VARIANCE ANALYSIS

B.COM-III

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It involves the measurement of the deviation of actual performance form the intended performances. It is based on the principle of management by exception. The attention of management is drawn not only to the variation in monetary gain but also to the responsibility and causes for the same.

Favourable and Unfavourable variances

Variances may be favorable (positive or credit) or unfavorable (or negative or adverse or debit) depending upon whether the actual cost is less or more than the standard cost.

Favorable variance: When the actual cost incurred is less than the standard cost, the deviation is known as favorable variance. The effect of the favorable variance increases the profit. It is also known as positive or credit variance.

Unfavorable variance: When the actual cost incurred is more than the standard cost, the variance is known as unfavorable or adverse variance. It refers to deviation to the loss of the business. It is also known as negative or debit variance.

Controllable and Uncontrollable variance:

Variances may be controllable or uncontrollable, depending upon the controllability of the factors causing variances.

C***ontrollable variance:*** It refers to a deviation caused by such factors which could be influenced by the executive action. For example, excess usage of materials, excess time taken by a worker, etc. When compared to the standard cost it is controllable as the responsibility can be fixed on the in-charge.

Uncontrollable variance: When variance is due to the factors beyond the control of the concerned person (or department), it is uncontrollable. For example, the wage rate increased on account of strike, government restrictions, change in market price etc. Only revision of standards is required to remove such in future.

Uses

The variance analysis are important tools of cost control and cost reduction and they generate and atmosphere of cost consciousness in the organization.

1. Comparison of actual with standard cost which reveals the efficiency or inefficiency of performance. The inefficiency or unfavorable variance is analyzed and immediate actions are taken.
2. It is a tool of cost control and cost reduction
3. It helps to apply the principle of management by exception.

4. It helps the management to maximize the profits by analyzing the variances into controllable and uncontrollable; the controllable variances are further analyzed so as to bring a cost reduction, indirectly more profit.
5. Future planning and programmes are based on the variance analysis.
6. Within the organization, a cost consciousness is created along with the team spirit.

Computation of variances

The causes of variance are necessary to find remedial measures; and therefore a detailed study of variance analysis is essential. Variances can be found out with respect to all the elements of cost, i.e., direct material, direct labour and overheads. The following are the common variances, which are calculated by the management. Sub-divisions of variances really give detailed information to the management in order to control the cost.

1. Material variances
2. Labour variances
3. Overhead variances (a) variable (b) fixed

Material variance:

The following are the variances in the case of materials

a) Material Cost Variance (MCV). It is the difference between the standard cost of direct materials specified for the output achieved and the actual cost of direct materials used. The standard cost of materials is computed by multiplying the standard price with the standard quantity for actual output; and the actual cost is computed by multiplying the actual price with the actual quantity. The formula is: