CHAPTER 19

Marginal Costing – Accept or Reject Decisions

19.1 INTRODUCTION

Marginal costing is a special technique of analysis and presentation of costs, which helps the management in decision-making. This technique enables the management to understand the effect of a change in a volume of output on costs and profit. Its importance lies in solving the managerial problems.

Marginal costing is also known as Variable costing.

Marginal costing is not an independent system of costing similar to process costing, operating costing or Job costing. In marginal costing, the cost of a unit comprises only variable costs. Fixed costs are treated as period costs and written off to costing Profit & Loss Account. Consequently, finished goods and work in progress are valued at marginal cost i.e. Prime cost plus variable overheads.

Marginal costing is Technique of costing.

19.2 BEHAVIOUR OF FIXED AND VARIABLE OVERHEADS

Overheads are of two types, fixed costs and variable costs. Marginal costing recognizes the distinction between Fixed costs and Variable costs in their behaviour. Fixed costs are constant, irrespective of the level of production. Fixed costs do not increase or decrease, with similar increase in the volume of production. They remain the same, whatever be the production, in the short run. Even if there is no production, fixed costs are incurred. Fixed costs like rent, insurance and salary of permanent staff are constant and do not change at all, even if there is a change in the volume of production. However, once production increases beyond the installed capacity of the machinery, then the fixed costs do not remain constant.

Variable costs behave, altogether, in a different manner. Variable costs increase or decrease with the volume of production. In other words, variable costs move in the same direction of production. If production increases, variable costs increase, while they decrease with the reduced volume of production.

Variable costs move in line with production, while fixed costs are constant.

Fixed costs tend to change in total with time, regardless of the volume of production, while variable costs change with increase or decrease in the volume of production. For this reason, fixed costs are known as period costs, while variable costs are called product costs.

Fixed costs are called Period costs as they change with time, while Variable costs are called Product costs as the latter change with the volume of production.

Marginal cost is the same as variable cost. Marginal costing is also known as Direct costing, Variable Costing, Differential Costing or Incremental Costing. The technique of Marginal costing can be used in conjunction with job or process costing or with other techniques such as standard costing or budgetary control.

19.3 MARGINAL COSTING AS A TECHNIQUE

Marginal costing understands the distinction between fixed costs and variable costs. On account of this, a special technique known as Marginal costing has been developed, which excludes the fixed overheads, entirely, from calculation of cost of production.

Under the technique of Marginal costing, cost of production includes variable overheads only and fixed overheads are, totally, excluded.

As a result, cost of production per unit remains the same up to a particular level of output. Under the technique of Marginal costing, fixed expenses are not allocated to cost units but charged against a "Fund", which arises out the excess of selling price over total variable costs.

In this technique of costing, only variable costs are charged to operations or products, leaving all fixed costs to be written off against the profits in which they arise.

19.4 DEFINITION

Marginal cost is the variable cost, comprising prime cost and variable overheads. Prime cost consists of direct material, direct labour and direct expenses. The variable overheads relating to factory, administration, selling and distribution have to be taken into account. In simple words, all variable expenses are taken into account, while fixed expenses are ignored.

The Institute of Cost and Management Accountants, England defines the term marginal cost and marginal costing as follows:

Marginal Cost: "The amount at any given volume of output by which aggregate costs are changed, if the volume of output is increased or decreased by one unit."

Additional cost incurred for one unit of output from the existing level to the new level is known as marginal cost.

In simple words, marginal cost is the incremental cost incurred for making for one more additional unit.

For example, a company is producing 1,000 air-coolers per annum. Total fixed cost is Rs. 1 lakh per annum. Variable cost per air-cooler comes to Rs. 500. Total cost appears as under:

Variable (Marginal) Cost (1,000 × 500)	=	5,00,000
Fixed costs	=	1,00,000
Total cost		6,00,000

If output is increased by one cooler, the cost will appear as follows:

Variable Cost (1,001 × 500)	=	5,00,500
Fixed costs	=	1,00,000
Total cost		6,00,500

Marginal cost per unit is, therefore, Rs. 500.

