# **Quadrant II- Notes**

# Paper Code : COD110

## Module Name: Direct Labour Cost Variance – 1

## Direct Labour Variance

Meaning:

A labour variance arises when the actual cost associated with a labour activity varies (either better or worse) from the expected amount. The expected amount is typically a budgeted or standard amount. The labour variance concept is most commonly used in the production area, where it is called a direct labour variance.

The labour variance can be used in any part of a business, as long as there is some compensation expense to be compared to a standard amount. It can also include a range of expenses, beginning with just the base compensation paid, and potentially also including payroll taxes, bonuses, the cost of stock grants, and even benefits paid.

Labour variances are just like material variances and can be defined as follows:

### (a) Labour Cost Variance:

It is the difference between the standard cost of labour allowed (as per standard laid down) for the actual output achieved and the actual cost of labour employed. It is also known as wages variance.

Labour Cost Variance = Standard Cost of Labour – Actual Cost of Labour.

### (b) Labour Rate (of Pay) Variance:

It is that portion of the labour cost variance which arises due to the difference between the standard rate specified and the actual rate paid.

It is calculated as follows:

Labour Rate of Pay Variance = Actual Time Taken (Standard Rate per hour – Actual Rate per hour).

### (c) Labour Efficiency Variance:

It is that portion of labour cost variance which arises due to the difference between the standard labour hours specified for the output achieved and the actual labour hours spent.

Labour Efficiency Variance (LEV) = Standard Rate (Standard Time for Actual Output – Actual Hours worked)

The labour efficiency variance is calculated only when there is abnormal idle time.

Here standard time for actual output means time which should be allowed for the actual output achieved.

Actual Time worked means actual labour hours spent minus abnormal idle hours.

## (d) Labour Mix Variance

Labour mix variance is just like material mix variance and it is the part of labour efficiency variance. If you would see any factory, you would see different type of workers. Workers may be skilled, semi skilled and unskilled. Company cost accountant has to make standard quantity of all these type of labourers but actual quantity may also be dependent on the supply of workers. Suppose, we make standard of skilled workers as 40 but actual supply was of that type worker 30, so we had to appoint semi-skilled workers. Due to this, there will happen labour mix variance.

Thus labour mix or gang variance arises due to difference in composition of standard and actual labour force. It is calculated using the following formula :



Revised standards hour's means that the standard proposition of each type of labour hours in the total actual hours. They are calculated as under:

Revised standard hours = Standard hours of each type of labour × Total Actual Hours

**Total Standard Hours** 

### e) Labour Idle Time Variance:

Labour Idle Time Variance is the cost of the standby time of direct labour which could not be utilized in the production due to reasons including mechanical failure of equipment, industrial disputes and lack of orders

Labour idle time cost always affects profits of the concern adversely and hence the variance is considered as adverse. The following formula is used to calculate idle time variance:



Labour Idle Time Variance = Standard Labour hour rate X Idle time hours