

Standard costing: meaning and objectives essay sample

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“ Standard costing” is a traditional cost accounting method and management tool in which “ standard costs are employed to value the overall cost of a production”. A “ Standard cost” can be defined as a “ predetermined/estimated future cost of performing an operation, producing a good or offering a service”. As explained in our workbook, using standard costs enable managers to identify in advance material, labor and overheads costs for a product or a service. Standard costing can be assigned to each activity of a business. Considering it is a hospitality perspective, standard costing can be assigned to all the main activities of a hotel operation: preparing a menu item or a cocktail, clearing a bedroom, checking a guest in, etc. Working within the Room Division, I am reporting below as an example the Standard Cost for “ Cleaning a bedroom for the next sale” (discussed during the course):

Standard Cost of Cleaning a Bedroom for the next Sale £

Labour – including NI and benefits 15

Cleaning supplies and amenities 10

Laundry cost – labor, laundry chemical, and utility costs incurred 5

Utilities – hot water, lighting, air con, etc 5

Depreciation 11

Reservation / marketing costs 70

Total costs 116

Daily Rate 350

Contribution to overheads (sales-variable costs / £350-£116) 234

Standard costing can be potentially and beneficially used in several managerial processes, such as:

- Price Formulation. The standard cost of a product or a service is seen as the base of price setting and profit forecasting. To run a hotel effectively, it is fundamental knowing the relation between how much a product/service is costing you in order to establish its price (how much to charge guests/customers for it) & to generate a profit. The price setting will always take into consideration both the Standard costing and the GOP (Gross operating profit) of any product/service.

Managers usually try to have a GOP that represents the 70% of the selling price and when it comes to Food, Beverage and Spa product/service, a Cost of Sales that represent the 30% of the selling price. The same happens when establishing the daily rate of a room, both the standard costing and the GOPPAR (Gross operating profit per available room) are taken into consideration;

- Planning and budgeting. Standard costs enable managers to estimate the overall cost of a production/operation and these future cost prediction can be used when creating a budget and when making future decisions.

- Performance Evaluation. By setting a standard cost per each activity and communicating it to the employees, managers aim to increase consistency in delivering each activity for any of the customers (standard cost should stay the same whichever is the level of sales - 30% of the service/product selling price) and to increase efficiency by reducing wastage. Therefore, employees are trained to deliver activities by following standard costs. Their

performance is monitored and evaluated based on the set standard achievement, which is a motivation source.

Considering the provided example of standard cost for cleaning a room, that establishes how much cleaning product should be used, how many housekeepers and for how long should be cleaning, etc. in order to maximize profitability. Same happens with the standard costing of a menu item, that gives chefs indications on ingredient usage and portion sizes, in order to maximize cost-effectiveness. Furthermore, both housekeepers and chefs' performance will be evaluated based on the standard costing being respected or not.

Lastly, standard costing is used for inventory valuation and overheads contributions.

However, the most important purpose of standard costing is definitely cost control. Managers can control costs by “ analyzing the variances between standard cost and actual cost per unit or operation center”. The “ variance is favorable” if the “ actual cost is lower than the standard cost and profit will be more than planned”. The “ variance is unfavorable” if the “ actual cost is higher than the standard cost and profit will be less than planned”.

Analysing the variance will identify the activities that are not performing to standards and that are being cost ineffective. Managers' duty will be to implement corrective actions and resolve the inefficiencies. Looking back at the standard cost of cleaning a room, the cost of cleaning supplies is £10. Therefore, if at the end of the month the rooms sold are 100, the total cost of cleaning supplies should be £1000. However, if an unfavorable variance

arises and cost of cleaning supplies is instead of £1500, a manager's duty will be to identify the reason behind it (excessive usage of the product, lack of training or price rise by suppliers). Once the reason will be identified, a corrective action will be implemented with the aim of reducing the cost and maximizing profit. Analysing the variances will give management the tools to control the cost of the housekeeping department and monitor its performance. In conclusion, the usage of Standard costing has mostly advantages, but one main disadvantage, it is non-accurate due to the constantly changing business environment.