Marginal Costing: Marginal costing is defined as "the ascertainment of marginal cost and of the effect on profit of changes in volume or type of output by differentiating between fixed cost and variable costs".

Variable costs are only regarded as costs of manufacturing, ignoring the fixed costs as they are permanent, irrespective of the level of output.

Marginal costing means finding the cost for a single unit, over the current level of production, and understanding the effect of incremental production on costs and profits.

19.5 BASIC CHARACTERISTICS OF MARGINAL COSTING

Marginal costing helps the management in taking several managerial decisions.

Under Marginal Costing Procedure, costs are separated into fixed and variable cost components. Fixed costs and variable costs are differentiated. Fixed costs are treated as period costs, regardless of the volume of output. Fixed costs are charged, directly, to Profit and Loss Account. Variable costs are treated as the cost of product. With change in the volume of output, the effect on profits is studied.

Only variable costs are treated as cost of manufacture of the product, under Marginal Costing.

MAIN FEATURES OF MARGINAL COSTING

- Costs are divided into two categories, i.e., fixed costs and variable costs.
- Fixed cost is considered as period cost, not considered for determination of product cost and valuation of inventories.
- Prices are determined, with reference to marginal cost and contribution required.
- Profitability of departments and products is determined, with reference to their contribution.
- Closing stock is valued on the basis of variable costs only.
- In presentation of cost data, display of contribution assumes dominant role.

19.6 MECHANISM OF MARGINAL COSTING

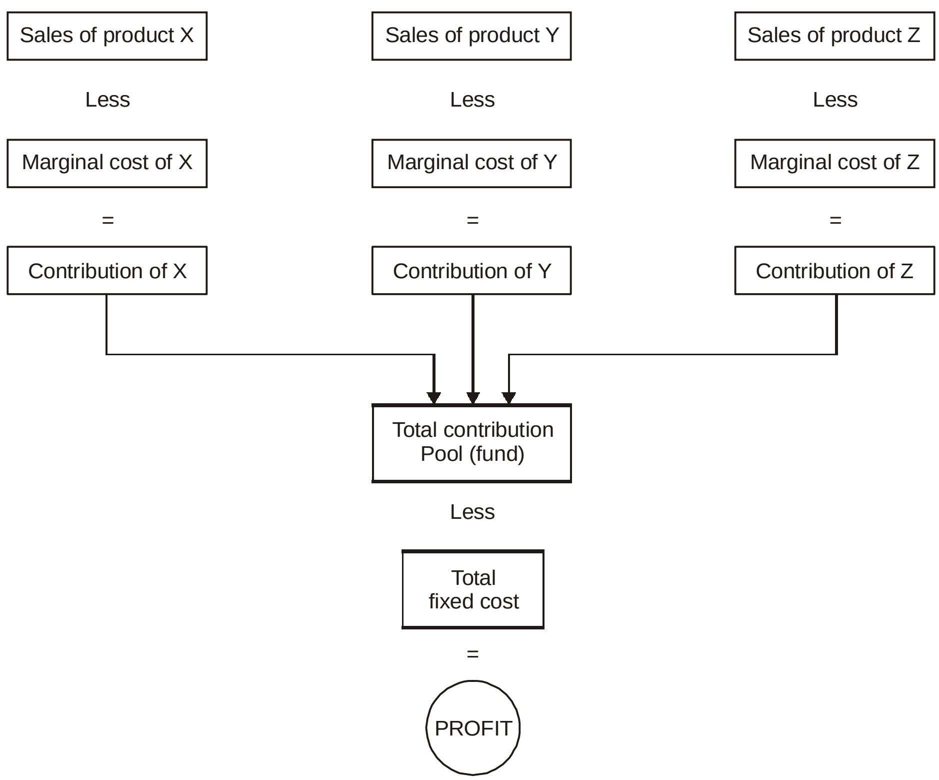
The mechanism of marginal costing is summed up hereunder:

1. Cost of direct material, direct labour and direct expenses are shown.
2. All elements of overheads–works, administration and selling and distribution are classified into fixed and variable components. Semi-variable costs are also analysed into fixed and variable elements. There is no third category of costs.
3. The variable cost component in overheads is added.
4. Fixed costs are charged to the Profit and Loss Account of the period during which they are incurred. These costs, therefore, do not find a place in the product cost. For valuation of closing stock or work in progress, these fixed costs component are not taken into account.
5. Prices are based on the marginal cost plus contribution. Contribution is the excess of selling price over the marginal cost of sales.

