

Module 15

Standard Costing and Variance Analysis

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Standard Costing

- Definition
- Steps in standard costing
- Types of Standards
- Variance
- Types of variance
- Variance Analysis
- Advantages & disadvantages of Standard costing

Standard Costing

- Standard cost is a pre-determined cost which is calculated from management's standards of efficient operation and the relevant necessary expenditure. It may be used as a basis for price fixing and for cost control through variance analysis.

In simple words it is a budget for the production of one unit of product or service. It is chosen to serve as a benchmark in the budgetary control system.

Steps in Standard Costing

Set
standard
Cost

Study the
actual cost

Cost
variance
Analysis

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- **Set the standard cost**

- ✓ A predetermined or standard cost per unit is set.
- ✓ Budgeted cost determined by using standard cost.

- **Study the actual cost**

- ✓ Calculate actual cost incurred in the production process

● Cost variance

- ✓ Comparison of the actual cost with the budgeted cost.
- ✓ The cost variance is used in controlling cost.
- ✓ Fix responsibilities to control cost
- ✓ Take suitable action and create effective control system .

Types of standards

➤ Ideal Standards:

These represents the level of performance attainable when prices for material and labour are most favorable, when the highest output is achieved with the best equipment and layout and when maximum efficiency in utilization of resources results in maximum output with minimum cost.

- Normal Standards: These are the standards that may be achieved under normal operating conditions. The normal activity has been defined as number of standard hours which will produce normal efficiency sufficient goods to meet the average sales demand over a term of years.

- Basic or Bogey standards: These standards are used only when they are likely to remain constant or unaltered over long period. According to this standard, a base year is chosen for comparison purposes in the same way as statisticians use price indices. When basic standards are in use, variances are not calculated as the difference between standard and

actual cost. Instead, the actual cost is expressed as a percentage of basic cost.

- Current Standard: These standards reflect the management's anticipation of what actual cost will be for the current period. These are the costs which the business will incur if the anticipated prices are

paid for goods and services and the usage corresponds to that believed to be necessary to produce the planned output.

Variance

The difference between standard cost and actual cost of the actual output is defined as Variance. A variance may be favourable or unfavourable. If the actual cost is less than the standard cost, the variance is favourable and if the actual cost is more than

the standard cost, the variance will be unfavourable. It is not enough to know the figures of these variances infact it is required to trace their origin and causes of occurrence for taking necessary remedial steps to reduce / eliminate them.

Controllable and uncontrollable Variance

The purpose of standard costing reports is to investigate the reasons for significant variances so as to identify the problems and take corrective action. Variances are broadly of two types, namely, controllable and uncontrollable.

Controllable variances are those which can be controlled by the departmental heads whereas uncontrollable variances are those which are beyond their control. If uncontrollable variances are of significant nature and are persistent, the standards may need revision.

Variance Analysis

Variance analysis is the analysis of the cost variance into its component parts with appropriate justification of such variances, so that we can approach for corrective measures.

Variations of Efficiency:

- Variance due to the effective or

ineffective use of material quantities, labour hours, once actual quantities are compared with predetermined standards.

Variiances of Price Rates:

- Variiances arising due to change in unit material prices, standard labour hour rates and standard allowances for indirect costs.

Variations of Due to volume:

- Variance due to effect of difference between actual activity and the level of activity assumed when the standard was set.

Analysis of Variance

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graph LR; A[Analysis of Variance] --- B[Material Variance]; A --- C[Labour Variance]; A --- D[Overhead Variance]; A --- E[Sales Variance];
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Material Variance

Labour Variance

Overhead Variance

Sales Variance

Reasons of Material Variance

- Change in Basic price
- Fail to purchase anticipated standard quantities at appropriate price
- Use of sub-standard material
- Ineffective use of materials
- Pilferage

Material Variance

- Material Cost Variance = (Standard Quantity X Standard Price) – (Actual Quantity X Actual Price)
- Material Price Variance = Actual Quantity (Standard Price - Actual Price)
- Material Usage Variance = Standard Price (Standard Quantity - Actual Quantity)

Reasons of Labour Variance

- Change in design and quality standard
- Poor working conditions
- Improper scheduling
- Improper placement of labour
- Increments / high labour wages
- Overtime

