

Evaluating operating performance Standard costing system

- Standard costing is method of controlling activities
- Set standard for business operations e.g. units of sales, sales price, materials usage, cost of materials, labour usage, cost of labour, cost of overheads
- Compare actual performance against these standards using variance analysis

Preparation of standard costing data

- Standards are attached to particular products and/or processes
- Standards are then used in preparing budgets
- Standard costing and budgeting periods usually the same

Types of standards

- Ideal standard attainable under the most favourable conditions
- Basic standards are not revised frequently and are out of date
- Attainable standard is one the entity can expect to achieve in a reasonably efficient working condition i.e. some delays and inefficiencies tolerated

Standard cost calculation

- Direct materials - quantity * price
- Direct labour - labour hours * hourly rate
- Variable overhead - hours * variable overhead rate per hour
- Fixed overhead – hours * fixed overhead absorption rate per hour

Information required to operate standard costing system

- Types of product / service sales and selling price of each product / service
- Types, quantities and prices of materials
- Grades, labour hours worked and pay for labour
- Variable overhead data by category
- Fixed overhead data by category

Key variances

- Sales variances– price and volume
- Material variances – price and usage
- Direct labour variances – rate and efficiency
- Variable production overhead – expenditure and efficiency
- Fixed production overhead – expenditure and volume

Direct materials

- **Price**
 - actual quantity used * (actual cost per unit – standard cost per unit)
- **Usage**
 - (actual quantity used – standard quantity for actual production) * standard cost

Direct Labour

- **Rate**
 - actual hours worked * (actual hourly rate – standard hourly rate)
- **Efficiency**
 - (actual hours worked – standard hours for actual production) * standard hourly rate

Variable Production overhead

- **Expenditure**
 - actual variable overhead – (actual hours worked * standard variable overhead absorption rate)
- **Efficiency**
 - (standard hours for actual production – actual hours worked) * standard variable overhead rate

Fixed Production overhead

- **Expenditure**
 - actual fixed overhead – budgeted fixed overhead
- **Volume –applicable to absorption costing system only**
 - budgeted fixed overhead – (standard hours for actual production * standard fixed overhead absorption rate)
 - can be further split into capacity and efficiency

Sales variances

- **Price**
 - Actual sales quantity *(actual price – standard price)
- **Volume**
 - if absorption costing used
 - (Actual quantity – budgeted quantity) * standard profit per unit
 - if marginal costing used
 - (Actual quantity – budgeted quantity) * standard contribution per unit