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M.Com. (Semester 4)

Accounts Group

Paper I : Financial Accounting and Analysis

Topic : Standard Costing

Meaning – Standard costing is a predetermined cost which determines in advance what each product or service could cost under given circumstances.

Terminology of cost accountancy defines standard costing as "The preparation and uses of standard cost and the analysis of variance to their cause and points of incidence"

STEPS involved in standard costing –

(i) Determination of standard cost
(ii) Recording of Actual cost
(iii) Comparison between the two
(iv) Finding/computing the variance
(v) Reporting of variance and taking corrective measures to improve inefficiency.

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Advantages of standard costing

(i) Measuring efficiency
(ii) formation of production & price policy
(iii) Determination/deduction of variances
(iv) Reduction in work (by reducing unnecessary information)
(v) Helps in Management by Expectation (MBE)
(vi) eliminates efficiency
(vii) Helpful in strategic decision making

Disadvantages/limitations of standard costing

(i) Cannot be used for non-standard products
(ii) Difficulty in setting appropriate standards
(iii) Standards donot remain fix due to changing circumstances
(iv) Expensive for small concerns
(v) Responsibility can be fixed only for Controllable variance
(vi) Not good for industries having frequent technological changes.

classification of Variance

1. Direct material variance
2. Direct labour Variance
3. overhead cost variance
4. Sales or Profit variance

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① Group 1 : Accounts Group.

Paper 1 : Financial accounting & analysis.

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Topic – Marginal Costing.

Marginal cost is "the amount of any given volume of output by which aggregate cost are changed if the volume of output is increased by one unit" – Institute of Cost & Management Accountants London

Marginal costing is "the ascertainment of marginal cost and the effect on profit of changes in volume or type of output by differentiating between fixed cost & variable cost" – ICMA, london

Characteristics of Marginal costing

(i) Not an independent system of costing like job or process costing. It is a technique of analysis of cost that helps in taking managerial decision.
(ii) All costs are classified as fixed cost or variable cost
(iii) only variable (Marginal) costs are regarded as cost of products
(iv) Fixed cost are treated as period cost
(v) Cost of finished goods and work in progress are valued at marginal cost only
(vi) Price is determined on basis of marginal cost.

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Contribution (C) → also known as Margin or Gross Margin
→ Excess of sales over variable cost

C = sales − variable cost ($S - VC$)

or C (per unit) = S.P. − VC/unit

or C = Fixed cost + {Profit (−Loss)}

Marginal Equation →

$$S - V = F \pm P$$

Derivation ⇒ $S - VC = C \quad \therefore S = C + VC$

so $S = VC + FC \pm P$ or loss

P/V ratio → Profit volume ratio. also known as C/S ratio ie. contribution sales ratio or marginal ratio or simply contribution ratio.

$$P/V \text{ ratio} = \frac{\text{Contribution}}{\text{Sales}} \text{ or } \frac{S-V}{S} \text{ or } \frac{F \pm P}{S}$$

$$\text{or P/V ratio} = \frac{\text{change in contribution}}{\text{change in sales}}$$

Advantages of contribution −

(i) helps in fixation of selling price
(ii) helps in determining Break Even point
(iii) helps in selecting suitable product mix
(iv) helps in choosing from alternative methods of production
(v) helps in purchase or manufacture decisions.
(vi) helps in deciding about adding a new product in the market.

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