

Lesson 8

Standard Costing -Part 1

9.1 Introduction

Standard costs are pre-determined cost. Standard costing is a control system for comparing the planned costs and revenues with actual results in order to report variances for the purpose of performance measurement and control.

9.2 Learning Outcomes

By the end of this lesson, you should be able to:

- define standards cost;
- outline the purposes of standard costing; and
- describe types of standards costing: Ideal, attainable & current standard;

9.3 Required Readings

Drury, Chapter 17

9.4 Points to Ponder/Takeaways

Standard Costing Standard costing is control technique that reports variances by comparing actual costs to pre-set standards.

Variances Differences between actual results and expected results.

9.5 Learning Material

Definition

Standard costs are target costs for each operation that can be built up to produce a product standard cost.

A budget relates to the cost for the total activity, whereas standard relates to a cost per unit of activity.

1. Most suited to a series of common or repetitive organizations (this can result in the production of many different products).

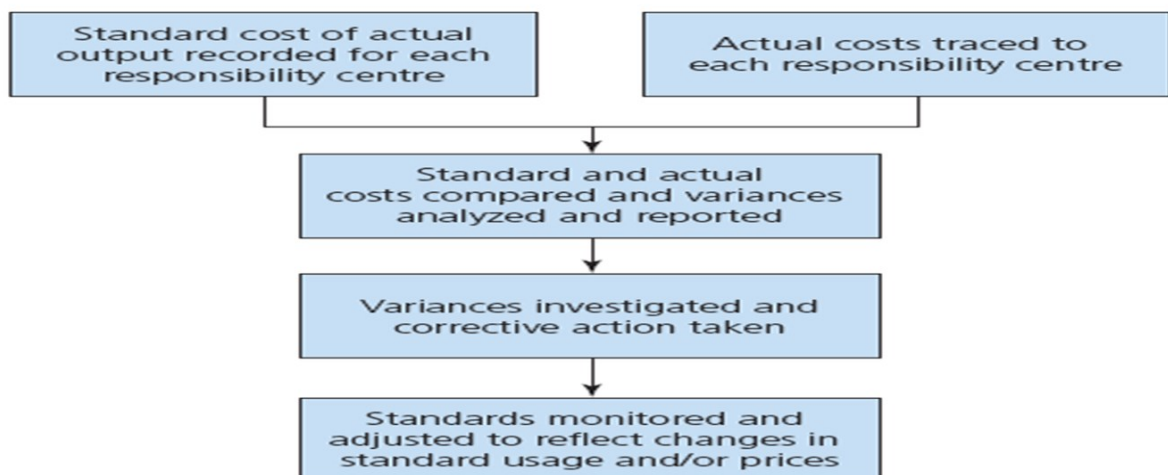
Responsibility centre	Operation no. and standard cost		Products							Total standard cost	Actual cost
	No.	£	100	101	102	103	104	105	106	£	
A	1	20	✓	✓		✓	✓	✓	✓	120	
B	2	30		✓		✓		✓		90	
C	3	40	✓		✓		✓			120	
D	4	50	✓	✓	✓				✓	200	
Standard product cost			£110	£100	£90	£50	£60	£50	£70	530	

2. Variances are traced to responsibility centres (not products).

3. Actual product costs are not required.

4. Comparisons after the event provide information for corrective action or highlight the need to revise the standards.

An overview of a standard costing system



Establishing cost standards

1. Two approaches:

(i) past historical records (ii) engineering studies

2. Engineering studies

A detailed study of each operation is undertaken:

- direct material standards (standard quantity × standard prices) • direct labour standards (standard quantity × standard prices)
- overhead standards:
- cannot be directly observed and studied and traced to units of output;
- analysed into fixed and variable elements;
- fixed tend not to be controllable in the short term.

Purposes of standard costing

- To provide a prediction of future costs that can be used for decision-making.
- To provide a challenging target that individuals are motivated to achieve.
- To assist in setting budgets and evaluating performance.
- To act as a control device by highlighting those activities that do not conform to plan.
- To simplify the task of tracing costs to products for inventory valuation.

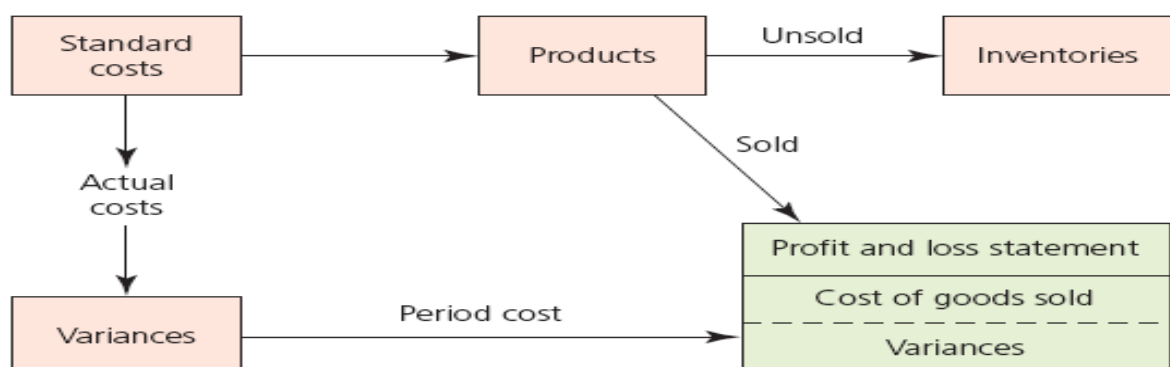


FIGURE 17.2
Standard costs for inventory valuation
and profit measurement

9.6 Activities/Discussion Question

PART A: STRUCTURED QUESTIONS

1. Define standard costing and describe types of standard costing.
2. Explain four major functions of standard costing.
3. Describe three (3) types of standard costing.
4. Describe three (3) limitations of standard costing.