

I. Flexible (Variable) Budgets

A. Budgets that can be adjusted for changes in the level of activity encountered by the firm (as opposed to static budgets that are only useful only at a fixed (static) level of activity).

1. Flexible budgets are used in conjunction with static budgets to identify:

a. sales volume variance; the difference in operating income (net income) between the flexible-budget amounts and the static (master) budget amounts while holding selling prices and variable costs constant;

$$\text{Sales Volume Variance} = (\text{Flexible-budget units sold} - \text{master-budget units sold})(\text{budgeted UCM})$$

b. flexible budget variance; the difference between actual operating income (net income) and flexible budget operating income;

$$\text{Flexible-budget Variance} = \text{Actual Operating Income} - \text{Flexible-budget Operating Income}$$

Note: All variances must be labeled as favorable (F) or unfavorable (U)

2. When using these variances to evaluate managerial performance it is important to distinguish between:

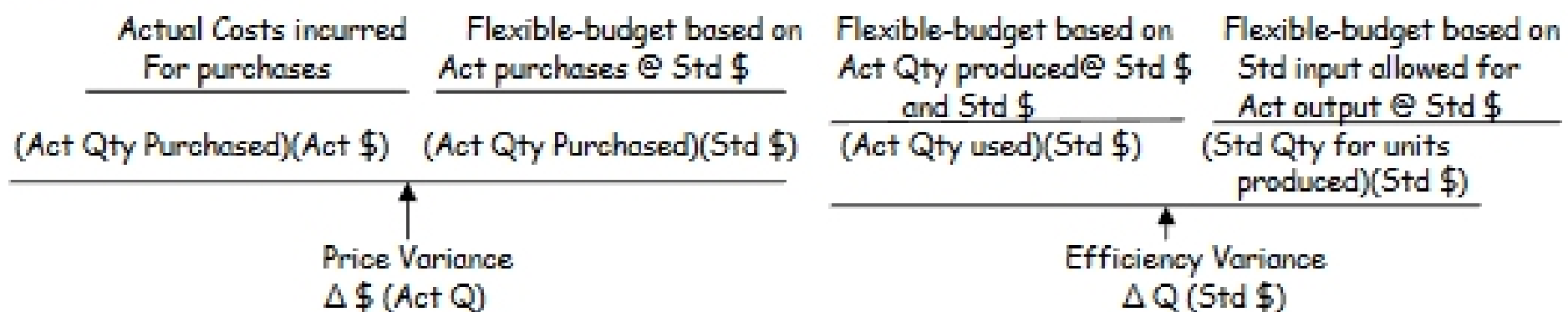
a. Effectiveness; the degree to which a manager has achieved a predetermined objective

b. Efficiency; the degree to which a manager maximizes outputs with a given number of inputs