6. The relative profitability of products or departments is determined, after a study of the available contribution of the different products or departments.
7. The product or department, which gives the highest contribution is regarded as efficient or profitable to pursue.

19.7 MARGINAL COSTING AND PROFIT

In marginal costing, profit is calculated by two-stage approach. First of all, contribution is determined for each product or department. The contribution of various products or departments is pooled together. The total contribution so calculated is called ‘Fund’. From the fund, the total fixed cost is deducted to arrive at profit or loss. This is illustrated below:



Profit Ascertainment in Marginal Costing

19.8 ASSUMPTIONS OF MARGINAL COSTING

The Marginal costing assumes the following:

1. All elements of cost–production, administration and selling and distribution can be divided into fixed and variable components.

2. Variable costs remain constant per unit and so they vary, with the level of production, proportionately.
3. Selling price per unit is constant at all levels. In other words, selling price does not fall, even if more units are sold.
4. Fixed costs are constant or unchanged for the entire volume of production.
5. Volume of production or output only influences the costs.

19.9 FIXATION OF SELLING PRICE, BELOW MARGINAL COST

A new product is sold at a lower price in the market, initially. The total costs may not be recovered by the selling price and so the unit may incur loss. With the passage of time, sales increase. Additional sales require more production. Increased production results in spread of fixed costs, over a higher volume of production. This results in a reduced total cost per unit. Finally, cost of production falls in line with the selling price and the concern starts making profit from the new product.

19.10 ADVANTAGES OF MARGINAL COSTING

Marginal costing claims the following advantages:

1. Better Suited for Decision-Making

Marginal costing is better suited to the needs of management. Management is interested to understand the behaviour of costs.

> **Fixed costs are more or less uncontrollable, while variable costs are controllable costs.**

Cost data prepared, differentiating fixed cost and variable cost, helps the management in decision-making.

> **Marginal Costing helps the management to accept or reject an offer, at a lower price, received from a foreign market, compared to the selling price, prevailing in the local market.**

Accepting the offer at a reduced rate from a foreign market does not affect the local market sales. It is not possible for the management to offer different prices in the local market. It results in a reduced market rate, totally, and is not, finally, beneficial to the concern.

2. Simple to Operate

Marginal costing is simple to operate. Apportionment of fixed costs is difficult and arbitrary. As the apportionment of fixed costs is, all together avoided, management finds marginal costing simple to understand and operate.

3. No Complication of Over Absorption and Under Absorption

As fixed costs are not apportioned, there is no complication of over absorption and under absorption of overheads.

4. Avoids Misleading Statement

Fixed costs are time costs. They are independent and occur, whether there is production or not. Fixed costs mislead the cost statement. It is better to consider marginal costs only, which fluctuate, in sympathy, with the volume of production. In the absence of fixed costs, cost statement provides better understanding.

5. Facilitates Profit Maximisation

When a number of products are manufactured, marginal costing facilitates the study of relative profitability of different products.

> **By choosing the highest contribution yielding products for production, while utilizing the capacity of the machinery, profitability would be maximized.**

6. No Fictitious Profit

When valuation of closing stock includes an element of fixed cost component, current year's fixed overheads are carried forward to the next year. Under Marginal Costing, closing stock is valued at variable cost only, excluding fixed costs. This procedure prevents presentation of fictitious profits.

7. Valuable Adjunct

Marginal Costing is a valuable adjunct to Standard Costing and Budgetary Control.

