and Loss Account: Under this method all variances are transferred to profit and loss account. In this method, the stock of finished goods, work-in-progress and cost of sales are shown at standard cost. It is considered that variances arise due to insufficiency or waste, so these should not become a part of normal cost of production.

(ii)Allocation of Variances to Finished Stock, Work-in-Progress and Cost of Sales: In this method, variances are apportioned to finished goods, work-in-progress and cost of sales either on the basis of value of closing balances or on the basis of units.

(iii)Transfer of Variances to the Reserve Account: In this method cost variances are taken to next accounting period as deferred items. The variances whether favourable or adverse are transferred to a reserve account and are offset against future fluctuations.

8. What are Control Ratios? What are the different types of control ratios?

Ans. Under the system of budgetary control, the actual performances are compared with budgeted performances so as to determine the deviations or variances. The deviations or variances may be favourable or unfavourable and may be expressed in terms of absolute figures or in terms of ratios. The ratios in terms of which the deviations or variances are expressed are known as Control Ratios.

Types of Control Ratios: These Control Ratios are:
(i)Capacity Ratio
(ii)Activity Ratio
(iii)Efficiency Ratio

(i) Capacity Ratio: It is also known as Actual Usage of Budgeted Capacity Ratio. It denotes the relationship between the actual number of working hours and the budgeted number of working hours. This ratio indicates the extent to which the available facilities were actually utilized during the budget period.
Capacity Ratio may be expressed or calculated as follows:
Capacity Ratio = (Actual Hours / Budgeted Hours) x 100

(ii)Activity Ratio: Activity Ratio is the number of standard hours equivalent to the work produced, expressed as a percentage of the budgeted standard hours. This ratio measured the level of activity at which a business concern is operating and may be expressed as follows:
Activity Ratio = (Actual Production in terms of Standard Hours / Budgeted Production in terms of Standard Hours) x 100

(iii)Efficiency Ratio: Efficiency Ratio is the number of standard hours equivalent to the work produced, expressed as a percentage of the actual hours spent in producing that work. This ratio measures the efficiency of the operation of the firm and may be expressed as follows:
Efficiency Ratio = (Actual Production in terms of Standard Hours / Actual Hours worked) x 100