CIHAN UNIVERSITY / SULAIMANI

Faculty of Administration and Financial

Sciences

Accounting Department

ADVANCED COST ACCOUNTING

(II)

Fourth Stage

2023 - 2024

Standard Costing System

Standard costing is an important subtopic of cost accounting. Standard costs are usually associated with a manufacturing company's costs of direct material, direct labour, and manufacturing overhead.

Rather than assigning the actual costs of direct material, direct labour, and manufacturing overhead to a product, many manufacturers assign the expected or standard cost. This means that a manufacturer's inventories and cost of goods sold will begin with amounts reflecting the standard costs, not the actual costs, of a product. Manufacturers, of course, still have to pay the actual costs. As a result there are almost always differences between the actual costs and the standard costs, and those differences are known as variances.

Standard costing and the related variances is a valuable management tool. If a variance arises, management becomes aware that manufacturing costs have differed from the standard (planned, expected) costs.

- If actual costs are greater than standard costs the variance is unfavourable. An unfavourable variance tells management that if everything else stays constant the company's actual profit will be less than planned.
- If actual costs are less than standard costs the variance is favourable. A favourable variance tells management that if everything else stays constant the actual profit will likely exceed the planned profit.

The sooner that the accounting system reports a variance, the sooner that management can direct its attention to the difference from the planned amounts.

The variances are: Materials variance, Labour variance, Manufacturing Overhead variance (Variable and Fixed) and Sales variance.

A standard cost involves the following processes:

1. Establishment of standard cost.
2. Compute the actual cost.
3. Comparison of the standard cost with the actual cost in order to find out the variances.
4. Analysis of the variances.

5. Report the analysis to responsible parties.

Cost of producing product or service is the total of the following costs:

- Material Cost
- Direct Labour Cost
- Overhead Cost

Standard cost is the budgeted cost and against which performance is monitored so that cost control is maintained. Each day accounting prepares reports that show:

- Whether the budgeted costs were exceeded
- Which ones (i.e. material, labour, overhead)
- Variances

This data should cause appropriate corrective action to be taken. Variance Usually Calculated

Material Price	Tells how much more than budgeted (standard) price was paid (or less) for the material that was used or bought
Material Usage	Tells whether the quantity of material used is more than what should have been used according to the standard and what the $ value is
Labour Price	Tells how much more or less was paid to workers per hour than the standard set and what the $ value is
Labour Efficiency	Tells difference between the hours expended and paid for compared to what should have been if standard was met
Overhead Budget Variance	Difference between the actual OH cost spent and what should have been spent if budget was met
Oh Efficiency Variance	Difference of what should have been spent if budget was met and what actual production should have cost if standards were met
OH Volume Variance	Difference due to output volume change from that planned which caused less or more fixed OH to be applied

Variances may be due to:

1. Paying more than the standard set
2. Using more quantities
3. Different production volume than anticipated

Reasons for this are numerous and must be investigated.

Example:

The Standard Cost for a product is:

Direct Material	2 lbs. @ $15 per lb.	$30
Direct Labour	2 hrs. @ $20 per hr.	40
Variable OH	2 hrs. @ $5	10
Fixed OH	2 hrs. @ $8	16
Total Unit Cost		$96

Anticipated production is 7,500 direct labour hours.

Fixed OH budgeted to be $60,000.

Materials to be used 12,000 units

6,000 Standard Labour Hours (3,000 units)

Actual Output:

Actual Variance OH Expense $30,600
Actual Fixed OH Expense $62,000
Bought and used 12,000 lbs. @ $17 lb. $204,000
Paid for 6,500 hrs. of Direct Labour $13,000

ANALYSIS:

D.M. Price Variance: (17-15) *12,000 = 24,000 UNF

D.M. Usage Variance (12,000-12,000)*15 = 0

D.L. Price Variance (21-20)*6,500 = 6,500 UNF

D.L. Efficiency Variance (6,500-6,000)*20 =10,000 UNF

Fixed OH Flexible Budget Variance:

Actual Cost - Budget based on standard inputs allowing for actual outputs achieved

62,000 - 60,000 = 2,000 UNF

NOTE: Fixed irrespective of volume.

Fixed OH Production Volume Variance:

Budgeted Cost - Fixed OH Applied

60,000 - (6000*8) = 12,000 UNF

Variable OH Flexible Budget Variance

Actual V OH Cost - Budget Based on Standard Inputs Allowed for Outputs Achieved

30,600 – (6,000*5) = 600 U

Analysis – OH:

Spent $92,600 - 6,000(8+5) = 14,600 U

Because worked at 6,000 instead of 7,500, did not absorb the Fixed OH fully.

<u>Fixed</u>

60,000 (Budget) – (6,000*8) = 12,000 not absorbed

62,000 (Actual) - 60,000 (Budget) = 2,000 spent more than budget

12,000 + 2,000 = 14,000 the variance

<u>Variable</u>

30,600 Actual - 30,000 (should have spent per budget) = 600

Total OH variance = 12,000 + 2,000 + 600 = 14,600

The CONTRIBUTION APPROACH of Income Statement

Income statement is prepared in terms of cost behaviour (variable and fixed costs).

While income statement according to the TRADITIONAL APPROACH is organised in a function format, emphasising the function of production, administration and sales.

Income Statement The Contribution approach	
Sales (Revenue)	×××××
- Total of variable Costs	×××
Contribution Margin	×××
- Total fixed costs	××
Net operating income	××

Example:

Based on the following given information, prepare **income statement** according on:

1. The traditional approach (Costs organised by function).
2. The contribution approach (Costs organised by behaviour)

Direct materials ………………….. 281,000

Fixed overhead costs ……..……… 200,000

Variable overhead cost……………. 175,000

Direct labour.................................. 196,000

Fixed administrative costs………… 142,000

Variable administrative costs……... 42,000

Sales (Revenue)…………………… 1,253,000

Fixed marketing costs…………….. 127,000

Variable selling costs……………... 15,000

Cost of goods Sold……………….. 899,000