Labour Variance

- Labour Cost Variance = (Standard Hrs X Standard Rate Per Hour) - (Actual Hrs X Actual Rate Per Hour)
- Labour Rate Variance = Actual Hrs (Standard Rate - Actual Rate)
- Labour efficiency Variance = Standard Rate (Standard Hrs - Actual Hrs worked)
- Idle Time Variance = Idle Hours X Standard Rate

Reasons of Overheads Variance

- Improper planning
- Under or over absorption of fixed overheads
- Reduction of sales
- Breakdowns
- Power Failure

Variable Overheads (OH) Variance

- Variable OH Cost Variance =
(Standard Hrs X Standard Variable OH Rate) – Actual OH Cost
- Variable OH Expenditure Variance =
(Actual Hrs X Standard Variable OH Rate) – Actual OH Cost
- Variable OH Efficiency Variance =
(Standard Hrs - Actual Hrs) X
Standard Variable OH Rate

Fixed Overheads (OH) Variance

- Fixed OH Cost Variance = Absorbed OH – Actual Fixed OH Cost
- Fixed OH Expenditure Variance = (Budgeted Hrs X Standard Fixed OH Rate) – Actual Fixed OH Cost
- Fixed OH Volume Variance = (Standard Qty – Actual Qty) X Standard Fixed OH Rate

Reasons of Sales Variance

- Change in price
- Change in Market size
- Change in Market share

Sales Variance

- Sales Value Variance =
Budgeted Sales – Actual Sales
- Sales Price Variance =
Actual Quantity (Actual Price – Budgeted Price)
- Sales Volume Variance =
Budgeted Price (Actual Quantity – Budgeted Quantity)

Advantages & Disadvantages of Standard costing

Advantages

- Basis for sensible cost comparisons
- Employment of management by exception

Disadvantages

- Too comprehensive to be useful
- Precise estimation of prices or rate to paid is not possible

- Means of performance evaluation for employees
- Result in more stable product cost

- May not be useful if frequent change in technology
- Focus on cost minimization rather than quality or service.



GOODS & SERVICES TAX (GST) IN INDIA

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CONTENTS

S. No	Topics	
I	Introduction /Concepts of GST	
II	Existing & Proposed Tax Structure in India	
III	Model/Components of GST	
IV	Benefits under GST	
V	Applicability & Rate in GST Regime	
VI	Impact of GST	
VII	GST Set off Chain & its methodology	
VIII	Functioning of GST	
IX	Others Areas of GST	
X	Key Amendments	
XI	Sector Wise Impacts	
XII	Flaws of the GST Model	
XIII	Conclusion	

GST Historic reform

"August 8th marks a crucial step towards freedom from tax terrorism," Prime Minister said, while recalling that this was the day in 1942 when Mahatma Gandhi started 'Quit India'

"GST can't be seen as a victory of a party or government. It is the victory for democratic ethos of India and a victory for everyone," he said, while noting that the measure was being supported by all parties, irrespective of different ideologies. The

Prime Minister said the new indirect taxation regime, which will subsume 7-13 taxes, will help end corruption as traders will be compelled to give proper bills and the consumer will be the "king".



PM Modi, humbly thanked all parties for supporting the GST, saying it reflected "maturity" of the Indian democracy as such a crucial legislation was approved with consensus rather than on the basis of numbers. He hailed it as a "great step by team India" that will help transform the economy, bring in transparency and bring in the system of "one country one tax". He emphasised that the passage of the bill by Parliament was not a victory of any party or government but was everybody's victory as it highlighted the success of the democratic ethos of the country.

GST (Goods and Service Tax) was first announced in 2000 by the then government.

The Constitution (122nd Amendment) Bill, which was passed by the Lok Sabha in May 2015, and the Rajya Sabha in August 2016. the Lower House passed the bill with all the 443 members present voting in favour.