Illustration No: 1

From the following data extracted from the books of Kumari & Co. ascertain profits in the formats of (1) financial accounting (2) Marginal costing system as on 31st March, 2008 :-

Costs		**Rs. .000**
Production		
Materials:	Direct variable	13
	Indirect variable	9
	Indirect fixed	8
Wages:	Direct variable	10
	Direct fixed	6
	Indirect variable	4
	Indirect fixed	5
Expenses:	Direct variable	3

	Indirect variable	12
	Indirect fixed	14
Marketing:	Selling indirect fixed	7
Distribution:	Direct variable	1
	Direct fixed	2
Administration indirect fixed		11
Total		105
Profit		15
Sale		120

(Assume no opening or closing stocks, and overheads are fully absorbed in cost accounting).

Solution:

(i) Profits as per Financial Accounting for year 2008:

Production cost:		Rs.
Materials 13 + 9 + 8		30
Wages 10 + 6 + 4 + 5		25
Expenses 3 + 12 + 14		29
		84
Sales		120
Gross profit		36
Admin cost	11	
Selling	7	
Distribution 1 + 2	3	21
Net Profit		15

(ii) Profit Calculation in Marginal costing for year 2008:

Sales			120
Production Cost:			
Prime cost			
Material	13		
Wages	10		
Expense	3	26	
Work overhead			
Material	9		
Wages	4		
Expenses	12	25	

Distribution cost		1	
Total marginal cost			52
Contribution			68
Fixed overhead			
Production 8 + 6 + 5 + 14	33		
Marketing	7		
Distribution	2		
Administration	11		53
Profit			15

19.11 ACCEPT OR REJECT DECISION-MAKING

Illustration No. 2

The Cost Sheet of a product is given as under:

		Rs.
Direct Materials		5.00
Direct Wages		3.00
Factory Overheads:		
Fixed	Rs. 0.50	
Variable	Rs. 0.50	1.00
Administrative Expenses		0.75
Selling and Distribution Overheads:		
Fixed	Rs. 0.25	
Variable	Rs. 0.50	0.75
		10.50

The selling price per unit is Rs. 12.

The above figures are for an output of 85,000 units, the capacity for the firm is 1,00,000 units. A foreign customer is desirous of buying 15,000 units at a price of Rs. 10 per unit.

(A) Advise the manufacture, whether the order should be accepted.

(B) What will be your advice, if the orders were from a local merchant, at the same price?

(C) What would be the profits, if the local selling price falls to Rs. 10 from Rs. 12, after acceptance of the order from a local merchant?

(B.U., MBA)

Solution:

(A) Marginal cost or additional cost for additional 15,000 units is as under:

	Per unit Rs.	For 15,000 units Rs.
Direct Materials	5.00	75,000
Direct Wages	3.00	45,000
Prime Cost	8.00	1,20,000
Variable Overheads:		
Factory	0.50	7,500
Selling and Distribution	0.50	7,500
Marginal Cost	9.00	1,35,000
Sales	10.00	1,50,000
Contribution	1.00	15,000

Additional order of 15,000 units is within the capacity of the firm. The order from the foreign customer would give an additional contribution of Rs. 15,000. Hence, the order should be accepted because additional contribution of Rs. 15,000 will increase the profit by Rs. 15,000 because fixed expenses have already been met from the sales of local market.

(B) If orders were from a local merchant, at the same price, instead of the foreign order:

The order from the local merchant should not be accepted at a price of Rs. 10, which is less than normal price of Rs. 12. Acceptance of the offer from the local market @ rs.10 gives additional contribution. However, this price will affect relationship with other existing customers and there will be a general tendency for reduction of price in future.

Finally, the order from the foreign buyer has to be accepted, while similar offer from the local buyer at the same rate is not to be accepted.

(C) Profit if the local selling price falls from Rs. 12 to Rs. 10, after acceptance of the local order for 15,000 units, additionally:

	Per unit Rs.	For 85,000 units @ Rs. 12	For 1,00,000 units @ Rs. 10
Direct Materials	5.00		
Direct Wages	3.00		
Prime Cost	8.00		
Variable Overheads:			
Factory	0.50		
Selling and Distribution	0.50		
Marginal Cost	9.00	7,65,000	9,00,000
Fixed Costs *		1,27,500	1,27,500

Total Costs		8,92,500	10,27,500
Sales	10.00	10,20,000	10,00,000
Profit / (Loss)		1,27,500	(27,500)

* Fixed costs are as under for 85,000 units:

Factory overheads @ Rs. 0.50	42,500
Administrative Expenses @ Rs. 0.75	63,750
Selling and Distribution overheads @ Rs. 0.25	21,250
Total	1,27,500

These fixed costs do not increase, even after increasing the production and sale from 85,000 units to 1,00,000 units.

