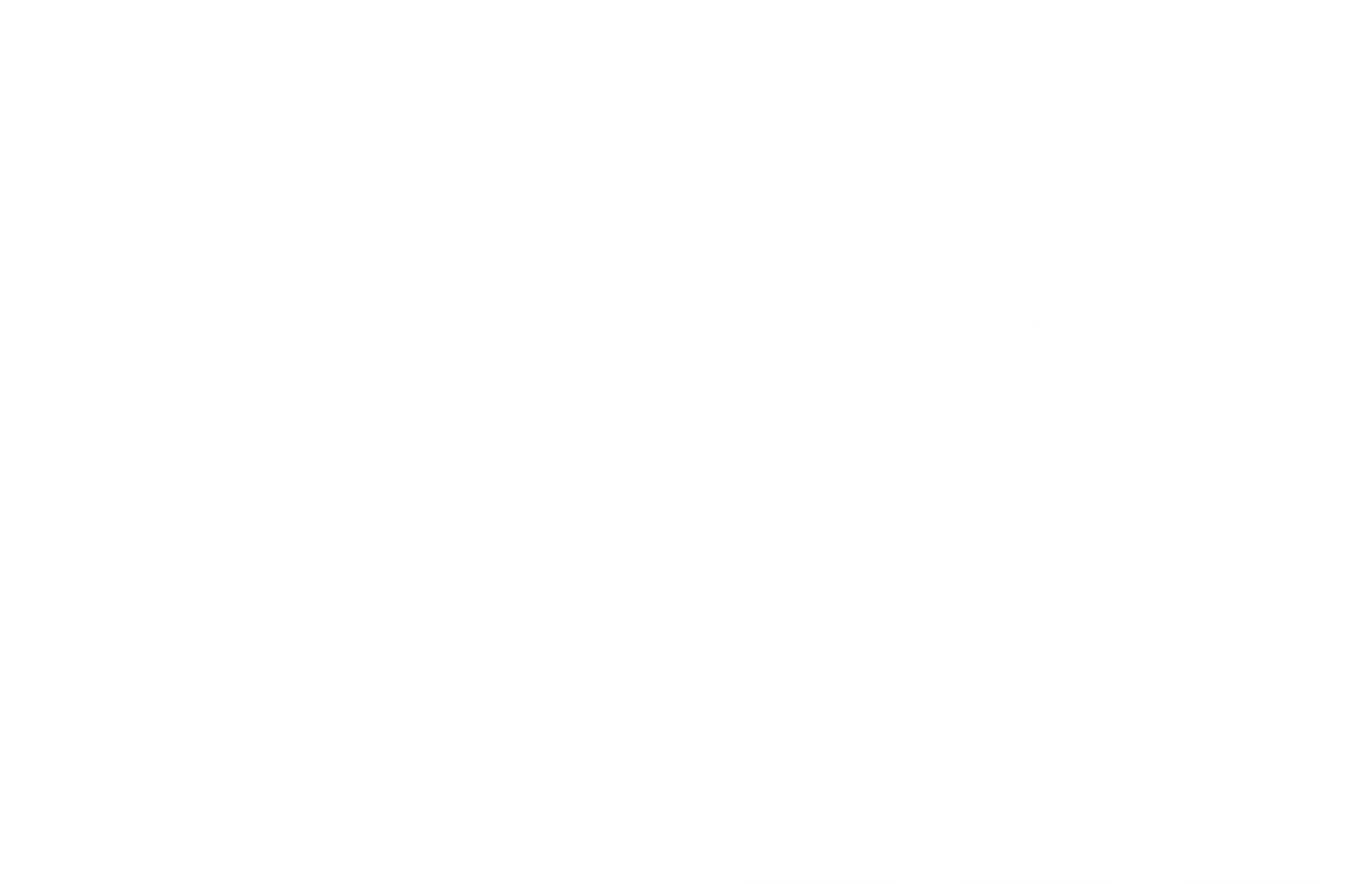
Flexible Budgets and Performance Analysis

A **budget** is a monetary plan for the future based on a planned level of activity for the company. Specifically, there are two types of budgets, planning budgets and flexible budgets.