Introduction/Concept of GST

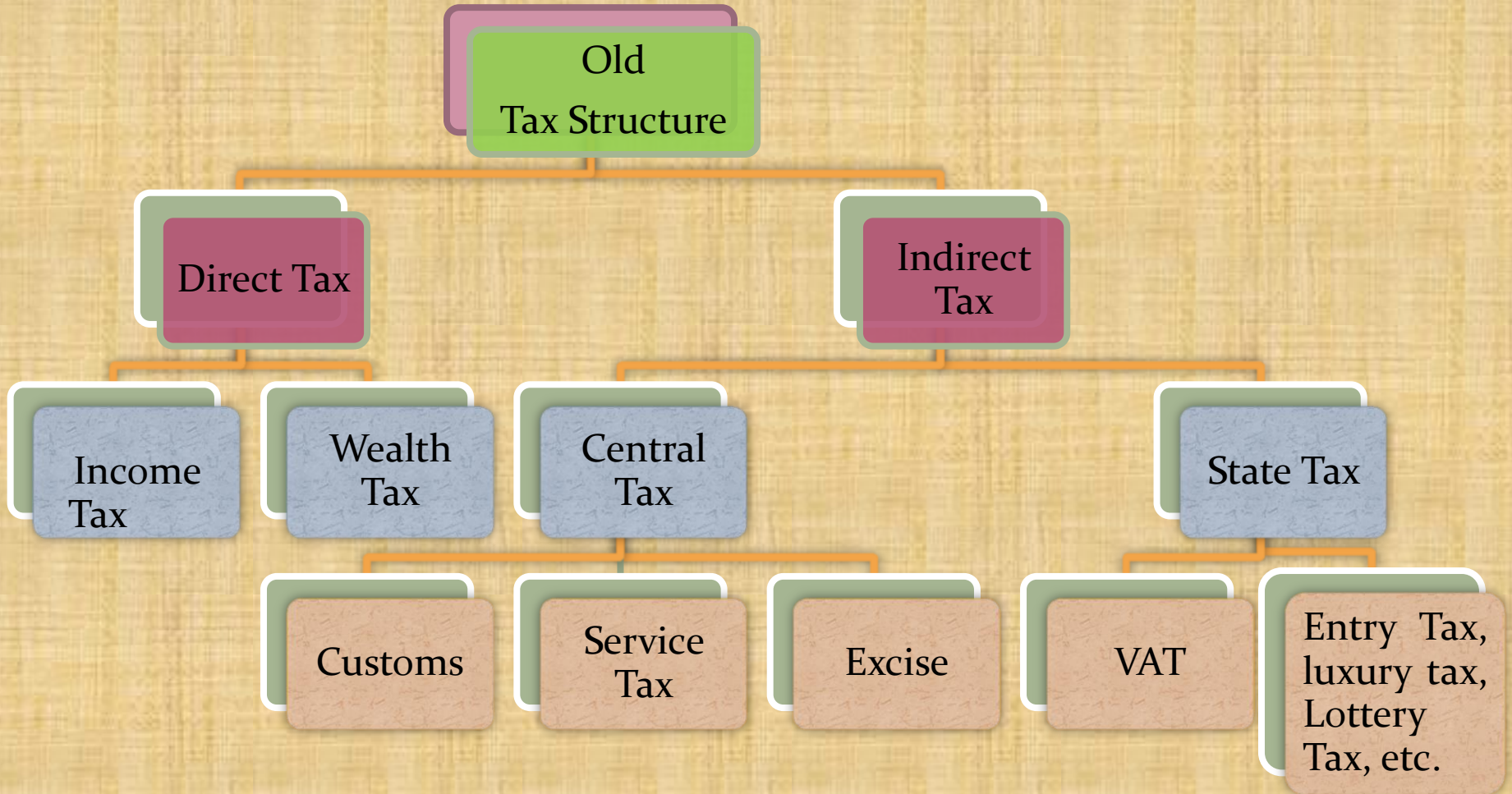
- It is a tax on Goods & Services with comprehensive & continuous Chain of Set off benefit from producers to retailer point.
- In other words, GST is an Indirect tax which is levy on consumption of all goods & services.
- It substitute most of the indirect taxes like excise, VAT, Service Tax, Entertainment Tax, Luxury Tax, CVD as well as SAD.
- Tax collection in India is around 14.5 Lakh Crore, of which 34% is indirect tax
- It is based on the VAT principles.

- **It is implemented w.e.f 1st July 2017**
- It is levied only at a destination Consumption Place.
- Taxation power lies with both in the hands of CG as well as SG also.
- There will be no distinction between goods & services.
- After Introduction of GST, all the traders including manufacturer will be paying both the type of taxes (CGST & SGST). (Administered by one authority)