Conclusion: After the selling price falls from Rs. 12 to Rs. 10, earlier profit of Rs. 1,27,500 would turn into a loss of Rs. 27,500.

Illustration No. 3

Cherry Ltd. has planned its level of production at 50% of its plant capacity of 30,000 units. At 50% of the capacity, the expenses are as follows:

		Rs.
(a)	Direct material	8,280
(b)	Direct labour	11,160
(c)	Variable manufacturing expenses	3,960
(d)	Fixed manufacturing expenses	5,000

The home selling price is Rs. 2 per unit. Now, the company has received a trade enquiry from overseas for 6,000 units at a price of Rs. 1.45 per unit. If you were the manager of the company, would you accept or reject the offer. Support your answer with suitable cost and profit details.

Solution:

Statement of Cost and Profit

	15,000 Units		6,000 Units		Total 21,000 Units
	Rs.	Per unit	Rs.	Per unit	Rs.
Direct Material	8,280	0.552	3,312	0.552	11,592
Direct Labour	11,160	0.744	4,464	0.744	15,624
Variable Mfg. Exp.	3,960	0.264	1,584	0.264	5,544
Marginal Cost	23,400	1.560	9,360	1.560	32,760
Sales	30,000	2.000	8,700	1.450	38,700
Contribution	6,600	0.440	(–)660	(–)0.110	5,940
Less: Fixed exp.	5,000	----	----	----	5,000
Profit/ loss (–)	1,600		(–)660		940

Conclusion:

The offer from overseas should not be accepted because price offered of Rs. 1.45 is even less than the variable cost of Rs. 1.56. It gives a reduced contribution of Rs. 0.11 per unit and thereby a loss of Rs. 660. Acceptance of export order results into reduction of profit. Once the export order is accepted, profit would be Rs. 940, compared to the earlier profit of Rs. 1,600/-.

Illustration No. 4

Quality products Ltd. manufactures and markets a single product. The following data is available.

	Rs. per unit
Materials	16
Conversion Cost	12
Dealer Margin	4
Selling Price	40
Fixed Cost	Rs. 5 lakh
Present Sales	90,000 units
Capacity Utilization	60%

There is over competition in the market. Firm has realized concerted efforts are necessary to increase sales. The following suggestions have been made for increasing sales.

(a) By reducing the sale price by 5%.

(b) By increasing the dealer's margin by 25% over the existing rates.

Which of these suggestions would you recommend?

(B.U., MBA)

Solution:

Present capacity utilization of the firm is 60%. In other words, capacity of 40% is unutilized. With the present capacity of 60%, the sales of the firm are 90,000 units. It is presumed that the entire production is sold. If 60% of the capacity is 90,000 units, 40% of unutilized capacity is 60,000 units.

There are two alternatives for increasing sales. The objective of increasing sales is to improve profits of the firm. So, we have to consider which of the options would improve profits.

	Reduction of Selling Price by 5%	**Increasing Dealer's Margin by 25%**
Materials per unit	16	16
Conversion Cost	12	12
Dealer's Margin	4	5
Total Variable Cost	32	33
Selling Price	38	40
Contribution	6	7

Contribution is 6 if the selling price is reduced by 5%, while contribution is 7, even after increase of dealer's margin by 25%. There would be no change in fixed costs in both the options.

Increased contribution would improve the profitability. So, option of increasing Dealer's Margin by 25% is recommended.

