

item of equipment (or all of these) for which costs may be ascertained and used for the purpose of cost control. Cost centres are set up for cost ascertainment and cost control.

Classification and codification of accounts: Different items of expenses are classified under suitable headings. Codes and symbols are given to each class of expenditure. Coding facilitates quick collection and analysis of cost information.

Establishment of standards: One of the most important and difficult tasks in standard costing is setting of standards for each element of cost. The success of the standard costing system depends upon the reliability and accuracy of standards. Standards are established scientifically after studying all details of elements of cost. In big concerns a committee is formed for this purpose.

2. **Ascertainment of actual cost:** Another step in the standard costing system is the recording of actual costs incurred.
3. **Comparison of standard cost and actual cost:** Standard cost and actual cost are compared and variance is calculated.
4. **Analysis of variances:** Variance analysis is the process of analysing variances by subdividing the total variances in such a way that management can assign responsibility for poor performance.
5. **Reporting of variance to management:** As soon as variances are analysed and investigated, they are reported to management. The management takes appropriate action where necessary.

Types of Standards

The following are the various types of standards:

1. **Basic standards:** Basic standards are those which are not changed from year to year. Once set, they are rarely changed. They are set on a long-term basis. CIMA terminology defines a basic standard as "a standard established for use over a long period from which a current standard can be developed". These are also known as *fixed or static or budget standards*.
2. **Current standards:** Current standards are those standards which undergo periodic revision. CIMA terminology defines current standard as "a standard established for use over a short period of time, related to current conditions". In short, current standards are prepared for current period.
3. **Ideal standards:** This is the standard which can be attained under the most favourable conditions such as maximum output and sales, advantageous prices for materials, satisfactory rates of labour and overhead etc. It is a standard which represents a high level of efficiency. Ideal standard can be achieved only if everything operates perfectly. It is assumed that there is no wastage, no idle time or no inefficiencies in the manufacturing process. It is, therefore, a theoretical standard. They are like 100 marks in a paper for students taking up examinations. They are impractical and unattainable. Hence they are rarely used. Ideal standard is also known as a *potential standard*.

Limitations of Standard Costing

Standard costing suffers from the following limitations:

1. **Difficulty in fixing standards:** It is difficult to establish accurate cost standards. This requires high technical skill.
2. **Frequent revisions:** As business conditions always change, it becomes essential to revise the standards. Revision of standards is costly and some firms may ignore it.
3. **Unsuitable:** Standard costing is not suitable for job order industries and industries producing non-standardised products.
4. **Costly:** Standard costing is very expensive. Small concerns cannot afford it.
5. **Failure:** Standard costing would be a failure if management doesn't have interest and faith in it. The success of the system is dependent on continued blessings and consistent support from management.
6. **Labour problems:** If the standards set are not accurate and are unreliable, it may lead to psychological effects.
7. **Requires co-operation at all levels:** Standard costing can be effective only if employees at all levels co-operate in the operation of the system.
8. **Adverse effect on morale:** When employees fail to achieve the standard set, their morale will be adversely affected.

Despite the limitations, standard costing is widely used in the modern world as a technique of cost control and cost reduction.

Applicability of Standard Costing

The technique of standard costing can be applicable under certain conditions. These are as follows:

1. There should be production of sufficient volume of some standard product.
 2. The methods, operations and processes should be capable of standardisation.
 3. The costs should be capable of being controlled.
- Standard costing is applied in those industries where products are standardised. The technique of standard costing can be applied in manufacturing industries like automobiles, cement, chemicals, paper, fertilisers, electric lamps, sugar, hosiery, rubber, tobacco products etc. It is applicable in service industries such as transport, banking etc. It is also applicable in parts of the public sector (e.g. street cleaning, refuse disposal etc). It is mostly used in manufacturing and repetitive assembly work.

Steps involved in Standard Costing

The procedure for establishing standard costing is summarised as follows:

1. **Establishment of cost centres:** The first step involved in the installation and operation of standard costing is the establishment of cost centres. A cost centre is a location, person or