

Variance Analysis

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What is Variance Analysis?

Variance analysis is a quantitative tool to investigate the difference between the actual outcome and the planned outcome. It helps management to find out the cause behind the variation in income and expenses.

Direct material variance and direct labor variance must be identified if such variance has a large difference.

What is the variance?

A variance is a difference between the standard resource and actual resource used in the operation. A variance can arise due to the difference in revenue or difference in cost. When actual cost is higher than standard cost or budgeted cost then such difference is a negative difference.

When actual cost is lower than standard cost or budgeted cost then such difference is a positive difference. The positive difference is a favorable variance while a negative difference is an unfavorable variance.

How can variance analysis effect on profitability?

Unfavorable variance should negatively impact on the profitability of the business. In another way, the favorable variance should positively impact on the profitability of the business. For example, an increase in an expense is unfavorable variance and thus, the budgeted profit would be decreased.

Relationship of variance

Variance is interlinked with other variances. Positive or negative correlations between variance are significant in business planning. For example, favorable sales variance of the coffee product may arise due to unfavorable sales variance of tea.

What are the benefits of variance analysis?

Variance analysis helps to assign the responsibility of the business to various persons or departments. For example, the production manager will be responsible for the unfavorable material quantity variance.

It is used as an accounting tool for cost control. Analysis of the large difference in particular variance helps management to look into further investigate and find out the best possible ways to avoid such variance in the future.

It helps the company for achieving its business target and ensure efficient utilization of the resource of the company. Thus, it helps to create value for its shareholders.

What are the limitations of variance analysis?

Variance analysis is done by the accounting staff at the end of each month. But it is not helpful in case of management requires the feedback much faster.

It is a much expensive activity for small businesses. Therefore, a detailed analysis of variance for each cost component might not make sense.

It is based on the predetermined standard. Standards limit the operating improvement upto a certain limit.

Types of variances

Variance can be divided into five types and further classified into sub-categories.

Direct Material Cost Variance

- Material cost variance
- Material price variance
- Material quantity variance
- Material mix variance
- Material yield variance

Direct Labor Cost Variance

- Labor cost variance
- Labor rate variance
- Labor efficiency variance
- Labor mix variance

- Labor yield variance
- Labor idle time variance

Variable Overhead Variance

- Variable overhead cost variance
- Variable overhead efficiency variance
- Variable overhead spending variance

Fixed Overhead Variance

- Fixed overhead cost variance
- Fixed overhead volume variance
- Fixed overhead budget variance

Sales Variance

- Sales price variance
- Sales volume variance
- Sales quantity variance
- Sales mix variance

**“If any Doubt & Question Contact During Class Time”
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