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Standard costing and variance analysis notes pdf download pdf format online

If say 40% of the material had been used in production and the items sold, and the balance of the material was in work in process, then 40% of the variance would be posted to the cost of goods sold account, and the balance (60%) would be posted to work in process inventory account.The how to treat standard costing variances diagram used in this tutorial is available for download in PDF format by following the link below.How to Treat Standard Costing Variances PDF Download LinkLast modified July 17th, 2019 by Michael Brown July 17, 2019 As an example, consider a manufacturing business, for each product it might set standards for each of its major cost types along the following lines:Direct MaterialsAllowing for normal wastage, the product is expected to need 2.00 units of material at a cost of 4.00 per unit.Direct LaborAllowing for normal inefficiencies, the product is expected to require 0.50 hours of labor at a cost of 15.00 per labor hour.Variable OverheadVariable overhead is allocated to the cost of the product based on the number of labor hours used at the standard rate of 5.00 per labor hour Fixed OverheadFixed overhead is allocated to the cost of the product based on the number of labor hours used at the standard rate of 2.60 per labor hour. Reporting a variance over which the business has no control, such as formally agreed labor rates, or an insignificant variance which can often occur with fixed overhead costs, is both time consuming and expensive and is unlikely to provide a significant benefit to the business.Any variances which are reported on the variance analysis report need to be investigated by the business to find the underlying cause, for example, labor rates may have increased and the business needs to reflect this change in its standard rates, or a supplier might have increased its prices resulting in a direct material variance.When undertaking standard costing variance analysis, it is important to understand that the costs and therefore the variances are all interrelated. The variance is the difference between the standard units and the actual units used in production, multiplied by the standard price per unit.Quantity variance = (Standard units - Actual units) x Standard priceFor example, if a business expects to use 1,000 units and actually uses 1,200 units, and the standard price per unit is 4.00, then the standard costing quantity variance is given as follows: Quantity variance = (Standard units - Actual units) x Standard price Quantity variance = (1,000 - 1,200) x 4.00 Quantity variance = -800 The standard costing variance is negative (unfavorable), as the actual units used are higher than the standard units, and the business incurred a greater cost than it expected to.Quantity variances occur when the cost is a function of the number of units used during production, and therefore apply only to variable costs. This standard rate is a function of the expected fixed overhead and the expected volume of production.During the year costs are allocated to inventory and cost of goods sold based on the actual volume of production at the standard rate.The difference between the standard (expected) volume of production and the actual volume of production, gives rise to the standard cost volume variance.Volume variance = (Standard fixed overhead rate x Actual units) - Budgeted fixed overheadFor example, if a business allocates fixed overhead based on the number of labor hours, and budgets a fixed overhead of 13,000 and expects to use 5,000 labor hours, then the standard fixed overhead rate set at the start of the year would be 13,000 / 5,000 = 2.60. Fixed costs are allocated to inventory based on a standard overhead rate usually calculated at the beginning or year. Fixed costs by their nature are fixed do not vary with the quantity of units used in manufacture and therefore do not have a quantity variance.Standard Costing Volume VarianceThe standard cost volume variance applies only to fixed costs. It is the repetitive nature of the production process which allows reliable and accurate standards to be established.The standard costs set should be realistic and achievable based on accurate historical or comparable industry data such as material and labor usage. The volume variance can also be calculated by multiplying the difference in the hours by the standard fixed overhead rate. Volume variance = (Standard hours - Budgeted hours) x Overhead rate Volume variance = (4,600 - 5,000) x 2.60 Volume variance = -1,040 Standard Costing Budget VarianceThe standard cost budget variance applies only to fixed costs and is the difference between the budgeted fixed overhead and the actual fixed overhead.Budget variance = Budgeted fixed overhead - Actual fixed overheadIn the example above if the actual fixed overhead was 11,000, then the budget variance is calculated as follows: Budget variance = Budgeted fixed overhead - Actual fixed overhead Budget variance = 13,000 - 11,000 Budget variance = 2,000 The standard costing budget variance is (positive) favorable as the business spent 2,000 less than it expected to in the original budget.Using Standard Costing and Variance AnalysisManagement use standard costing and variance analysis as a measurement tool to see whether the business is performing better or worse than the