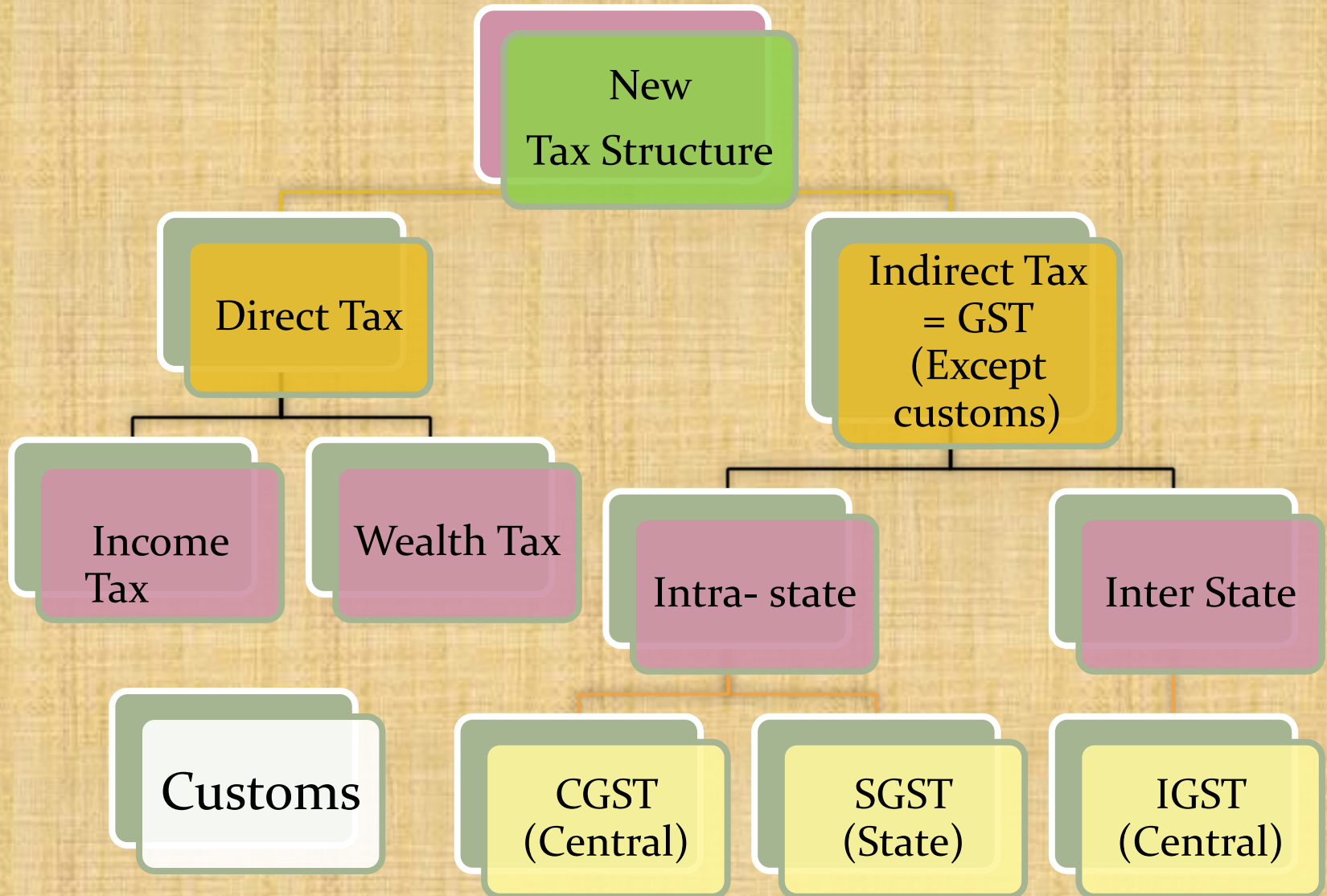
- GST leads to immense scope, opportunities as well as some challenges also.
- Centre is empowered to levy GST on Goods & Services upon the Production stage, while State have the power to tax on sale of goods.
- India has implemented dual GST.
- GST law emphasizes on voluntary compliance .
- It is a comprehensive levy and envisages tax collection on both goods and services.

- It is also expected that GST will mitigate the cascading effect of taxes.
- In the mean time, it also helps in terms of uniformity like in case of chargeability, definition of taxable services or person, measure of levy, basis of classification etc.

Old Tax structure in India



New Tax structure in India



Model/Components of GST

CGST (Central GST)

- Replace central Excise Duty & service Tax.
- Levied on all intra-state sale/supplies of goods or services.

SGST (State GST)

- Replace State Vat, Entry Tax, Entertainment Tax, & Luxury Tax.
- Levied on all intra-state sale/supplies of goods or services.