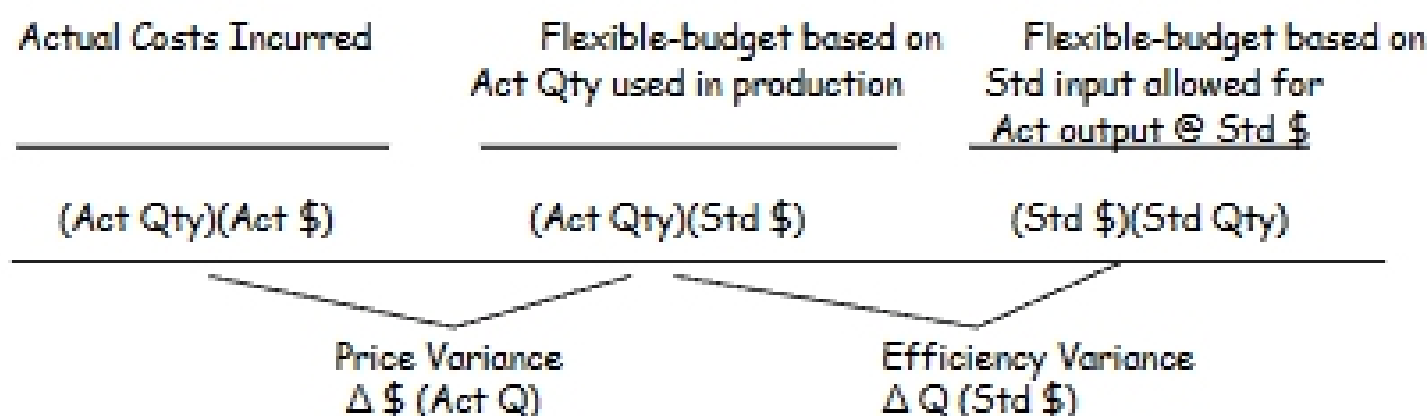
II. STANDARD COSTING

A. A flexible-budgeting system that utilizes predetermined per unit standard costs for Direct Material (DM) Direct Labor (DL) and Variable OverHead (VOH)

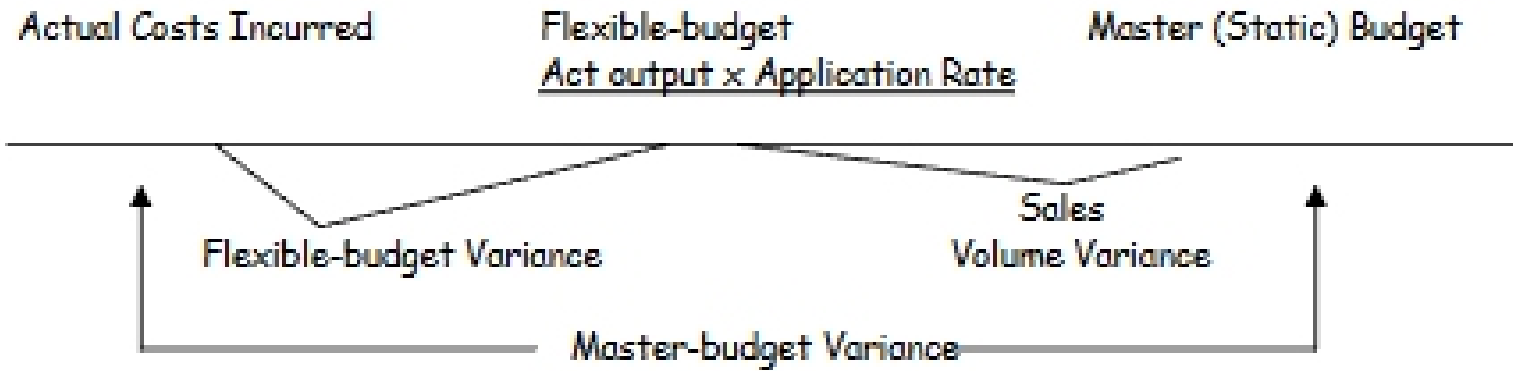
Direct Material Format



Direct Labor and Variable Overhead Format



Fixed Overhead Format



B. Standard Costing Journal Entries

Record Direct Materials Purchased and Isolate DM Variances:

Stores (Act Q purchased)(Std \$).....	xxxxx	
DM \$ Variance (U) [Δ \$ (Act Q)]	UUUU*	
DM \$ Variance (F) [Δ \$ (Act Q)]		FFFF*
Accounts payable (Act Q)(Act \$).....		xxxxx

Record Direct Materials Used In Production:

Work in process (Std Q for units produced)(Std \$).....	xxxxx	
DM Efficiency Variance (U) [Δ Q (Std \$)]	UUUU*	
DM Efficiency Variance (F) [Δ Q (Std \$)]		FFFF*
Stores (Act Q used in production)(Std \$).....		xxxxx

Record Direct Labor Cost and Isolate DL Variances:

