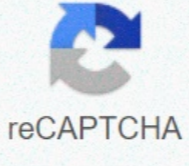




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Flexible budget variance equation

How to calculate the flexible budget variance. How to find the flexible budget variance. What is the formula for flexible budget variance.

At the beginning of the chapter, you learned that a budget should be adjusted for changes in the assumptions or changes in the level of operations. Managers use a technique known as flexible budgeting to deal with budget adjustments. A flexible operating budget is a special type of budget that provides detailed information on budget expenditure (and revenue) at various levels of production. The Leed Company's production budget is more than 70%. Leed can produce 25,000 units in a period of 3 months or a quarter, which represents 100% of the capacity. 3 month budget supply Leed 3 month budget tips for 3 months \$1,400 Power 7,000 Insurance 4,200 Maintenance 4,900 Depreciation 18,000 Supervision 57,000 Total Costs Overhead \$92,500 Units produced (70% capacity) 17,500 To maintain the simple example, we assume that the first four costs are strictly variable and that we calculate a unit budget for such costs. On the other hand, the last two costs, depreciation and supervision, are fixed costs and it is assumed that they are constant for the entire range of relevant activities, which means that they do not change according to the volume. The following table shows the calculations for units produced at 70% capacity and calculates the variable cost per unit for all variable costs. Variable fixed calculation units produced 17,500 units (25,000 units x capacity 70%) Supply \$1,400 \$0.08 (\$1,400 / 17,500 units) Power 7,000 \$0.40 (\$7,000 / 17,500 units) Insurance 4,200 \$0.24 (\$4,200 / 17,500 units) Maintenance 4,900 \$0.28 (\$4,900 / 17,500 fixed unit) We can calculate the flexible budget for any level of activity using this data. Leed Company prepares a flexible budget for 70%, 80%, 90% and 100% capacity. Note how variable costs change with volume but fixed costs remain the same. Flexible budget for Mfg Overhead Capacity of 70% Capacity 80% Capacity 90% Capacity 100% Capacity Volume (in units) (25,000 units x capacity %) 17,500 20,000 22,250 25,000 (500 dollars) (500 dollars)MFG raised \$ 92,500 \$ 95,000 \$ 97,250 \$100,000 A flexible budget can be prepared for any level of activity. The advantage of a flexible budget is to create a budget based on the actual level of production to give us a clearer picture of our results by comparing flexible budget to actual results. This analysis would compare the actual level of activity, so volume variances are not a factor and management can focus on variances of cost only. We will discuss this analysis after the performance report. A company has a budget for the smallest time period possible so that management can find and adapt problems to minimize their impact on business. Everything starts with estimated sales, but what happens if sales are more or less expected? How does this affect the budget? What adjustments should a company be made to compare actual numbers to the numbers you have anticipated during the evaluation of results? If the production is higher than the planned one and has been increased to satisfy the greater sales, the expenses will be to the budget. Is that so bad? In order to take into account actual sales and expenses different from sales and preventive expenses, companies will often create flexible budgets to allow balance sheets to fluctuate with future demand. A flexible budget is one based on different sales volumes. A flexible budget pushes the static budget for each early production level. This flexibility allows management to estimate what the preventive numbers look like at various levels of sales. Flexible budgets are prepared in every analysis period (usually monthly), rather than in advance, since the idea is to compare operating income to expenses considered appropriate at the actual production level. Big Bad Bikes is planning to use a flexible budget when they start making trainers. The company knows its variable costs per unit and knows that it is introducing its new product on the market. Its estimates of the sale and sale price will probably change as the product takes hold and customers buy it. Big Bad Bikes has developed a flexible budget that shows the change of income and expenses as the number of units changes. He also examined the effect that a price change would have if the number of units remained the same. The expenses that do not change are fixed expenses, as shown in (figure). Flexible budget for big bad bikes. (Attribution: Copyright Rice University, OpenStax, under the CC BY-NC-SA 4.0 license) A static budget is prepared according to a single level of production for a given period. The main budget and all budgets included in the main budget are examples of static budgets. The actual results are compared with the budget numbers as one to assess the performance of the company. However, this comparison can be like