Illustration No. 5

A firm, having a capacity of 15,000 units per year, produces 10,000 units, which are consumed in home market at Rs.25 per unit. The cost sheet per unit is as under:

	Rs.
Material	8.00
Labour	6.00
Factory Expenses:	
Fixed	2.00
Variable	1.50
Office Expenses (Fixed)	1.00
Selling Expenses:	
Fixed	0.50
Variable	1.00
Total Cost	20.00

A foreign consumer is interested in the product and is willing to buy 5,000 units at a price of Rs. 18 per unit only. Do you advise the firm to accept the order? Justify your recommendation, with suitable reasoning.

Solution:

The existing capacity of the firm is 15,000 units and its current demand is 10,000 units. So, there is an existing capacity of 5,000 units, which is not utilized. To utilize the unutilized capacity, only variable costs are to be incurred and no fixed costs are, additionally, required to be made.

A comparison of the variable cost is to be made with the proposed selling price to decide whether the offer is worthwhile or not. If the amount of proposed sales is more than the additional variable costs, it would result in additional contribution. In consequence, profitability of the firm would go up.

Marginal cost or additional cost for additional 5,000 units is as under:

	Per unit Rs.	For 5,000 units Rs.
Direct Materials	8.00	40,000
Direct Wages	6.00	30,000
Prime Cost	14.00	70,000

Variable Overheads :		
Factory	1.50	7,500
Selling	1.00	5,000
Marginal Cost	16.50	82,500
Sales	18.00	90,000
Contribution	1.50	7,500

Acceptance of the foreign order would result in additional contribution of Rs. 7,500 to the firm. So, the additional order even at a reduced price of Rs. 18, in comparison to the local market rate of Rs. 25, is recommended.

19.12 FIXATION OF SELLING PRICE, BELOW MARGINAL COST

Ideally speaking, product price is to be fixed to cover variable cost as well as fixed cost and leave a reasonable return on the capital employed. But, there may be certain circumstances, requiring the firm to fix the selling price, below its variable cost.

It may be advisable to fix selling price below the marginal cost under the following circumstances:

1. **New Introduction of Product:** When a new product is introduced in the market, initially, it is sold below the variable costs to attract customers towards the product. The new product is sold, at a very low price, to make it popular.
2. **Import Quota Against Foreign Exchange Earned:** Government, sometimes, allows import quotas against foreign exchange earned and provide subsidy or duty drawback. Profits from the sale of import quotas may be more than the loss incurred by selling the product, below the marginal cost.
3. **Large Quantities of Raw Materials Already Purchased:** A firm may find itself with excess of raw materials, purchased. Sale of excess raw materials may be resulting in loss. It is desirable for the firm to convert the raw materials into finished goods and sell at a lesser loss than the loss that may be incurred by selling the raw materials.
4. **Goods are of Perishable Nature:** It is better to sell the perishable goods at a price which they can realize, otherwise these goods perish and nothing may be realized. This happens, normally, with the sale of fruits, as the shelf life of fruits is always short.
5. **Closure of Business and Subsequent Revival:** In some types of business, once the business is closed, it is difficult to revive, again. This is the case with industries, where skilled and trained employees are needed. Instead of closing the business, temporarily, and reviving later, which would attract lot of costs in recruitment and training, business may be continued. When it is difficult to revive the business connections, the firm also may decide to continue the business, despite loss, for a short period.
6. **Elimination of Competitors from Market:** To eliminate competitors in the market, market price may be fixed below the variable cost. An existing photocopier may find another

photocopier, opening his shop in the same locality. Till date, there has been no competitor to the existing photocopier. After allowing the competitor to open his new shop and installing the photocopy machine, the existing photocopier reduces the photocopy rate to 25 paise per page, from the earlier rate of 50 paise. The new photocopier too has to fix the rate at 25 paise to remain in business. But, the new firm would not be able to run the business and continue to sustain the loss, for long, as the reduced rate does not cover even the paper cost. The old photocopier would be able to withstand the loss from the, earlier, profits. Once the competitor closes the business, the old photocopier may increase the rate to 60 paise per page, if there is no competition. Closure of business would result in heavy loss. Seeing the plight, people may be afraid to open new shops to give competition. This would be a strategy to avoid competitors, emerging in the existing business, when only one firm has been enjoying the monopoly.