Work in process (Std Q for units produced)(Std \$).....	xxxxx	
DL \$ Variance (U) [Δ \$ (Act Q)]	UUUU*	
DL Efficiency Variance (U) [Δ Q (Std \$)]	UUUU*	
DL \$ Variance (F) [Δ \$ (Act Q)]		FFFF*
DL Efficiency Variance (U) [Δ Q (Std \$)]		FFFF*
Payroll Payable (Act Q)(Act \$).....		xxxxx

RECORD VARIABLE OVERHEAD AND ISOLATE VARIANCES (three steps):

1. Record VOH Incurred:

VOH Control (Act Q)(Act \$).....	xxxxx	
Accounts payable and other credits.....		xxxxx

2. Record VOH Applied to WIP:

WIP (Std Q for units produced)(Std \$).....	xxxxx	
VOH Applied.....		xxxxx

3. Isolate VOH Variances for the period:

VOH Applied (Std Q for units produced)(Std \$).....	xxxxx	
VOH \$ Variance (U) [Δ \$ (Act Q)]	UUUU*	
VOH Efficiency Variance (U) [Δ Q (Std \$)]	UUUU*	
VOH \$ Variance (F) [Δ \$ (Act Q)]		FFFF*
VOH Efficiency Variance (U) [Δ Q (Std \$)]		FFFF*
VOH Control (actual amounts).....	xxxxx	

Record Fixed Factory Overhead and Isolate Variances: (two steps)

1. Record Actual FOH:

Fixed Overhead (FOH) Control (Actual amounts incurred)	xxxxx	
Various Accounts (at actual billed amounts).....		xxxxx

2. Isolate FOH Variances:

FOH Applied (application rate)(level of activity).....	XXXXX
FOH Budget Variance (Actual Cost - Flex-budget cost) (U)	UUUU*
FOH Volume Variance (Flex-budget - Master Budget) (U)	UUUU*
FOH Budget Variance (Actual Cost - Flex-budget cost) (F)....	FFFF*
FOH Volume Variance (Flex-budget - Master Budget) (F).....	FFFF*
FOH control (actual amounts).....	XXXXX

Allocate Variances [Variances may be allocated to inventory accounts and COS or allocated directly to COS]

* Two accounts of the same type will not occur simultaneously; they are depicted here to illustrate handling for favorable (F) and unfavorable (U) variances

C. Criteria for Selecting Standards

1. The nature of the standards selected and utilized by the firm in a standard costing system can have profound affects on those employees striving to attain them. To the extent that the standards are viewed as unobtainable or not realistic they will not have a motivating influence on managers or other employees. The following is a list of types of standards sometimes utilized in practice:
 - a. **Perfection Standards:**(AKA ideal, maximum efficiency and theoretical standard) Those standards obtainable only in a "perfect environment"; should be used only in those circumstances where they may provide a psychological motivation
 - b. **Currently Obtainable Standards:** Standards that are difficult but obtainable. These standards take into account normal spoilage, breakdowns, absenteeism etc.; are more widely accepted as realistic by employees (especially if employees are involved in there creation) and therefore generally provide the most motivation. Most widely used in practice.

D. Investigation of Factors Underlying Variances:

1. The decision to investigate the underlying causes of variances must be made based on the size of the variance without regard to whether a particular variance is favorable or unfavorable.

Summary of Absorption Costing Systems

Type of Cost	Actual Absorption Costing Balance in WIP	Normal Absorption Costing Balance in WIP	Standard Absorption Costing Balance in WIP
Direct Materials	(Act Q)(Act\$)	(Act Q)(Act \$)	(Std Q for Output)(Std\$)
Direct Labor	(Act Q)(Act\$)	(Act Q)(Act\$)	(Std Q for Output)(Std\$)
Variable Overhead	(Act Q)(Act\$)	(Activity level)(Appl. Rate)	(Std Q for Output)(Std\$)
Fixed Overhead	(Act Q)(Act\$)	(Activity level)(Appl. Rate)	(Std Q for Output)(Std\$)