standards. Their knowledge, experience and the shop floor situation are instrumental in deciding upon the quality and quantity of each material.

Then material price standards are fixed. These are fixed on the basis of the following factors

(i) Cost of stock.
(ii) Quality of material required.
(iii) Price trends.
(iv) Current prices.
(v) Possible price fluctuations.
(vi) Size of purchase order.
(vii) Discounts and rebates to be received.

(b) ***Standards for direct labour cost:*** Determination of direct labour cost standards involves determination of standard time and standard rate. In fixing the standard labour time, the following steps may be taken:

(i) Standardisation and classification of products.
(ii) Time and motion studies.
(iii) Works and methods analysis.
(iv) Preparation of estimates or trial runs (test runs).

The standard labour rate is usually determined by the cost accountant after consulting the personnel manager. While fixing the standard labour rate, the following factors may be considered:

(i) Existing labour rates.
(ii) Rates paid by similar firms.
(iii) Labour laws.
(iv) Influence of trade union.
(v) Skill required for the job.

(c) ***Standards for overheads:*** The fixation of standards for overheads involves three steps: (i) determination of standard overhead costs, (ii) estimating production, and (iii) calculation of standard overhead rate. In order to determine the overhead cost, all expenses have to be classified into fixed, variable and semi variable categories. A correct estimate in respect of each class may be prepared for the budget period. The standard overhead rate is then determined for these on the basis of past records and future trend of prices. It is calculated for a unit or for an hour with reference to a particular level of activity.

Standard overhead costs (both fixed and variable) should be determined. Based upon the standard output and standard hours, the overhead rates are finalised. Once all the cost standards are finalised, it is possible to consolidate them in the shape of 'standard cost for standard output'.

The material cost per unit, direct wages per unit, fixed and variable overheads per unit can be listed out. The total of all of these represents standard cost per unit. This can be multiplied with the standard output for the budget period or a specified period to ascertain the standard cost of the standard output.

Problems in Setting Standards

The following problems may arise while setting the standards:

1. It is difficult to forecast market trends.
2. There is always the problem of inflation.
3. It is difficult to decide which quality of material should be used.
4. There may be resistance from departmental managers.
5. It is difficult to take a decision regarding allowable waste, idle time etc.
6. It is difficult to decide the normal production.

Analysis of Variance

Variance means difference or deviation. In standard costing variance means the difference between the standard cost and the actual cost. It is the deviation of actual cost from the standard. According to ICMA, London, "Variance is the difference between a standard cost and the comparable actual cost incurred during a period".

Variance may be favourable or unfavourable. If the actual cost is less than the standard, the difference is known as favourable or positive variance which is a sign of efficiency. If the actual cost is more than the standard cost, the difference is known as unfavourable or adverse variance which is a sign of inefficiency. In short, positive variance indicates favourable variance and negative variance indicates unfavourable or adverse variance.

The utility of standard costing lies in the analysis of variance. Analysis of variance means carrying out the appropriate investigations to identify the reasons for the variance. On the basis of analysis of variance, remedial action can be taken. Variance analysis indicates to the management whether the costs are under control or not.

Managerial Uses (or Benefits) of Variance Analysis

The benefits or managerial uses of variance analysis may be outlined as below:

1. It indicates the areas where variance arises. This facilitates management by exception.
2. It identifies the causes for variances. This helps to assign the responsibility for the variance to a particular department. In other words, it helps to pinpoint responsibilities for the variance.
3. It can be used as an effective tool of cost control. In other words, it helps to ensure cost control.
4. It helps to compare the performance of different departments.
5. It helps in future planning and in formulating policies.