SHALINI

ASSISTANT PROFESSOR (GUEST FACULTY)

VANIJYA MAHAVIDYALAYA,

PATNA UNIVERSITY, PATNA

CONTACT: 7903953783

EMAIL: shalinigalax@gmail.com

E- CONTENT FOR M.COM (SEMESTER- 2)

SUBJECT: MANAGEMENT ACCOUNTING

PAPER CODE: COMCC-9

UNIT-III : STANDARD COSTING AND VARIANCE ANALYSIS (Theory)

TOPIC: Introduction, Definition, Meaning, Importance and Kinds of Variance (Material, Labour and Overhead)

STANDARD COSTING

Standard costing is basically a technique of cost control. It involves following process or features:

1. Recording and setting up of standard cost for various elements of total cost.
2. Recording of actual cost.
3. Comparison of actual cost with standard cost and finding out the variance of actual from standard, if any.
4. Locating the factors responsible for such variances.
5. Reporting to management for appropriate action.

Under this technique, cost data for each activity are pre-determined on the basis of normal levels of operation and efficiency and costs incurred at actual performance are compared with pre- determined standards and thus variance, if any, is found out. Then after locating the factors responsible for variance management is accordingly informed by taking necessary remedial steps, makes efforts to keep actual cost consistent with standard costs in future.

Definition:

According to Brown and Howard, "Standard costing is a technique of cost accounting which compares the standard cost of each product or service with actual cost to determine the efficiency of the operation, so that any remedial action may be taken immediately."

Meaning:

We can say, standard costs are those costs which are pre-determined for a normal level of efficiency of operation and which are used periodically as a basis for comparison with actual costs to disclose the cost of deviations from standard and classifies these as to their causes so that management informed of the sphere of operations in which remedial action is necessary.

Variance Analysis

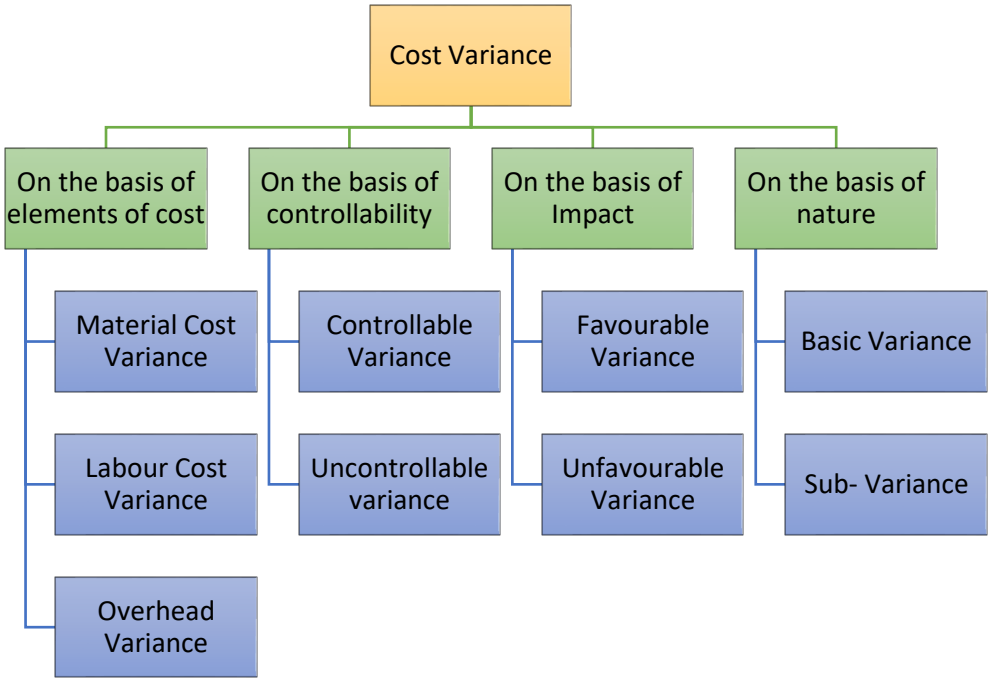
Variance analysis is the study of deviation of actual performance from standard performance.

Analysis of variance involves the segregation of total cost variances into different elements in such a way as to indicate or locate clearly the cause for such variances and persons held responsible for them. Thus, comparison of actual costs periodically with standard costs traced not only the variance but also the root cause of such deviation. Moreover, they can suggest remedial action accordingly.

Importance of Variance Analysis:

a) Variance analysis acts as control mechanism.
b) It helps managers in making efficient budgeting decisions.
c) It helps to identify the reasons for the overall variances.
d) It is highly useful for fixing responsibility of an individual or department or section for each variance separately.
e) The top management can follow the principle of management by exception. Only unfavourable variances are reporting to management.
f) Sometimes ,the variances can be classified as controllable and uncontrollable variances. In this case, controllable variances are taken into consideration for further action.

Classification of cost variance



Controllable Variance-

When a particular person or department held responsible for variance such variance is controllable variance. All basic variance arising due to non-monetary factors and sub variances are said to be controlled variance. These variance are much significance for the management as controllable variance is identified as primary responsibility of a specified person.

Uncontrollable Variance-

Variance for which a particular person or a specific department cannot be held responsible are known as uncontrollable variance. External factors that are beyond the power of management are responsible for such variance. All basic variance arising due to monetary factors are said to be uncontrollable.

Favourable variance-

Favourable variance arise only when actual costs are lower than the standard costs for the same level of activity as pre-determined. It is considered as good and indicator of business efficiency.

Unfavourable or adverse variance-

It arise when actual costs are more than the determined standard costs. Normally these variances indicate the inefficiency and hence there is need for a closer and deeper analysis of these variance.

Basic Variances-

Basic variances are those variances which arise on account of monetary rates (i.e. price of raw material or labour rate) And also on account of non-monetary factors(physical units or time).

Sub- Variance-

In sub variance, basic variances arising due to non-monetary factors are further analysed and classified into sub variances taking into account the factors responsible. Example: Material cost variances occurs due to price variance or quantity variance

Material Cost Variance:

MCV is the difference between actual cost of materials used and the standard cost for the actual output.

Labour Cost Variance:

It is the difference between the actual direct wages paid and the direct labour cost allowed for the actual output to be achieved.

Overhead Variance:

It is the difference between the standard cost of overhead allowed for actual output (in terms of production units or labour hours) and the actual overhead cost incurred.

The above bases of classification of variables are complementary to each other. Material cost variance on the basis of elements of cost may be controllable and favourable and may be broken into basic and sub- variance.

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