APPLIED COST
ACCOUNTING

MARGINAL COST

- Amount by which aggregate cost are changed if the volume of output is increased or decreased by one unit
- In simple words , it means variable cost

Marginal costing

- Marginal costing is the ascertainment of marginal cost and the effect on profit of changes in volume or type of output by differentiating between fixed costs and variable cost. In marginal costing, costs are classified into fixed and variable costs.

Features of Marginal Costing:

- i) This technique is used to ascertain the marginal cost and to know the impact of variable costs on the volume of output.
- (ii) All costs are classified on the basis of variability into fixed cost and variable cost. Semi-variable costs are segregated into fixed and variable costs.
- (iii) Marginal (i.e., variable) costs are treated as the cost of the product or service. Fixed costs are charged to Costing Profit and Loss Account of the period in which they are incurred.
- (iv) Stock of finished goods and work-in-progress are valued on the basis of marginal costs.
- (v) Selling price is based on marginal cost plus contribution.

Advantages of Marginal Costing:

- (i) The technique is simple to understand and easy to operate because it avoids the complexities of apportionment of fixed costs which, is really, arbitrary.
- (ii) It also avoids the carry forward of a portion of the current period's fixed overhead to the subsequent period. As such cost and profit are not vitiated. Cost comparisons become more meaningful.
- (iii) The technique provides useful data for managerial decision-making.
- (iv) There is no problem of over or under-absorption of overheads.

Limitations of Marginal Costing:

- (i) Segregation of costs into fixed and variable elements involves considerable technical difficulty.
- (ii) The linear relationship between output and variable costs may not be true at different levels of activity. In reality, neither the fixed costs remain constant nor do the variable costs vary in proportion to the level of activity.
- (iii) The value of stock cannot be accepted by taxation authorities since it deflates profit.
- (iv) This technique cannot be applied in the case of contract costing where the value of work-in-progress will always be high.
- (v) This technique also cannot be used in the case of cost plus contracts unless fixed costs and profits are considered.
- (vi) Pricing decisions cannot be based on contribution alone.
- (vii) The elimination of fixed costs renders cost comparison of jobs difficult.
- (viii) The distinction between fixed and variable costs holds good only in the short run. In the long run, however, all costs are variable.