



TWO VARIANCE ANALYSIS

1. Overhead cost allowed (budgeted) for the level of activity attained (represented by the dot on the budget line) is determined by an output measure, such as units produced or standard direct labor hours, rather than by an input measure, such as actual direct labor hours used.
2. The line 'standard cost applied' represents the amount of cost charged to the product through the work in process account.
(STD DLH X STD overhead rate)

THREE VARIANCE ANALYSIS

1. Overhead cost allowed (budgeted) is based on an input measure, such as actual labor hours used, (in two-variance analysis, budgeted cost is based on completed production or on standard labor hours)
2. The 'applied' cost is not recorded in the accounts. It is generated by multiplying actual hours used by the standard overhead rate and is used to isolate the efficiency variance only.
3. The standard cost (STD DLH X STD overhead rate) is the amount charged through the WIP account.
4. The actual cost incurred and the standard cost applied are the same under both the two and three variance methods.

Volume Variance - measure of fixed costs related to idle capacity.

Spending variance - difference between actual overhead incurred and budgeted overhead based on actual direct labor hours.

Efficiency variance - measures amount of overhead costs incurred (at standard rates) for actual hours in relation to what would have been used if the direct labor had been worked at standard hours.