**Week 3 Forecasting Assignment Background**

**The Flexible-Budget Variance Analysis**

The initial measure in flexible budgeting is to establish the flexible budget for the actual workload level. It must be determined what the cost should have been given the workload level that actually occurred. For example, consider the supplies budget for the cardiac unit at Saint Louis Medical Center (SLMC) during the month of July:

**Actual Budget Variance**

Supplies $12,000 $10,000 $2,000 U

Suppose that the budget assumed that there would be 400 patient days for this unit for July, but there actually turned out to be 500 patient days.

*1. The first step is to establish the flexible budget for the actual patient volume.*

The cardiac unit of SLMC budgeted $10,000 for supplies for the month of July—and the actual supply consumption was $12,000. The unit encountered a $2,000 supply variance. Suppose that July’s budget was built on 400 patient days but there actually was an increase in the number of patients admitted to the unit, which equaled 500 patients days. The planned supply cost was $25 for each patient ($10,000 **/** 400 patients = $25). The flexible budget demonstrates that $25 was actually spent on each patient even though there was an increase in the number of patients seen: $25 X 500 = $12,500. This is what the unit would have expected to spend if the actual number of patient days would have been known.

For the cardiac unit, the total variance = $2,500. However, this volume variance is considered unfavorable because more spending occurred than was expected. Even though the increased number of patients admitted to the cardiac unit may represent more patient revenues, the excess cost is viewed as unfavorable. At this point, the variance in supplies has been explained by the fact that there was a different (higher) volume of patients than had been anticipated.

**Actual Flexible Original**

**Budget Budget Budget**

Supplies $12,000 $12,500 $10,000

**Flexible Volume**

**Budget Variance**

**Variance**

$500 $2,000 U

**Total Variance**

$2,500 U

2*. The next step entails reviewing nursing labor costs to note whether there is a differences in the amount that was budgeted for in the month of July and the amount that actually occurred.*

**Actual Budget Variance**

Salaries $110,000 $92,000 $18,000 U

**Flexible Budget**

$115,000

First, determine the flexible-budget salaries. The nursing salaries should vary in direct proportion to patient days. As more patients are admitted to the unit, more nursing care hours will be delivered to care for these extra patients. For example, nursing salaries had been budgeted at $92,000 for the 400 patient days. This was a cost of $230 per patient. Instead, 500 patients were admitted to the unit during the month of March, which should equal $115,000 (500 X $230 = $115,000).

Next, determine if there is a variance between the flexible-budget salary and actual budget amount that occurred. When the flexible salary costs are subtracted from the actual salary costs, it turns out that there is a $5,000 favorable variance ($115,000 - $110,000 = $5,000). The actual amount spent was less than the flexible budget. In fact, the manager should have expected to spend $5,000 more on nursing salaries than was in the original budget, given the 100 extra patient days. The cardiac unit actually spent $5,000 less than should have been expected.