

Discuss how standard costing is used in management planning

[Business](#), [Management](#)



Since the company's main objective is to maximize profit, a planning and control system is essential. Firstly, a strategy that best satisfies the objectives of a company has to be selected. Secondly, the decision has to be implemented into a planning process. Therefore, a budget that relates to the entire activity of a company and to forecasted future revenues and expenditures has to be prepared. Standard costing can assist in budget setting and it supports cost control by setting standards.

Establishing a standard cost for each unit produced enables a detailed analysis of budgeted and actual costs so that costs can be controlled more effectively. Once a budget is set, it becomes the target by which performance is evaluated and assured. A company must remember that targets must be realistic and achievable to motivate people, otherwise the budget will become a source of demotivation. After finishing the budget the input of a company (4 M's = Manpower, Machines, Money and Material) is going to be transformed to output units during the production process.

The production is followed by the control process: actual costs incurred are compared with standard costs to reveal variances, to monitor performance and to provide feedback. A standard cost system highlights exceptions (instances where things are not going as planned). The identification of variances (variance analysis) serves as an early warning system for management. Variance analysis is generally concerned with material usage and price variances, labor rate and efficiency variances and total material and labor variances.

It points out potential problem areas for closer investigations, for example adverse (actual costs > budgeted costs) and favorable (actual costs < budgeted costs). The entire process is known as "system-feedback-loop", and it indicates that planning and control process is dynamic and that a standard cost system can support the management decision making process by discovering better ways of adhering to standards, of altering standards, and of achieving objectives.