

*A. Panchenko, Master student*  
*J. Bezverkhniy, PhD of Ec., As. Prof., research advisor*  
*T. Zhukova, language advisor*  
*Tavria State Agrotechnological University*

## **STANDARD COSTING: ADVANTAGES AND DISADVANTAGES**

The basic function of management accounting is to facilitate the managerial control in a business unit or organisation. Management control is the process of evaluating performance and applying corrected measures, if required, so that performance takes place according to plans. The major aspect of managerial control is cost control. And the “standard costing” is that technique which helps management to control costs and business operations. It aims at eliminating wastes and increasing efficiency in performance through setting up standards or formulating different cost plans [1, c. 163].

The research and study of the method standard costing, its advantages and disadvantages have been worked out by such scientists: H. Harrison, T. Downey, G. Emerson, V. E. Kerimov, R. S. Kaplan and others.

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. The terminology of cost accountancy defines standard costing as “the preparation and use of standard costs, their comparison with actual costs, and the analysis of variance to their causes, and points of incidence” [1, c. 164].

Standard costing is a management accounting tool used in management decision making to allow better cost control and optimal resource utilization. When there are variances between the standard and actual costs, the reasons for them should be researched, analyzed and remedies should be introduced by the management to ensure the variances are minimized in the next accounting period [3].

Further, it is a system of cost accounting, which is designed to find out how much should be the cost of a product under the existing conditions. The actual cost can be ascertained only when production is undertaken. The predetermined cost is compared to the actual cost and a variance between the two enables the management to take necessary corrective measures.

The technique of standard costing involves the determination of cost before occurring. The standard cost is based on technical information after considering the impact of current conditions. With the change in condition, the cost also can be modified so as to make it more realistic. The standard cost is divided into standards for materials, labour and overheads. 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 variances are calculated element wise. The management can take corrective measures to set the things right on the basis of different variances.

The basic purpose of standard costing is to determine efficiency or inefficiency in manufacturing a particular product. This will be possible only if both standard costs and actual costs are given side by side. Though standard costing system will be useful for all types of commercial and industrial undertakings but it will be more useful in those

undertakings 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 [1, c. 165].

The establishment of a standard costing system involves the following steps:

- Determination of cost centre. A cost centre may be a department or part of a department or item of equipment or machinery or a person or a group of persons in respect of which costs are accumulated and one where control can be exercised. Cost centres are necessary for determining the costs.

- Classification of accounts. It is necessary to meet a required purpose i.e. function, asset or revenue item. Codes can be used to have a speedy collection of accounts. A standard is a predetermined measure of material, labour and overheads. It may be expressed in quantity and its monetary measurements in standard costs.

- Types of standards. The standards are classified into three categories:

- current standard. A current standard is a standard which is established for use over a short period of time and is related to current condition. It reflects the performance which should be accomplished during the current period. The period for current standard is normally one year. It is supposed that the conditions of production will remain unchanged. In case there is any change in price or manufacturing condition, the standards are also revised. Current standard may be ideal standard and expected standard (ideal standard represents a high level of efficiency and it's fixed on the assumption that favourable conditions will prevail and management will be at its best; expected standard is based on expected conditions and it is the target which can be achieved if expected conditions prevail).

- basic standard. A basic standard is established for use for an indefinite period or a long period. These standards are revised only on the changes in specification of material and technology production.

- normal standard. Normal standard is a standard which is anticipated can be attained over a future period of time, preferably long enough to cover one trade cycle. This standard is based on the conditions which will cover a future period, say 5 years, concerning one trade cycle. If a normal cycle of ups and downs in sales and production is 10 years then standard will be set on average sales and production which will cover all the years.

- Organisation for standard costing. In a business concern a standard costing committee is formed for the purpose of setting standards. The committee includes production manager, purchase manager, sales manager, personnel manager, chief engineer and cost accountant. The cost accountant acts as a coordinator of this committee. He supplies all information for determining the standard and later on coordinates the costs of different departments. He also informs the committee about the change in price level, etc. The committee may revise the standards in the light of the changed circumstances.

- Setting of standards. The standard for direct material, direct labour and overhead expenses are fixed. The standards for direct material, direct labour and overheads should be set up in a systematic way so that they can be used as a tool for cost control easily [1, c. 171].

Steps in standard costing are the following:

1. Determining standard costs for the unit. This is achieved by reviewing in detail the processes and inputs that are required to produce a unit.

2. Agreeing the budgeted sales price of each unit. This may be determined by using the standard cost per step 1 as the baseline for cost plus mark up based pricing.

3. Preparing budgets for each budgetary period (normally one year), which are typically broken down into shorter term budgets (normally monthly). This aids the short term control.

4. Recording actual costs and revenues for each short term control cycle.

5. Preparing an operating statement that reconciles the actual and budgeted cost/profit for each control cycle. The differences will be reported as variances.

6. Investigate the reasons for the occurrence of significant variances.

7. Identify and agree the control actions required to correct adverse variances and accentuate favourable variances.

8. Implement and monitor the results of the control actions instituted per step 7 [4].

Standard costing is not only helpful for cost control purposes but it is also useful in production planning and policy formulation. It derives many advantages: measurement of efficiency, production and price policy formulation, management by exception.

Measurement of efficiency is a tool for assessing the efficiency after comparing the actual costs with standard costs to enable the management to evaluate performance of various cost centres. Production and price policy formulation becomes easy to formulate production plans by taking into account standard costs. As for management by exception it means that everybody is given a target to be achieved and management need not supervise each and everything. The responsibilities are fixed and every body tries to achieve his targets and management by exception is possible only when targets of work can be fixed. Standard costing enables the determination of targets [1, c. 168].

Besides all the above benefits derived from this system, it has a number of limitations: standard costing cannot be used in those concerns where non-standard products are produced; the time and motion study is required to be undertaken for the process of setting up standards; there are no inset circumstances to be considered for fixing standards; this system is expensive and small concerns may not afford to bear the cost; this system will not be useful for industries where methods and techniques of production are fast changing [1, c. 170].

So, from the above we can conclude that standard costing has its advantages, and certain disadvantage. Therefore, this system will be useful for industries where methods and techniques of production do not change very quickly.

Standard Costing is a cost accounting technique, which helps to measure the performance of material, labour and overhead and report the variances, to take corrective actions. The variances are being analysed in detail and reported by comparing the actual costs with the standard cost for actual output along with determining the reasons for the same [2].

Standard costing is a management tool that is used in organisations to improve many key management processes including:

- understanding and determining unit costs;
- arriving at cost plus prices budgeting revenues;
- costs and expected profits/contribution;
- planning resource inputs such as direct materials and direct labour;

- reporting performance;
- controlling performance variances [4].

Standard costing can help organisations make best possible use of the resources. In addition to this, the management can keep a check on the organisational activities by assessing the deviations, i.e. analysing the difference between actual performance and the standard performance.

### **REFERENCES**

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