**Instructor Notes – Chapter 9. Flexible Budgets**

1. The material in some of our chapters can be quite challenging. Hopefully you will find this chapter to be very straightforward, with a few key points that are easy to understand.
The publisher PowerPoint file is a very valuable learning aid.
2. A budget provides a plan of action that is developed before the start of a period (month, quarter, etc.). At the end of the period, actual results are compared with the budget plan.
3. A budget variance occurs when a revenue or expense amount for the period is different from the amount for that account shown on the budget. For example, if your budget shows expected revenue of $720,000 and actual revenue is only $710,000, you have an unfavorable budget variance of $10,000 for revenue. If your budget shows expected utility expense of $70,000, and actual utility expense is only $65,000, you have a favorable budget variance of $5,000 for utility expense. (reducing expense is positive or favorable)
4. **Example**. Assume you prepare a budget based on **sales of 100,000 units** which you will deliver to your customers. **Selling price is $1,000 per unit.** Assume you expect to incur **delivery costs of $400,000, to deliver 100,000 units to customers.**
5. **If you sell and deliver 120,000 units** to your customers, your actual delivery costs will likely be more than the $400,000 amount which has been budgeted for delivery costs.
With a 20% increase in the number of units delivered, you may expect a 20% increase in delivery costs (an increase from $400,000 to $480,000). **A budget for 100,000 units is a static budget,** because it does not report your expected costs if the level of sales changes (such as the change above from sales of 100,000 units to sales of 120,000 units).
6. **Continuing the example above.** The budget variance of $80,000 for delivery costs ($480,000, less $400,000) is an unfavorable variance. This variance is caused by an increase in sales, which causes the company to make more deliveries. This budget variance of $80,000 does not mean the company operated its trucks inefficiently. This variance of $80,000 is called an activity variance, because it is caused by a change in the level of activity (increase in sales and increase in deliveries).
7. If you prepare a multi-column **“flexible budget”** (a different budget for each level of sales), the column for sales to **120,000 units** will show expenses expected for that level, including delivery costs (expenses) of **$480,000**.
8. At the end of the period, you will complete a column that contains actual costs.
Assume that (for a period of sales of 120,000 units) you incurred delivery costs of $525,000. The difference between the flexible budget amount of $480,000 and the actual cost of $495,000 is an indication that the company was less efficient than planned (spending variance of $45,000).
9. The delivery cost line on your budget statement might look like this.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Budget for Sales** | **Activity** | **Budget for Sales** | **Spending** | **Actual for Sales** |
|  | **of 100,000 units** | **Variance** | **of 120,000 units** | **Variance** | **of 120,000 units** |
| Revenue | $100,000,000 |  | $120,000,000 |  | $120,000,000 |
| Delivery costs | $400,000 | **$80,000** | $480,000 | **$45,000** | $525,000 |

1. The variance of $80,000 is not a problem needing attention, because this additional cost is caused by an increase in sales (which is good). The spending variance of $45,000 needs to be investigated. It suggests inefficient operation of the delivery trucks. Total variance is $125,000. See: M11-Chp-09-2-Food-Place-Flexible-Budget.xlsx