IGST (Integrated GST)

- Levied on all inter-state supplies of goods or services which are sold or transferred.
- Applicable to imports of goods or services.

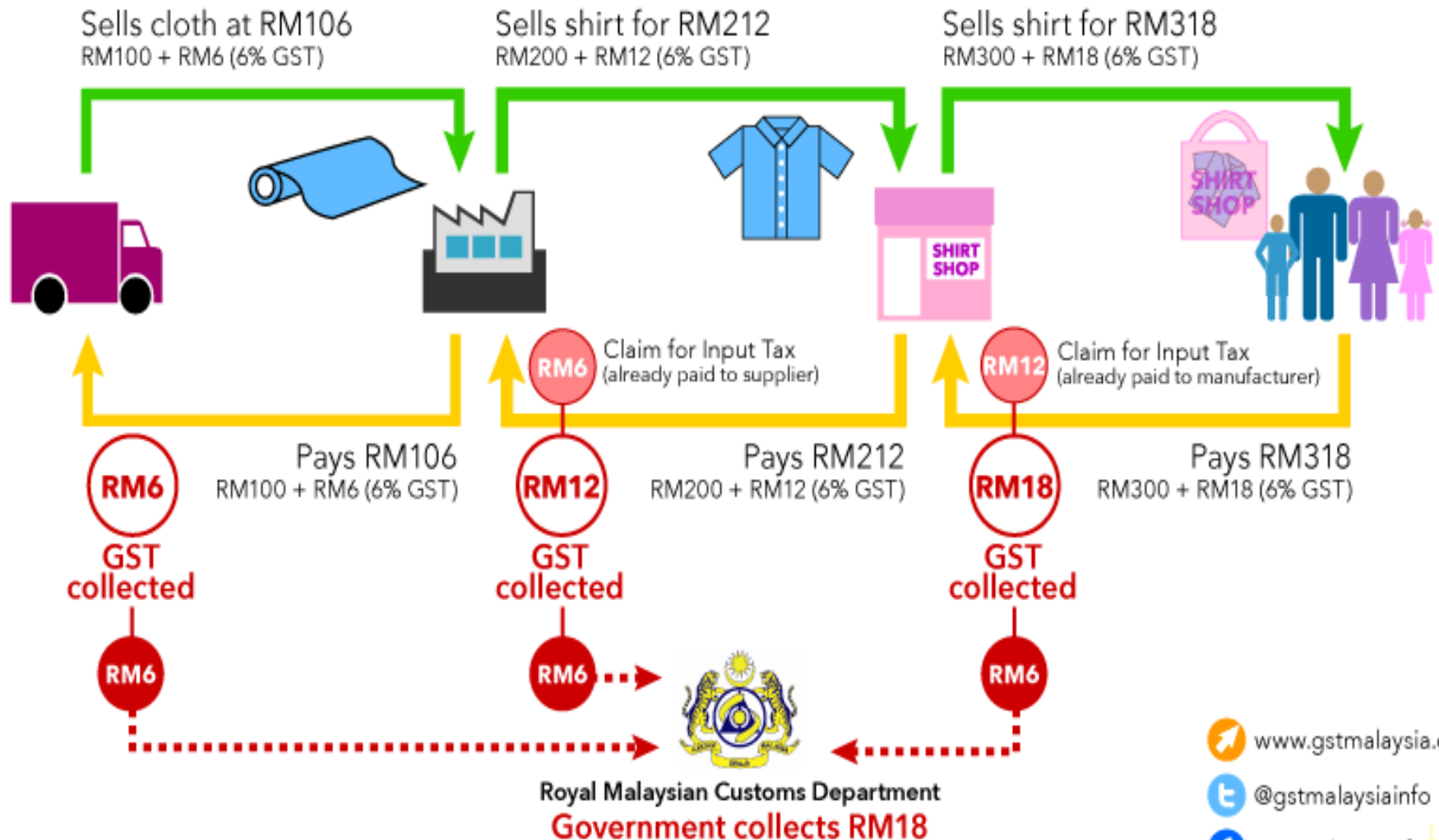
Goods and Services Tax (GST)

Supplier

Manufacturer
(Makes 100% profit)

Retailer
(Makes 50% profit)

Consumer



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Benefit under GST

- Single taxation point.
- Uniform tax rate throughout India
- Common market
- Reduces Transaction cost. Computerized.
- Eliminates the cascading effect of taxes.
- Increase in Transparency.
- Widening the tax base
- More compliance. Less evasion
- Reduces corruption.