7. **Publicity:** A small quantity may be sold at a low rate to provide publicity for the product. The latest classical example is sale of flight ticket to USA from Hyderabad by Jet Airlines at Rs. 999 + taxes to as many as 23 destinations. Number of tickets reserved at the special concession rate is very low, but the publicity has been immense that tickets to USA are cheap in Jet Airlines.
8. **Push up Sales of other Profitable Products:** Sale of one product at a price below the marginal cost would result in loss; but may push up sales of other products. The loss of one product may be made up from the profit of other products.

19.13 LIMITATIONS OR DISADVANTAGES OF MARGINAL COSTING

Marginal costing suffers from the following limitations:

1. Classification of Expenses

Marginal costing assumes all expenses can be classified into fixed and variable. Such classification is not possible with certain expenses such as exgratia amount to Staff (amount not legally bound to pay) and amenities to staff. These expenses are caused, purely, by management decisions, which are voluntary in character. These expenses do not have any relation to volume of output or with time factor. So, it is wrong to assume all expenses can be classified into fixed and variable.

2. All Costs are Variable in the Long Run

It is difficult to segregate all costs into fixed and variable. In reality, all costs are variable in the long run. Even, the machinery can be sold to avoid fixed costs.

3. Valuation of Closing Stock

For valuation of closing stock, fixed costs are not taken into account. The technique of marginal costing is difficult to apply to certain industries where the manufacturing cycle-production of one product – is very long. For instance, in ship building industry, manufacture of one ship or one turbine in BHEL takes years. In such a case, while the manufacture is in progress, the corresponding year's show loss. On completion, the relevant year shows abnormal profits.

4. Resistance of Customers

It is not possible to sell a product, without including the fixed cost component, all the time. In certain circumstances, output may be sold at less than the total cost (aggregate of variable cost as well as fixed cost). But, such course of action cannot be continued for long. At best, this technique of costing can be followed when the product is sold in different markets and price in one market does not affect the other market. An order from a foreign market may be accepted at a lower price, based on marginal costing.

This approach cannot be followed for a new customer in a local market. This may, sometimes, lead to a general reduction in selling price and thus to heavy losses. If this course of action were done for a long period, there would be resistance from the existing customers, for the differential selling price.

5. Increased Usage of Automation

Technological automation is much in progress. Where automation is more, the proportion of fixed costs (depreciation and maintenance) increases. A system, which ignores fixed costs, is, therefore, less effective.

6. Balance Sheet does not Show a True and Fair Picture

Balance sheet does not exhibit a true and fair picture, as finished stock and work in progress are valued at marginal cost, which does not include fixed expenses. Thus, the inventory is understated in the balance sheet, which is against the fundamental principles of accounting.

7. Insurance Claim Settlement

In case of fire accident, full loss of stock cannot be recovered, as the stock is valued without taking the fixed cost component. Due to non-consideration of fixed cost, the valuation in accounts presents a lower value and in consequence, insurance company may pay lesser amount than the actual cost towards claim settlement.

8. Cost Control

Cost control can be better achieved with the help of other techniques such as budgetary control and standard costing.

Check Your Understanding.