comparing apples to oranges because variable costs should follow production, which should follow sales. Therefore, if sales differ from what is anticipated, then comparing actual costs to preventive costs cannot be a clear indicator of how the company is achieving its objectives. A flexible budget created for each period allows a comparison between apples and apples, as it calculates the cost estimates based on the actual sales activity. For example, (Figura) shows a quarterly static budget for 1,500 trainers sold by Big Bad Bikes. The budget will change if there will be more or less units sold. Static budget for Big Bad Bikes. (attribution: Copyright Rice University, OpenStax, licensed CC BY-NC-SA 4.0) Companies develop a budget based on their expectations for their most likely level of sales and expenses. Often, a company can expect that production and sales volume will vary from one period to another. They can use their different production levels to create a flexible budget that includes these different production levels. They can therefore change the flexible budget when they have their actual production volume and compare it with the flexible budget for the same volume of production. A flexible budget is more complex, it requires a solid knowledge of the fixed and variable costs of an enterprise and allows a greater control over changes occurring over the year. For example, we assume that a sales proposal of articles does not occur because the expected customer has chosen another supplier. In a static budgetary situation, this would result in great changes in many accounts, since the static budget is set on the basis of sales that include the potential large customer. On the other hand, a flexible budget would allow the management to adapt its budgetary expectations to changes in costs and revenue resulting from the loss of potential customers. The changes to the flexible budget would therefore be compared with what actually happens to achieve a more realistic and representative variance. This ability to change the budget also makes it easier to identify those responsible for failing to achieve an objective of revenue or costs. Big Bad Bikes has used the concept of flexible budget to develop a budget based on its expectation that production levels will vary from quarter to quarter. By the fourth quarter, sales should be strong enough to repay the funding obtained at the beginning of the year. The budget shown in the figure illustrates the payment of interest and contains useful information to the management to determine which products should be produced in case of limited production capacity. Change production levels for Big Bad Bikes. (attribution: Copyright Rice University, OpenStax, licensed CC BY-NC-SA 4.0) Flexibility of budgets and sustainability The ability to provide flexible budgets can be fundamental in new companies or inWhere the accuracy of sales or use estimates is not strong. For example, organizations often report their sustainability efforts and can have some products that require more electricity than other products. The declaration of the energy for production unit was sometimes erroneous and can mislead the management a who may or may not help the company. For example, based on the reported energy per unit, management may decide to change the product mix, the outsourced amount and/or the product amount.1 If the energy output is not correct, the decisions could be wrong and create a negative impact on the budget. Key Concepts and Summaries A main budget and related budgets are prepared as static budgets for the estimated level of activity. A flexible budget adjusts budgets for various levels of activity and allows you to evaluate the actual results to the actual volume of activity. (Figure) Which balance sheet assesses the results of operations at the actual level of the activity? Capital balance sheet Cash balance sheet Flexible balance sheet Static balance sheet (Figure) What is the main difference between static and flexible budgets? The fixed production overload is adjusted for units sold in the flexible budget. Variable production overload is regulated in the static budget. There is no difference between budgets. Variable costs are regulated in a flexible budget. (Figure) A company prepared the operating and cash balance sheets. He is now preparing the budget. Identify the document containing each of these balances. Cash accounts Finished account accounting Products for inventory of finished goods Equipment to be paid A. Cash balance sheet; B. Balance sheet of cash receipts; C. Production budget; D. Planning of cash payments; E. Equity Capital Balance Sheet (Figure) Fill in blanks: a flexible budget summarizes _____ and _____ for various volume levels by adjusting the costs _____ for the various activity levels. Costs _____ remain the same for all activity levels. (Figure) What information is included in the capital budget? This budget is the plan for the purchase and disposal of plant resources and lists the estimated dollar amounts