C 11 - FLEXIBLE BUDGETS AND OVERHEAD ANALYSIS
Written by Professor Gregory M. Burbage, MBA, CPA, CMA, CFM ©

CHAPTER LEARNING OBJECTIVES:
MAJOR:
- Calculate all variances (also see chapter 10 notes).
- Explain what each variances means in non-technical language (also see chapter 10 notes).
- Prepare a flexible budget.

STATIC BUDGET has one level of activity. When comparing an original static budget with actual results, you can't distinguish between cost control and activity control. I.e., you can't tell if you have a favorable or unfavorable Price Variance and a favorable or unfavorable Quantity Variance.

FLEXIBLE BUDGET is several budgets at various levels of activity. In fact, after the activity level is determined (after the fact) we will prepare a new flexible budget at the actual activity level achieved (if we didn't already have one). Then we will calculate our variance analysis comparing the revised flexible budget and actual results, so as to determine the Price and Quantity Variances.

FLEXIBLE BUDGET CONSTRUCTION:
- Determine relevant range of activity
- Analyze costs. I.e., variable, fixed & mixed
- Prepare flexible budget based upon cost behavior at the actual level achieved.

CHOOSING AN ACTIVITY BASE:
- Causal (cause and effect) relationship is best
- Avoid using dollars in the base, if possible. Prefer ABC but when using conventional approach use such activity bases as DL, MH, amount of materials, etc.
- Pick a base that is easy to understand.

VFOH Variance:

SPENDING variance is a combination of the Price and Quantity variances of material or Rate and Efficiency variances of labor. I.e., it is a Price and Usage variance.

EFFICIENCY variance is how efficiently the base underlying the flexible budget is being utilized. I.e., if actual hours exceed standard hours for level of output achieved, we have used too many hours to produce our output -> therefore, Unfavorable. This variance will have a direct relationship to DL Efficiency Variance if DLH is used.

<table>
<thead>
<tr>
<th>Actual costs</th>
<th>Revised budget</th>
<th>Applied FOH</th>
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<tbody>
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<tr>
<td>!<em><strong><strong>SPENDING</strong></strong></em>__!</td>
<td><em><strong><strong>EFFICIENCY</strong></strong></em>!</td>
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Spending Variance means: spent more or less than in revised budget because we paid more/less and/or used more/less variable FOH items.

Efficiency Variance means: Unfavorable: Took more time, on average, than planned.
Favorable: Took less time, on average, than planned.
For example, if MH was the Deno. Activity, and it was suppose to take 3 MH each unit, but on average it took 3.1 MH per unit, then it took more time than it should have - Unfavorable.
FFOH Variances:

BUDGET variance is a spending-type variance, but VOLUME variance is a measure of the utilization of the plant and equipment in relation to our predetermined usage.

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<th>Actual Cost</th>
<th>Original Budget</th>
<th>Applied FOH</th>
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<td>!<em><strong><strong>BUDGET</strong></strong></em>!</td>
<td>! VOLUME_____!</td>
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Budget Variance means: spent more or less than in original budget
Volume Variance means: more or less units produced than in original budget