State whether the following Statements are True or False

1. Marginal costing recognizes the distinction between Fixed Costs and Variable Costs in their behaviour.

2. Under the technique of Marginal costing, cost of production includes fixed overheads as well as variable overheads.
3. Cost of production per unit remains the same up to a particular level of output under marginal costing.
4. Under the technique of Marginal costing, fixed overheads are not allocated to cost units, but charged against a "Fund", which arises out of the excess of Selling price over Total Variable costs.
5. Overheads can be of two types, fixed costs and variable costs.
6. Fixed costs are called Product costs, while Variable costs are called period costs.
7. The technique of Marginal costing can be used in conjunction with job or process costing or with other techniques such as standard costing or budgetary control.
8. Fixed costs are more or less uncontrollable, while variable costs are controllable costs.
9. Marginal costing assumes all expenses can be classified into fixed and variable, which is always possible.
10. Certain expenses such as exgratia amount to Staff (amount not legally bound to pay) and amenities to staff cannot be classified into fixed and variable costs.
11. Marginal costing is a valuable adjunct to Standard costing and Budgetary control.
12. The fixed costs component is included in the valuation of work-in-progress and finished stocks in marginal costing.
13. Closing stock valuation is made at a higher price in marginal costing, compared to absorption costing.
14. Approach of marginal costing and absorption costing in the treatment of variable cost is one and the same.
15. Semi-variable costs, containing fixed costs component, form part of product cost in marginal costing.
16. Marginal costing cannot be used without standard costing.
17. Overheads can be fixed and variable in nature.
18. Marginal costing is the appropriate technique of costing for decision-making in accepting or rejecting an offer from a foreign market at a price lower than the local market price.
19. Marginal costing has no utility as it does not recover fixed costs.
20. Marginal costing is not an independent system of costing.
21. Fixed costs are constant, irrespective of the level of production, within the capacity of the machine.
22. Ideally speaking, product price is to be fixed to cover variable cost as well as fixed cost and leave a reasonable return on the capital employed.
23. When a firm has idle capacity to manufacture, 'Accept or Reject Decision' depends on the comparison of variable cost of the component with its current market price.
24. It is always better to reject a foreign order, when the price offered does not cover total cost.

25. When a firm has idle capacity, it is cheap to buy, if the market price is in excess of the marginal costs.

Answers

1. True 2. False 3. True 4. True 5. True 6.False 7. True 8. True 9. False 10. True 11. True 12. False 13 False 14. True 15. False 16. False 17. True 18. True 19. False 20. True 21. True 22. True 23. True 24. False 25. False

Pick up the most appropriate:

1. Cost accounting mainly helps the management in
   (a) Controlling costs
   (b) Decision-making
   (c) Fixing prices of products
   (d) Earning extra profits
2. Fixed costs per unit decreases when
   (a) Production volume decreases
   (b) The volume of production fluctuates
   (c) Variable costs per unit increase
   (d) Production volume increases, within the capacity of the machinery
3. Variable costs
   (a) Change with fixed costs
   (b) Remain constant per unit
   (c) Increase per unit, with increased production
   (d) Behave in an unpredictable manner
4. Behaviour of fixed costs and variable costs
   (a) One and the same
   (b) Fixed costs are constant, while variable costs move in the direction of production volume
   (c) Fixed costs move with volume of production, while variable costs are constant
   (d) Unpredictable
5. Fixed costs are called
   (a) Period costs
   (b) Product costs
   (c) Marginal costs
   (d) Variable costs
6. For calculation of contribution from export order for acceptance or rejection, the following is appropriate for decision-making.
   (a) Marginal Costing
   (b) Standard Costing
   (c) Absorption Costing
   (d) Process Costing

Answers

1. (b) 2. (d) 3. (b) 4. (b) 5. (a) 6. (a)

Descriptive Questions

1. Define 'Marginal cost' and 'Marginal costing'. How profit is calculated in Marginal costing? **(19.4 and 19.7)**

2. Explain the concept of Marginal Costing? What are the basic characteristics of Marginal costing? **(19.4 and 19.5)**
3. What is marginal costing and state the assumptions? **(19.4 and 19.8)**
4. What are the Advantages and Limitations of Marginal costing? **(19.10 and 19.13)**
5. Explain the technique of Marginal costing and state its importance in decision-making? **(19.6 and 19.10)**
6. Narrate the circumstances when the firm would fix the selling price below its marginal cost? **(19.12)**
7. Explain the difference in the behaviour of fixed costs and variable costs? **(19.2)**

Interview Questions

Q.1. What is the utility of marginal costing as this technique, totally, ignores fixed costs, while calculating costs?

Ans. The objective behind any decision of every firm is to improve the level of profits, from the current stage it is in. For example, when the firm receives an export order, it need not recover full costs. Fixed costs are constant, whatever be the level of production. So, if the market price that can be procured covers the variable costs and leaves something extra, which is called contribution, the extra would go for increasing the level of current profits. Here, marginal costing helps the management in decision-making to improve the profits. So, it is wrong to consider that marginal costing has no utility simply because it ignores fixed costs, totally.

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