- Simplified tax laws.
- Increase in exports & employments.
- GDP Growth -HSBC estimates an 80 basis point rise in GDP growth over 3-5 years. NCAER pegs this at 0.9-1
- International competitiveness – set to go up by about 5%.
- Increased FDI
- Growth in overall Revenues.
- Prevention of unhealthy competition among states.
- Reduction in logistic costs

Challenges of the GST Model

Detailed and Timely Accounting is required.

High compliance cost for small players

Returns on 10, 12 n 15th for each month (Slightly changed now)

Huge demand for accountants

Will help in improving efficiency and cost reduction

Applicability & Rate under GST Regime

- ❑ **Basic threshold limit for Goods & Services shall be RS. 20 Lakh & for North east Region (NER) Rs. 10.00 Lakh.**
- ❑ **GST on Exports would be zero rated**, but on the other hand in “import” IGST will be levied.
- ❑ GST does not apply on Alcohol & petroleum products.
- ❑ Tobacco products included in the frame of GST.
- ❑ Gov. Can levy extra tax/ Cess apart from GST .
- ❑ Full exemption is applicable on basic necessities goods like Flour, rice, pulses, textiles, buildings, education & healthcare etc.
- ❑ Assesse can have an option to pay tax as per composition scheme or may join the GST law whose turnover is up to Rs. **1.50 cr.**
- ❑ But, those assesse whose turnover is and above Rs. 1.50 Cr will need to be within the framework of GST.

❑ A four-tier structure for Goods and Services Tax (GST) comprising a lower rate of 5 per cent, two standard rates of 12 per cent and 18 per cent, and a higher rate of 28 per cent with an additional cess for luxury and demerit goods were proposed

❑ GST rate on Gold Bullion/ Jewelry - 3%

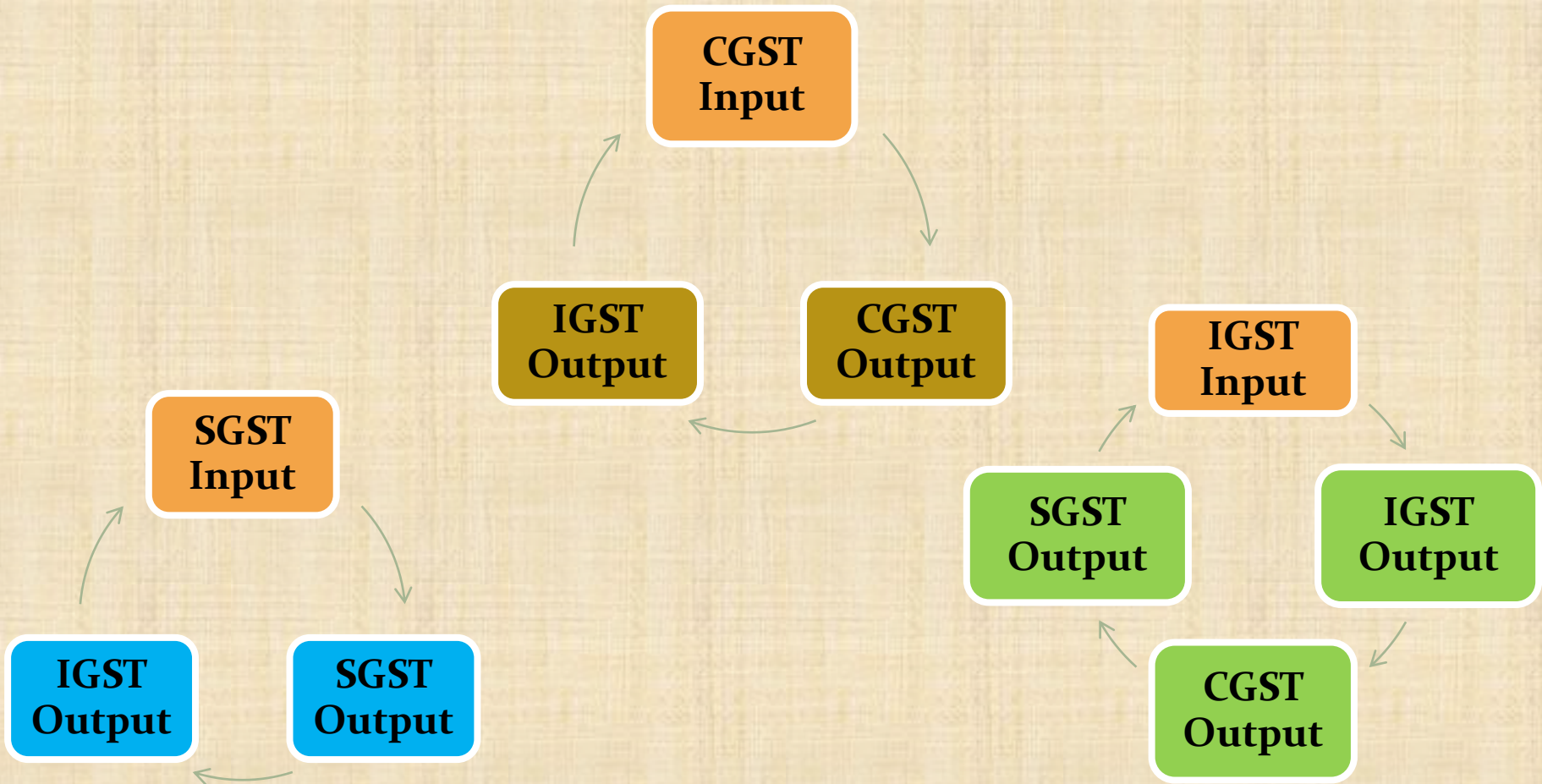
Around 70 per cent of the taxable base is proposed to be taxed at either 18 per cent, 12 per cent or 6 per cent, with more than 50 per cent of the items to be taxed at 12 per cent or 18 per cent. Luxury items like high-end cars and demerit goods like tobacco, cigarettes, pan masala and aerated drinks, comprising about 25 per cent of the taxable base, attracts an additional cess over and above the higher rate of 28 per cent.

