

Advantages of standard costing accounting essay



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Despite the advantages just noted for some applications of standard costing, there are substantially more situations where it is not a viable costing system. Here are some problem areas:

Cost-plus contracts. If you have a contract with a customer under which the customer pays you for your costs incurred, plus a profit (known as a cost-plus contract), then you must use actual costs, as per the terms of the contract. Standard costing is not allowed.

Drives inappropriate activities. A number of the variances reported under a standard costing system will drive management to take incorrect actions to create favorable variances. For example, they may buy raw materials in larger quantities in order to improve the purchase price variance, even though this increases the investment in inventory. Similarly, management may schedule longer production runs in order to improve the labor efficiency variance, even though it is better to produce in smaller quantities and accept less labor efficiency in exchange.

Fast-paced environment. A standard costing system assumes that costs do not change much in the near term, so that you can rely on standards for a number of months or even a year, before updating the costs. However, in an environment where product lives are short or continuous improvement is driving down costs, a standard cost may become out-of-date within a month or two.

Slow feedback. A complex system of variance calculations are an integral part of a standard costing system, which the accounting staff completes at the end of each reporting period. If the production department is focused on

immediate feedback of problems for instant correction, the reporting of these variances is much too late to be useful.

Unit-level information. The variance calculations that typically accompany a standard costing report are accumulated in aggregate for a company's entire production department, and so are unable to provide information about discrepancies at a lower level, such as the individual work cell, batch, or unit.

The foregoing list shows that there are a multitude of situations occur where standard costing is not useful, and may even result in incorrect management actions. Nonetheless, as long as you are aware of these issues, it is usually possible to profitably adapt standard costing into some aspects of a company's operations.

Advantages of Standard Costing

Though most companies do not use standard costing in its original application of calculating the cost of ending inventory, it is still useful for a number of other applications. In most cases, users are probably not even aware that they are using standard costing, only that they are using an guesstimate of actual costs. Here are some potential uses:

Inventory costing. It is extremely easy to print a report showing the period-end inventory balances (if you are using a perpetual inventory system), multiply it by the standard cost of each item, and instantly generate an culmination inventory valuation. The result does not exactly match the actual cost of inventory, but it is close. However, it may be necessary to update standard costs frequently, if actual costs are continually changing. It

is easiest to update costs for the highest-dollar mechanisms of inventory on a frequent basis, and leave lower-value items for intermittent cost reviews.

Overhead application. If it takes too long to aggregate actual costs into cost pools for allocation to inventory, then you may use a standard overhead application rate instead, and adjust this rate every few months to keep it close to actual costs.

production costs at different volume levels, since this may call for the use of longer production runs that are less expensive.

Budgeting. A budget is always composed of standard costs, since it would be impossible to include in it the exact actual cost of an item on the day the budget is finalized. Also, since a key application of the budget is to compare it to actual results in subsequent periods, the standards used within it continue to appear in financial reports through the budget period.

Price formulation. If a company deals with custom products, then it uses standard costs to compile the projected cost of a customer's requirements, after which it adds on a margin. This may be quite a complex system, where the sales department uses a database of component costs that change depending upon the unit quantity that the customer wants to order. This system may also account for changes in the company's

Nearly all companies have budgets and many use standard cost calculations to derive product prices, so it is apparent that standard costing will find some uses for the foreseeable future. In particular, standard costing provides a benchmark against which management can compare actual performance.

Following through all the arithmetic's of variances I have pin pointed reasons for the Material Price Variance, Material Usage Variance, Labour Efficiency Variance, and Labour Rate Variance.

Material Price Variance occurs a failure to purchase the standard quality, thereby resulting in a difference price paid. This will lead into bad purchasing, in which is very discomfoting the company's interest such as a rush purchase for an uneconomical markets, and also pushes a purchase of a substitute material on account of non-availability of the material specified by the company. This all are related to the interdependence at variances when it ensues an event has a favorable impact on one variance but an adverse impact on another variance. For example, the purchase of inferior quality materials may account for a favorable price variance but it may also have a negative impact on the material usage & labor efficiency variance due to the quality causing an increase in usage. The adverse may also be affected by inflation and general increase in the market price. In such circumstances the selling price should be altered to refract the current market.

Material Usage Variances may be affected by a whole lot of reasons such as carelessness in the use of material also affect the reason of material usage in resulting excessive consumption. Which brings us to the use of defective or sub-standard material that will cause spoilage to the material. Other reasons such as a change in t plant and machinery who also results to excessive consumption of material. The adverse on the variances is due to excess issues. Managers should check the stock are securely locked away & that only the standard quantity is issued each day. And it's not just that, There are a few more such as :

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Faulty workmanship

Faulty material processing

Pilferage of materials

Use of material mixture, rather than standard mixture

Labour Efficiency Variance is affected because of the actual hours used is greater than the standard hours, and it adverse is due to the use of an inappropriate standard that should be changed. Alternatively, there may have been idletime, ten working time should be synchronized.

Bridget, C. (2012). Standard Costing. Available: <http://www.accountingtools.com/standard-costing>. Last accessed 28th Oct 2012.