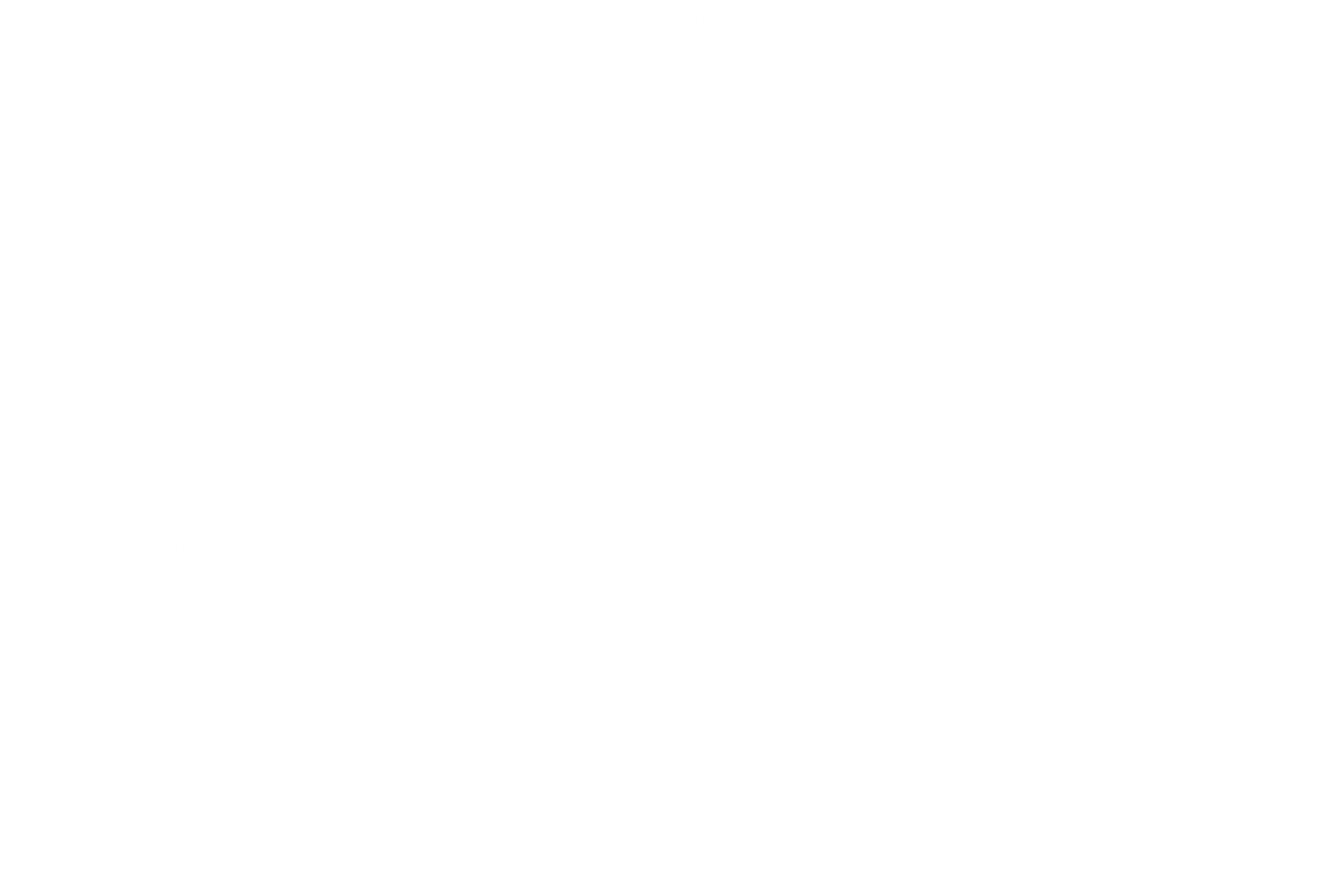
A **planning budget** is prepared before the period begins and is only valid for the planned level of activity. This is good for planning things, but the actual level of activity will be different from this. When analysing revenues and costs, if we use the planned budget to determine whether there are any issues, the results will be misleading.

A **flexible budget** takes into account the actual level of activity for the period. It is an estimate of what revenues and costs should have been, given the actual level of activity. Therefore, using the flexible budget when analysing revenues and costs to determine whether there are any issues is far more accurate.