for each. (Figure) Cold X, Inc. Use this information when preparing their flexible budget: direct materials at \$2 per unit, direct labor at \$3 per unit and manufacturing output at \$1 per unit. Fixed costs are \$35,000. What would be the estimated amounts for 20,000 and 25,000 units? (Figure) Using the expected information based on the information provided for the production of 10,000 and 15,000 units, prepare a flexible budget for 17,000 units. (Figure) The judge's hammer uses this information when preparing their flexible budget: direct materials of \$3 per unit, direct work of \$2.50 per unit and overhead of \$1.25 per unit . Fixed costs are \$49,000. What would be the expected amounts for 33,000 and 35,000 units? (Figure) Using the following estimated information for the production of 5,000 and 12,000 units, prepare a flexible budget for 9,000 units. (Figure) Prepare a Flexible quote for 120,000 units using the following information from a static budget for 100,000 units: (figure) The following static budget for estimated sales of 100,000 was developed before the year. Sales are less and management must review his own Use this information to prepare a flexible budget for 80,000 and 90,000 sales units. (Figure) Caribbean hammocks currently sell 75,000 units for \$ 50 per unit. His expenses are: management believes they can increase sales of 5,000 units for every \$ 5 decrease in selling price. It also believes that additional sales will allow a decrease in the direct material of \$ 1 for every 5,000 additional units. Prepare a flexible economic statement for sales from 75,000, 80,000 and 85,000 units. (Figure) Total pop data show the following information: new machinery will be added to April. This machine will reduce the job requested by unit and will increase the work rate for those qualified employees to operate the machine. The inventory of the finished goods is required to be 20% of the needs of next month. Direct material requires 2 pounds per unit at a cost of \$ 3 per kilo. The final inventory required for direct materials is 15% of the requirement of the following month. In January, the initial inventory is 3,000 finished product units and 4,470 pounds of material. Prepare a production balance, direct material budget, and direct work budget for the first quarter of the year. (Figure) Identify the document that contains the information listed in these lines of the expected budget shown. Cassa Active Contl Inventory Raw Materials Computer Passive Content (figure) Prepare a flexible economic statement for 47,000 units using the following information from a static balance for 45,000 units: (figure) before the start of the year, was developed The following static budget for an estimated turnover of 50,000 units. Sales are higher than expected and the management must review its budget. Prepare a flexible budget for 100,000 and 110,000 sales units. (Figure) Artic Camping Gear Ę Ąs currently sells 35,000 units for \$ 73 the unit. Its expenses are as follows: management believes they can increase sales of 2,000 units for every \$ 5 decrease in selling price. It also believes that additional sales will make a decrease in the direct material of \$ 1 for every 2,000 additional units. Prepare a flexible economic statement for 35,000, 37,000 and 39,000 sales units. (Figure) The fruit tea data show the following information: new machinery will be added in October. This machine will reduce the job requested by unit and will increase the work rate for those qualified employees to operate the machine. The inventory of the finished goods is required to be 20% of the needs of next month. Direct material requires 2.5 pounds per unit at a cost of \$ 5 per kilo. The final inventory required for direct materials is 20% of the requirement of the following month. In August, the initial inventory is 3,750 finished products units 13,125 pounds of materials. Prepare a production balance, direct material budget, and direct work budget for the first quarter of the year. (Figure) Identify the document that contains the information listed in these lines of the expected budget shown. Accounts to receive warehouse goods Machinery Depreciation accumulated Payable Notes Stock (Figure) Hess, Inc., is developing a flexible budget for the next year. It is unsatisfactory of the net revenue which the budget has shown at all levels of sale and plans to use a less expensive material. This action reduces the direct cost of the material of \$1 per unit. What would be the effects on financial statements and a flexible budget if the management adopted this approach? Are there any other factors to consider? (Figure) When would a static budget be effective in assessing a manager's performance? Notes 1 Jon Bartley, et al. "Use the flexible budget to improve sustainability measures." American Institute of CPAs. Jan. 23, 2017. flexible budget based on different levels of static budget activity prepared for a single level of activity for a given period

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