Impact of GST

The total impact of the proposed rate structure on Consumer Price Index (CPI)-based inflation rate will be (-) 0.06 per cent.

Under the proposed GST rate structure, the inflation impact on constituents of CPI such as health services, fuel and lighting and clothing is estimated to be 0.56 per cent, 0.05 per cent and 0.23 per cent, respectively, while for transport it is estimated at (-) 0.65 per cent, education at (-) 0.08 per cent and housing at (-) 0.09 per cent. Total revenue collection under the proposed GST structure is estimated at Rs 8.72 lakh crore (based on 2015-16 estimates).

GST Set off chain & its methodology



Functioning of GST

The Illustration shown below indicates, in term of a hypothetical example with a manufacturer, wholesaler, along with retailer .

★ **Manufacturer:** Let us suppose manufacturer Manufactured 1800 Kg of Finished Goods & sold 600 Kg of FG within the state, 300 Kg of FG outside the state & rest is stock transfer outside the state @ Rs. 10.00 Per K/g to wholesaler.

CGST & SGST rate is 5% & 7% respectively. IGST rate is 12%. Also assume ITC of SGST & CGST of Rs. 500.00 & Rs.950.00.

★ **Wholesaler:** Now suppose wholesaler sell the whole FG @ Rs. 13 Per K/g to retailer accordingly as above mentioned

★ **Retailer:** Now finally retailer retail the above mentioned FG @ Rs.15 Per K/g and avail ITC as per GST rules & regulations to the customers.



Microsoft Excel
Worksheet

Other Aspects of GST

- The Place of supply would determine first as to whether the transaction is in India or Outside India. If it is outside India it would not be liable to GST.
- The POT in GST is the Point of supply of Goods. In case of service , then it is somehow based on the POT rules of Service tax.
- Under the GST structure , the tax would be collected by the states where the goods or services are consumed .
- Hence there would be losses for the producer states .
- Petroleum products, Alcohols/Liquor , Stamp/Custom duty, Consm. & Sale of Electricity etc. are not covered under the GST purview.
- If a company is having four branches in four different states, then all the four branches will be considered as Taxable Person.
- Importers have to register

- GST paid by exporter on the procurement of Goods & services will be refunded later on if paid.
- Each taxpayer is allotted a PAN linked taxpayer identification number
- This is the GST PAN-linked system in line with the prevailing PAN-based system for Income tax facilitating data exchange and taxpayer compliance.
- Common standardized return for all taxes (with different account heads for CGST, SGST, IGST) can come into picture.
- Common standardized Challan for all taxes (with different account heads for CGST, SGST,IGST) can come into picture.
- ITC credit can also be verified on the basis of the returns filed and revenues reconciled against Challan data from banks.