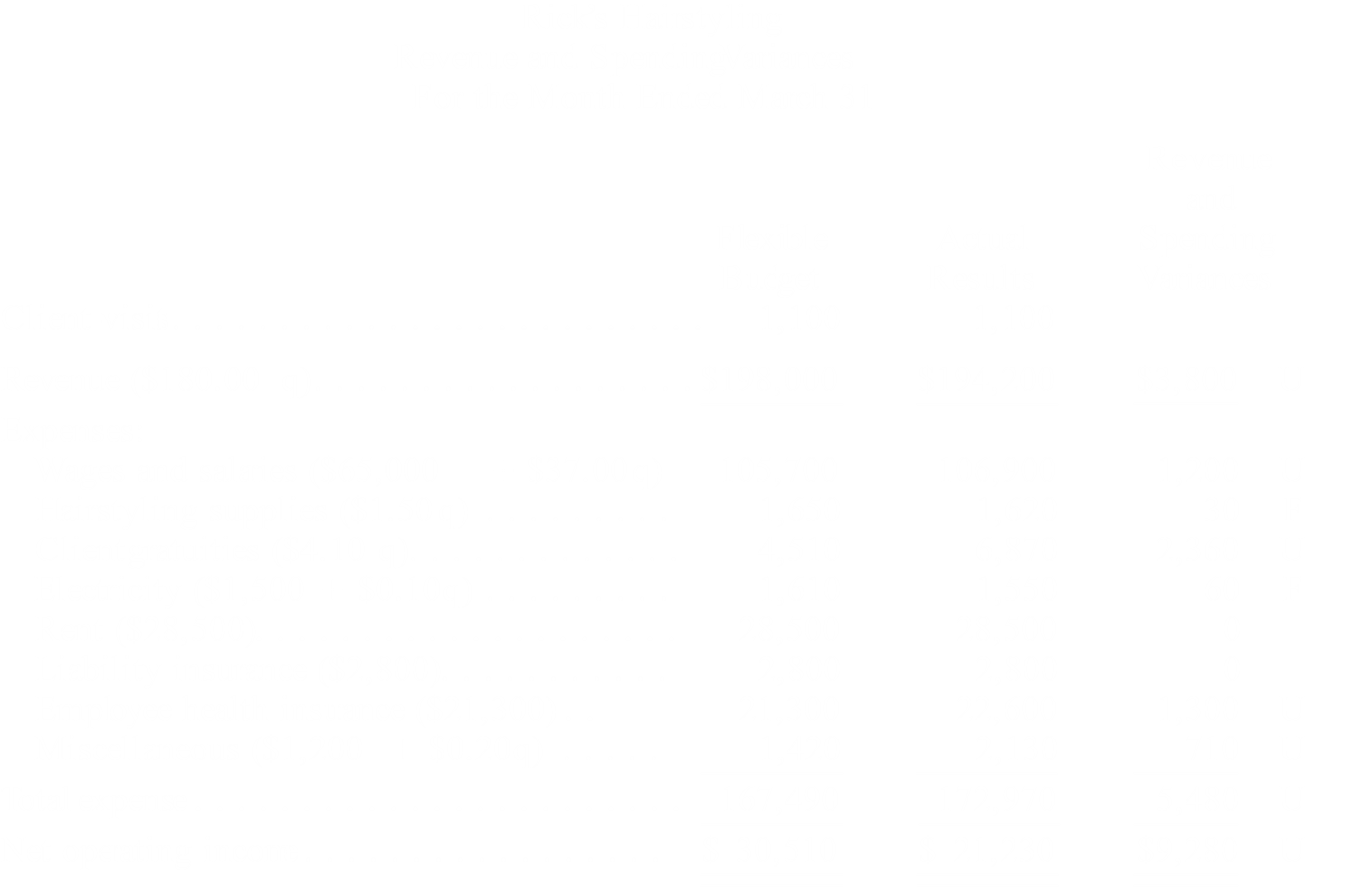
Consider the table above, which compares the planned budget to actual results for a given company. Here, the **F** marks are for Favourable results and the **U** marks are for Unfavourable results. However, as mentioned previously, this comparison is not entirely fair, since the activity level for the planned budget is different from the activity level of the actual results. This results in things like the variable expenses (e.g. Wages and Salaries) to change.

Since we recognize that at least a part of the differences is due to the different activity levels, we can figure out just how much that was by comparing the planned budget and the flexible budget. This different is called the **activity variance**.



Notice that certain costs in the table above have a fixed part as well as a variable part. Such costs are called **mixed costs**.

Finally, we can compare the flexible budget to the actual results. This difference is called the **revenue and spending variance**.



The revenue and spending variance tells us how much of the difference is due to factors outside the change in activity level. These differences are of importance, since they should not occur. For example, the revenue difference is unfavourable. We now know that something must have gone wrong there and can look deeper into the issue. On the other hand, the electricity difference is favourable, meaning our actual cost is lower than expected. Looking deeper into that could give us an indication about why this happened.

We can combine all the different information into a single table as well, called a **Flexible Budget Performance Report**.

