

Variance – A – Introduction

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Variance – A – Introduction

- Variances are the difference between actual and expected (budgeted).
- Here is a memory key – Alphabetical order:
 - Actual cost
 - Less Standard cost
 - Equals Variance

(Now think of a glass of milk.)

$$\boxed{\text{Actual Cost}} - \boxed{\text{Standard Cost}} = \boxed{\text{Variance Amount}}$$

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- Here is my *Milk Glass Theory* as related to variances.
- If the glass of milk is not overfull, if actual (7 ounces) is not greater than standard (full glass of 8 ounces), no mess, this is favorable.
- If actual (9 ounces) is greater than standard (full glass of 8 ounces), the glass overflows, I have to clean up the mess, this is unfavorable.

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- The primary variances are related to:
 - The purchase of materials,
 - The usage of materials,
 - The payroll rate of labor,
 - The amount of time used by labor, and
 - Factory / Manufacturing overhead.

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- As with production, variances are normally handled in the same order – Direct materials, Direct labor, and Factory / Manufacturing overhead.
- I have issues with some textbooks regarding variances and their recordings and that issue is timing.
- Therefore, this presentation may not parallel your textbook.

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- In real life standard costing, the source for variances, requires all values moving through production to move at standard costs.
- This makes life simple as it does not matter which one of those ¼” washers you picked up in the warehouse or what the exact pay rate is for the Level 4 Laborer is receiving while working on the production line.
- Both are “standard” costs.

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- Therefore, when you purchase materials, and it does not matter direct or indirect, you recognize the difference between actual and standard cost at the time of purchase.
- This is the Material Purchase Price Variance.
- Now the material in the warehouse at standard cost for issuing at any time for any use – direct or indirect.

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- When the material is issued it is issued at a standard cost.
- However, when production needs a few extra because of errors or extra ordinary waste, we have another variance, this is the Material Efficiency Variance.

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- However, in real life, not textbook accounting, production usually has a “yield factor.”
- If production needs to produce 144 units for a customer it is not uncommon to be issued something like 148 ¼” washers to make those 144 part.
- It is because there will most likely will be some loss due to malfunction or testing.

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- If production only uses 147 they actually have a favorable Material Efficiency Variance.
- If production has to request another $\frac{1}{4}$ " washer, utilizing 149 to make those 144 items, they would have an unfavorable Material Efficiency Variance.
- Textbook accounting ignores this reality.
- Therefore I will ignore it in these presentation.

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- Labor has a Labor Rate Variance related to the actual payroll per hour as opposed by the standard payroll per hour for the position.
- If the actual payroll rate is greater than standard, it is unfavorable Labor Rate Variance.
- If the actual payroll rate is less than the standard, it is a favorable Labor Rate Variance.

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- Labor has a Labor Efficiency Variance related to the actual hours used to complete a task as opposed by the standard hours for the task.
- If the actual hours are greater than the standard hours, it is unfavorable Labor Efficiency Variance.
- If the actual hours to complete the task are less than the standard hours to complete the task, it is a favorable Labor Efficiency Variance.

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- Depending on the textbook and company, there are other variances such as:
 - Factory / Manufacturing variable overhead variances, and
 - Factory / Manufacturing fixed overhead variances.

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- These variances work the same way as material and labor variances, the differences between actual costs and standard costs, and actual hours and standard hours.

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- In summary, the basis of all variances is:

$$\boxed{\text{Actual Cost}} - \boxed{\text{Standard Cost}} = \boxed{\text{Variance Amount}}$$

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- The next recommended presentation is Variances – B – Material Variances.
- Then Variances – C – Labor Variances is recommended.

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The end.