Labor rate

The labor rate variance is the difference between the actual labor rate paid and the standard rate, multiplied by the number of actual hours worked. The formula is: Actual rate - Standard rate x Actual hours worked = Labor rate variance. An unfavorable variance means that the cost of labor was more expensive than anticipated, while a favorable variance indicates that the cost of labor was less expensive than planned. There are a number of possible causes of a labor rate variance. The labor rate variance will not be zero because workers ate under contract.

Wage rates paid to workers are quite predictable. Nevertheless, rate variances can arise because of the way labor is used. Skilled workers with high hourly rates of pay may be given duties that require little skill and call for lower hourly rates of pay. This will result in an unfavorable labor rate variance, since the actual hourly rate of pay will exceed the standard rate specified for the particular task. In contrast, a favorable rate variance would result when workers who are paid at a rate lower than specified in the standard are assigned to the task.

However, the lower-paid workers may not be as efficient. Finally, overtime work at premium rates will result in an unfavorable rate variance if the overtime premium is charged to the direct labor account.

Direct labor variance is the difference between the standard cost and the actual cost of production.

The standard labor rate established by a company is an average, usually pertaining to average quality workers. Newly hired workers will likely get paid less which creates a favorable labor rate variance. They will also work more slowly than more experienced workers creating an unfavorable labor efficiency variance.

The opposite is true if a company employs highly skilled workers The production supervisor hires production workers and assigns each a wage rate. He is able to give them raises and terminate them if necessary. For this reason, if a labor rate exists, we inquire with the production supervisor to try to determine the variance cause. The production supervisor oversees the production workers and monitors the efficiency with which each of these workers works.