Unit III

Marginal Costing: Meaning

Marginal costing is a technique of costing. This technique of costing uses the concept `marginal cost’. Marginal cost is the change in the total cost of production as a result of change in the production by one unit. Thus marginal cost is nothing but variable cost. In marginal costing technique only variable costs are considered while calculating the cost of the product, while fixed costs are charged against the revenue of the period.

Various Elements Of Marginal Costing

According to the institute of cost and management accountants (icma), london, marginal cost is `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’. Thus marginal cost is the added cost of an extra unit of output.

Marginal Cost = Direct Material + Direct Labour + Other Variable Costs

= Total Cost – Fixed Cost.

Features of Marginal Costing

The following are the special features of Marginal Costing:

- Marginal costing is a technique of working of costing which is used in conjunction with other methods of costing (Process or job)
- Fixed and variable costs are kept separate at every stage. Semi – Variable costs are also separated into fixed and variable.
- As fixed costs are period costs, they are excluded from product cost or cost of production or cost of sales. Only variable costs are considered as the cost of the product.
- As fixed cost is period cost, they are charged to profit and loss account during the period in which they incurred. They are not carried forward to the next year's income.
- Marginal income or marginal contribution is known as the income or profit.

Assumptions in Marginal Costing

The technique of marginal costing is based on the following assumptions:

1. All elements of costs can be divided into fixed and variable.
2. The selling price per unit remains unchanged at all levels of activity.
3. Variable cost per unit remains constant irrespective of level of output and fluctuates directly in proportion to changes in the volume of output.
4. Fixed costs remain unchanged or constant for the entire volume of production.
5. Volume of product is the only factor which influences the costs.

Characteristics of Marginal Costing

- Segregation of cost into fixed and variable elements
- Marginal cost as product cost
- Fixed costs are period costs
- Valuation of inventory
- Contribution is the difference between sales and marginal cost

Advantages of Marginal Costing

Marginal costing is an important technique of managerial decision making. It is a tool for cost control and profit planning. The following are the advantages of marginal costing technique:

- Simplicity
- Stock Valuation
- Meaningful Reporting
- Effect on Fixed Cost
- Profit Planning
- Cost Control and Cost Reduction
- Pricing Policy
- Helpful to Management

Limitations of Marginal Costing

Following are the limitations of marginal costing:

- Classification of Cost
- Not Suitable for External Reporting
- Lack of Long – term Perspective
- Under Valuation of Stock

Marginal Cost

Marginal cost is the cost of producing one additional unit of output. It is the amount by which total cost increases when one extra unit is produced or the amount of cost which can be avoided by producing one unit less.

The ICMA, England defines marginal cost as, *"the amount of any given volume of output by which the aggregate cost are charged if the volume of output is increased or decreased by one unit".*

Thank You

*In case of any query you are free to ask