22nd GST Council meeting of 6th October 2017

- ❑ **Lesser burden of compliance for small businesses**
- ❑ The government has recognised hardship faced by small businesses with turnover of within Rs 1.5cr, by delaying their return filing compliance to once a quarter from once a month. Taxes will be paid quarterly.
- ❑ **Relief for Service Providers**
- ❑ Exemption from Registration for a service provider if the aggregate turnover is less than Rs. 20Lacs (10 Lacs in special category state except for J&K) even if they are making inter-state supplies of services.
- ❑ TDS/TCS provisions shall be postponed till 31.03.2018

22nd GST Council meeting of 6th October 2017

Relief for Exporters

- ❑ Refund cheques for July exports will be processed by Oct 10 and refund cheques for August exports will be processed by Oct 18.
- ❑ Every exporter will now get an e-wallet. In the e-wallet, there would be a notional amount for credit. The refund they will eventually get will be offset from that amount. The e-wallet will be introduced from April next year.

Composition Scheme changes

Eligibility of composition scheme raised to Rs 1 crore.

Traders will pay 1%, manufacturers 2% and restaurants 5% under the composition scheme.

22nd GST Council meeting of 6th October 2017

Significant rate changes

- GST on unbranded Ayurvedic medicines has been reduced from 12% to 5%.
- Tax rate for man-made yarn has been reduced to 12% from 18%. The decision will have an effect on textiles.
- GST rate on many job work items reduced from 12% to 5%. GST rate on some stationery items, diesel engine parts also reduced to 18% from the earlier 28%.
- GST on khakra and unbranded namkeen has been reduced from 12% to 5%. Tax on zari work has been reduced from 12% to 5%.
- Printing Job work rate revised from 12% to 5%

22nd GST Council meeting of 6th October 2017

RCM postponed

RCM applicable for the purchases from the unregistered dealer shall be suspended till 31.03.2018.

E-way bill has been deferred to 1st April 2018

Sector wise impact of GST

After implementation of GST, it seems that there is going to be a positive impact on various Industry.

Some Glimpse of GST Impact of various Industry :

Automobiles Industry

- Drive overall demand & reduce cost for end user by about 10%.
- Transportation time & overall cost will be reduced.
- Cost of Logistics will be curtailed by almost 30-40%.

Key beneficiaries : Bajaj Auto, Eicher Motors, Ashok Leyland, Maruti Suzuki, Hero MotoCorp,

Consumer Durables

- Reduction of the Price gap between organized & unorganized sector.
- Warehouse/logistics costs will be curtailed.
- Improve the operational profitability by almost 300-400 bps.

Key beneficiaries: Havells, Voltas, Blue Star, Bajaj Electricals, Hitachi

Logistics

- Boost demand for high tonnage trucks.
- Overall reduction in transportation costs.
- Improving growth opportunities for the organized players.
- Facilitate seamless inter-state flow of Goods.

Key beneficiaries : VRL Logistics, GATI Ltd, Blue Dart, Snowman Logistics

Cement

- Tax rate expected to decline
- Able to save their logistics costs/transportation costs.

Key beneficiaries : ACC, Ultratech, JK Cement, Shree Cement

Banking & Financial services

- Under GST , effective tax rate is 18% as 14% earlier.
- Moderate increase in the cost of financial services like loan processing fees, debit/credit charges, insurance premium etc.

IT

- Tax Rate is increased to 18%.
- Litigation around taxability of canned software will probably end under GST Regime.

Textile /Garments

- May be negatively impacted in case the output tax rate is high.
- No clarity whether a lower rate will continue in the proposed Tax regime.
- No clarity about the duty drawback benefits.

Key Players : Arvind, Raymond, Page Industries

Media

- Tax rate of around 18% as compared to 20-21%.
- Post GST, we expect concessional rate in news & Print sector.

Key beneficiary : Dish TV

Conclusion

- GST being a dynamic & comprehensive legislation which has replaced most of the Indirect Taxes of our Country.
- Since it is a major indirect tax reform in India, there are new legislation and procedures.
- GST is the best example of cooperative federalism.
- Together, it take India to new heights of progress.
- In Nutshell, it is a biggest tax reform till date in our country.



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