MARGINAL COSTING

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The cost of a product or process can be ascertained using different elements of cost using any of the following two techniques viz.,

1. Absorption Costing
2. Marginal Costing

Absorption Costing

Under this method, the cost of the product is determined and variable costs. Thus this technique is also called traditional or total costing. The variable costs are directly charged to the products where as the fixed cos a suitable basis, manufactured during a period. Thus un with the manufactured products.

Limitations of Absorption Costing

1. Being dependent on levels of output which vary from period to period, costs are vitiated due to
   the existence of fixed overhead. This renders them use
   (If, however, overhead recovery rate is based on normal capacity, this situation will not arise).
2. Carryover of a portion of fixed costs, i.e., period c of the cost of inventory is a unsound practice because costs pertaining to a period should not be
   allowed to be vitiated by the inclusion of costs pertaining to the previous period.
3. Profits and losses in the accounts are related not on the product which is unsold. This is contrary to the when products are manufactured but only when they are sold.
4. There is no uniformity in the methods of application of overhead in absorption costing. These problems have, no doubt, to be faced in the case of m fixed overhead will not arise in the case of marginal Absorption costing is not always suitable for decision making solution to various types of problems of management decision making, where the absorption cost method would be practically ineffective, such as selection of production volume and optimum capacity utilization, selection
   of production mix, whether to buy or manufacture, ch performance can be had with the help of marginal cost analysis. Sometimes, the conclusion
   drawn from absorption cost data in this regard may be misleading and lead to losses.

Marginal Costing

Marginal costing is "the ascertainment of marginal cos volume or type of output by differentiating between fi terms in use like direct costing, contributory costing, variable costing, comparative costing, differential

costing and incremental costing are used more or less synonymously with marginal costing.

It is a process whereby costs are classified into fixed managerial decisions are taken. The essential feature of marginal costing is division of total costs
into fixed and variable, without which this could not h production or output, whereas fixed costs remains uncha of output. It is to be understood that unit variable cost remains same at different levels of output and

total variable cost changes in direct proportion with th cost remains same disregard of changes in units, while cost per unit and the number of units.

Features of Marginal Costing

The main features of Marginal Costing may be summed up as follows:

1. Appropriate and accurate division of total cost into portion of semi variable costs also.
2. Valuation of stocks such as finished goods, work-in-p
3. The fixed costs are written off soon after they are i or inventories.
4. Prices are based on Marginal Cost and Marginal Contribution.
5. It combines the techniques of cost recording and cost reporting.
6. Fixed costs are treated as period costs and charged t which they are incurred.
7. Profitability of departments and products is determine

Advantages or Merits or Applications of Marginal Costing

1. Marginal costing system is simple to operate than absorption costing because they do not involve the problems of overhead apportionment and recovery.
2. Marginal costing avoids, the difficulties of having t absorption to management that accompany absorption co to explain because they result from cost volume inter valuation.
3. It is easier to make decisions on the basis of marginal cost presentations, e.g., marginal costing shows which products are making a contribution and which are failing to cover their avoidable (i.e., variable) costs. Under absorption costing the there is the added danger that management may be misled by reliance on unit costs that contain an element of fixed cost.
4. Marginal costing is essentially useful to management as a technique in cost analysis and cost presentation. It enables the presentation of data in a manner useful to different levels of management for the purpose of controlling costs. Therefore, it is an important technique in cost control.
5. Future profit planning of the business enterprises ca contribution ratio and marginal cost ratios are very useful to ascertain the changes in selling price, variable cost etc. Thus, marginal costing is greatly
6. When a business concern consists of several units and produces several products and evaluation of performance of such components can well be made with the help of marginal costing.
7. It is helpful in forecasting.
8. When there are different products, the determination of number of units of each product, called Optimum Product Mix, is made with the help of margina
9. Similarly, optimum sales mix i.e., sales of each and be determined with the help of marginal costing.
10. Apart from the above, numerous managerial decisions can be taken with the help of marginal costing, some of which, may be as follows:-

(a) Make or buy decisions,

(b)Exploring foreign markets,

(c) Accept an order or not,

(d) Determination of selling price in different conditions,

(e) Replace one product with some other product,

(f) Optimum utilisation of labour or machine hours,

(g) Evaluation of alternative choices,

(h) Subcontract some of the production processes or not,

(i)Expand the business or not,

(j)Diversification,

(k) Shutdown or continue.

Limitations of Marginal Costing

(a)The separation of costs into fixed and variable prese is completely variable nor is a fixed cost completely

(b)Under the marginal cost system, stock of finished go After all, fixed costs are incurred in order to manuf a part of the cost of the products. It is, therefore, stock and work-in-progress.

(c)The exclusion of fixed overhead from the inventories produces an unrealistic and conservative Balance Sheet, unless adjustments are made in the financial accounts at the end of the period.

(d)In marginal costing system, marginal contribution and sales volume. Where sales are seasonal, profits fluct statements under the marginal costing system will not, therefore, be as realistic or useful as in

absorption costing.

(e)During the earlier stages of a period of recession, t in a magnified way in the marginal costs statements, management to take action that may lead to further depression of the market.

(f)Marginal costing does not give full information. For may be due to extensive use of existing equipments (expansion of the resources, or by the replacement of contribution fails to reveal these.

(g)Though for short-term assessment of profitability mar correctly determined on full costs basis only.

(h)Although marginal costing eliminates the difficultie and over-absorption of fixed overhead, the problem st is concerned.

(i)With increased automation and technological developm products is much more than that of variable costs. A less effective because a major portion of the cost, such as not taken care of.

(j) Marginal costing does not provide any standard for the evaluation of performance. A system of budgetary control and standard costing provides more effective control than that obtained by marginal costing.