original budget (standards). The business will now allocate 2.60 of fixed overhead for every labor hour used during production.If the business actually uses 4,600 hours at the standard rate is would allocate 4,600 x 2.60 = 11,960 to the inventory, and the standard costing quantity variance is given as follows: Volume variance = (Standard fixed overhead rate x Actual units) - Budgeted fixed overhead Volume variance = (2.60 x 4,600) - 13,000 Volume variance = 11,960 - 13,000 Volume variance = -1,040 In this standard costing variance example, the volume variance is negative (unfavorable), as the actual labor hours allocated (4,600) were lower than the budgeted hours (5,000) used when calculating the standard rate. The standard rate is calculated based on a production volume of 10,000 items (equivalent to 5,000 labor hours), and a total budgeted fixed cost of 13,000.Variance AnalysisVariance analysis is the process of breaking down the difference between standard (budget) and actual costs to explain whether differences in price, quantity or both caused the business not to perform to expectations.There are numerous variances which can be calculated for each type of cost the business has, but they generally fall into one of the four categories listed below.Price varianceQuantity varianceVolume varianceBudget varianceStandard Costing Price VarianceThe standard costing price variance is the difference between the standard price and the actual price of a unit, multiplied by the quantity of units used.Price variance = (Standard price - Actual price) x Actual quantityFor example, if the standard price is 4.00 per unit, and the actual price is 3.80 per unit, and 2,000 units are used in the manufacture of a product, then the standard costing price variance is given as follows: Price variance = (Standard price - Actual price) x Actual quantity Price variance = (4.00 - 3.80) x 2,000 Price variance = 400 The standard costing variance is positive (favorable), as the actual price was lower than the standard price, and the business paid less for the units than it expected to.Price variances can occur for all types of cost, variable and fixed.Standard Costing Quantity VarianceThe standard cost quantity variance is sometimes referred to as the efficiency variance or usage variance. Whatever the cause the business should decide what action it needs to take to correct the situation.How to Treat Standard Costing VariancesWhen a business uses standard costing, the inventory and cost of goods sold accounts are recorded at the standard cost. Which variances are calculated and shown in the variance report depends on how useful the information will be in controlling the business. For example, a business might purchase lower quality materials at a cheaper price resulting in a favorable direct material price variance, however, the lower quality material might be difficult to work with which, apart from resulting in significant material wastage, could lead to an increased labor cost and an unfavorable labor quantity (efficiency) variance. A standard costing system has two main uses. It allows inventory and cost of goods sold to be recorded at standard cost to avoid the time consuming process of inventory valuation at the end of each accounting period.It allows the preparation of budgets at standard costs which enables management to monitor the performance of the business with variance reports showing the differences between the standard (expected) costs and the actual costs.Setting Standard CostsStandard costing and variance analysis is usually found in manufacturing businesses which tend to have repetitive production processes. If the original standards are set incorrectly, then the variances produced against those standards will also be incorrect and misleading, resulting in poor management decisions being made by the business. In order to reconcile this standard cost to the actual cost, it must also post the difference between the two costs to a variance account.Ultimately, however, the financial statements must show the actual costs incurred by the business, and at the end of an accounting period, having investigated the variances using the variance report, the balances on each of the variance accounts need to be removed.The method used to clear the standard costing variance accounts is to transfer and apportion the balances to either an inventory account or the cost of goods sold account, dependent on the size of and reason for the varianceFor small, insignificant variances it is not worth the time and effort apportioning the balance so they are simply transferred to the cost of goods sold account.Larger unfavorable variances (debit balances) which have resulted from errors and inefficiencies in the business, are also transferred to the cost of goods sold account as apportioning them to an inventory account would incorrectly increase the value of the inventory.All other significant variances (debit or credit balances) are split between inventory accounts and the cost of goods sold account in proportion to the amount of the item (material, labor, overhead) remaining on that account.For example, the balance on the direct material variance account is posted to either an inventory account (raw materials, work in process, finished goods) or to the cost of goods sold account depending on the location of the direct material.

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