

ACCT 102 – Fundamentals of Accounting II

Ch 21- Flexible Budgets & Standard Costing

Fixed Budget – based on a single predicted amount of sales (Ch. 20)

Flexible Budget – based on predicted amounts of revenue and expenses corresponding to actual levels of output (Ch. 21)

Standard Costs

Cost Variance - the difference between budgeted amounts and actual amounts. The actual amounts must be compared to the budgeted amounts to evaluate and analyze the company's performance. (The budgeted amounts are often referred to as the standard amounts)

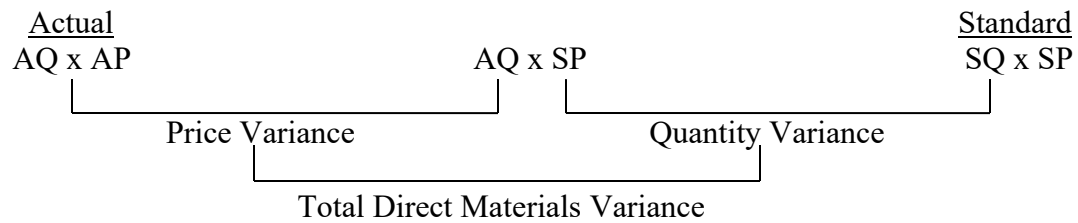
Favorable Variance – If Actual Net Income is higher than budgeted Net Income, the variance is *favorable*. If Actual Revenue is higher than Budgeted Revenue, the variance is *favorable*; if Actual Expenses are lower than Budgeted Expenses the variance is *favorable*.

Unfavorable Variance – If Actual Net Income is lower than budgeted Net Income, the variance is *unfavorable*. If Actual Revenue is lower than Budgeted Revenue, the variance is *unfavorable*; if Actual Expenses are higher than Budgeted Expenses the variance is *unfavorable*.

$$\text{Cost Variance} = \begin{array}{c} \text{Actual Costs} \\ \text{(actual quantity x actual price)} \end{array} - \begin{array}{c} \text{Standard Costs} \\ \text{(standard quantity x standard price)} \end{array}$$

The Cost Variance must be analyzed further to determine what caused the variance, was it due to a variance in the quantity, a variance in the price or a combination of the two. To analyze the variance further, we must analyze the costs separately.

Direct Materials Cost Variance



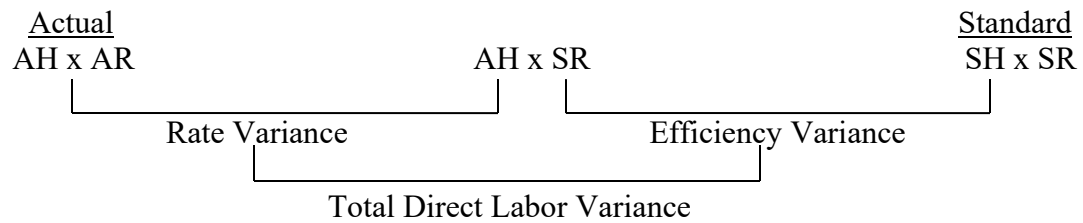
Della Lishus Cakes, Inc. makes wedding cakes. The accountant for Della Lishus Cakes, Penny Pincher, has established the following direct materials standards for wedding cakes:

Direct Materials Standard per cake: 40 pounds of materials at \$3 per lb.

During April, Della Lishus used 3,020 lbs. of materials at an actual cost of \$2.90 per lb. for the production of 75 wedding cakes.

Compute the following variances: (1) direct materials price variance, (2) direct materials quantity variance, and (3) total direct materials variance

Direct Labor Cost Variances



Della Lishus Cakes, Inc. makes wedding cakes. The accountant for Della Lishus Cakes, Penny Pincher, has established the following direct labor standards for wedding cakes:

Direct Labor Standard: 7 hours at \$10 per hour.

During April, Della Lishus Cakes used 519 hours of direct labor time at an actual rate of \$10.35 to make 75 wedding cakes.

Compute the following variances: (1) direct labor rate variance, (2) direct labor time variance, and (3) total direct labor variance.

Example 1

Paige Turner started Turner Publishing, Co. for the one book it publishes:

Direct Materials: 30 lbs. @ \$4 per lb.	\$120.00
Direct Labor: 5 hrs. @ \$14 per hr.	<u>70.00</u>
Total standard cost per unit	<u>\$190.00</u>

During the quarter, Turner Publishing, Co. produced 54,000 units. Actual costs incurred were:

Direct Materials: 1,615,000 lbs. @ \$4.10 per lb.
Direct Labor: 265,000 hrs. @ \$13.75 per hr.

1. Compute the direct materials cost variance, price variance and quantity variance.
2. Compute the direct labor variance, rate variance and time variance.

Example 2

Ally Kaneet Ice Cream Co. makes one flavor of premium ice cream in one size, a 5 gallon bucket. Ally established the following standard unit costs:

Direct Materials: 6 lbs. @ \$5 per lb.	\$30.00
Direct Labor: 2 hrs. @ \$17 per hr.	<u>34.00</u>
Total standard cost per unit	<u>\$64.00</u>

During July, Ally Kaneet produced 15,000 buckets of ice cream. Actual costs incurred were:

Direct Materials: 91,000 lbs. @ \$5.10 per lb.
Direct Labor: 30,500 hrs. @ \$17.25 per hr.

1. Compute the direct materials cost variance, price variance and quantity variance.
2. Compute the direct labor variance, rate variance and time variance.