Budget Vs. Actual Report: How to Reduce Variance and Keep in Budget



In order to make smart business decisions, plan for their financial futures, and invest wisely, small business owners and their teams need accurate budgets.

But in an imperfect world, comparing the submitted budget vs. actual report requires careful analysis of variances to understand where you are (and aren't!) meeting your financial planning goals.

What is Budget Vs. Actual Report?

Budgets are generally static in nature. Business owners, chief financial officers (CFOs), and financial professionals on their teams use each year's anticipated revenue and expenses to create a yearly budget.

But as Plato might have said, the ideal and the actual are never quite the same; over the course of the fiscal year, line items *will* vary from their budgeted amounts.

The difference between the amounts budgeted and the actual expenses and

revenue (which are known as *actuals*) is examined called a *variance* or sometimes a *budget variance.* In financial reporting, examining this difference is known as *actual variance analysis* or *budget variance analysis*, and is often referred to informally in bookkeeping as "budget vs. actual" or a "budget vs. actual report".

Companies perform an actual variance analysis in order to:

- Identify opportunities to reduce expenses or boost revenue.
- Modify budgets to improve the accuracy and utility of next year's financial reports.
- Calculate how much additional financing (if any) will be required to meet next year's targets for cash flow, investment, profits, and growth.

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Types of Budget vs Actual Variances

Depending on where the numbers fall, variances can be classified as either positive or negative.

A *positive variance* (also called a *favorable variance*) could include higher income than anticipated, higher sales than were forecast, or expenses that fell below those in the budget.

Let's say you've budgeted $40,000 annually to cover electricity costs at your main office. However, with so many team members working from home, demand is down significantly and your actual expenses for electricity over the year total just $32,000.

That $8,000 is a positive variance, since your actual costs recorded on the balance sheet were 20% lower than those budgeted.

A *negative variance* (or *unfavorable variance*), on the other hand, would be something like sales numbers that fell below projections, greater expenses than in the budget, or a negative impact from failing to hit key performance indicator (KPI) targets for performance, spend, etc.

For example, let’s say a company’s sales were estimated at $300,000 for Q2 of the fiscal year.

However, due to the pandemic, consumer behaviors changed, demand dropped, and the actual revenue recorded by the company for Q2 is $270,000. That’s a negative variance of $30,000, or 10%.

What Causes Budget vs. Actual Report Variances?

While variances can happen for a range of reasons, some are more common than others.

1. Budgeting Errors

Errors can creep into your budget process at the front end via typos, incorrect data, or inaccurate forecasting.

If you don’t have a clear view of your total spend, for example, or don’t have complete or accurate pricing information for goods and services, it can be very difficult to put together a budget that will match your actual expenses and revenue.

Without proper oversight, errors can also occur in the actual figures, usually via incomplete or incorrectly entered information.

Either way, if your numbers are off the mark, it will be tough to hit your targets for actual income, cash flow, and expense management.

2. Shifting Market Conditions

Absent a crystal ball, even the most astute CFOs and financial teams will be able to anticipate and mitigate every single disruption to the market, their supply chains, or both.

Major disruptors such as the COVID-19 novel coronavirus pandemic, the Amazon rainforest fires, and BREXIT can (and did) alter pricing, logistics, material availability, and consumer demand.

COVID-19 also forced countless businesses to rapidly adapt to new paradigms for remote working and social distancing—or die trying.

Digital transformation is another disruptor; changing technologies can significantly lower costs once adopted, for example, but wreak havoc on sales and market share for those lagging behind the curve.

Senior management and small business owners develop business continuity plans to attempt to mitigate the impact of such disruptors, but without the tools to properly collect, manage, and analyze data from a diverse range of internal and external sources, it can be challenging to build budgets that mesh with both organizational ambitions and the reality of a complex global marketplace.

3. Unclear or Inaccurate Expectations

The performance expectations set by CFOs, managers, etc. are based on estimates, insights, and forecasts drawn from your data, and create assumptions baked into your budget.

You need high quality, complete, and transparent data to ensure those assumptions are based on the realities of the market and your business, rather than blue skies.

Tips for Reducing Variances

When it comes to keeping variances from wrecking your diligently-crafted budgets, a proactive approach does wonders.

1. Perform a budget variance analysis monthly.

Conceivably, you could use an Excel spreadsheet or even pen and paper to perform a monthly budget vs. actual analysis (although optimally you'll have the help of more advanced procurement and accounting software solutions).

What matters is that you do it, because you want your finger on the pulse of your business if you want to nip potential crises in the bud (and a month is a reasonable period of time to address all but the most urgent concerns as they arise).

Gather your financial statements; perform a budget vs. actual report on your balance sheet, profit and loss statement, cash flow statement, and KPI reports.

Keep an eye out for large variances (which have a powerful impact on performance, profits, and competitive advantage); recurring variances (which can indicate either forecasting/budgeting errors or a lack of adherence to internal controls); and most of all *increasing* variances—these can serve as red flags marking trends and market conditions that need to be addressed as soon as possible.

As you review each line item in each variance report, consider:

- Is this a positive or negative variance?
- What circumstances led to this outcome?
- What strategic adjustments are required to minimize or eliminate this variance moving forward?

2. Invest in Procure-to-Pay (P2P) software.

Like dairy, budgets and forecasts have a definite shelf life. The fresher and more wholesome they are, the more useful and "nutritious" they'll be. You need complete and transparent data from diverse sources, analyzed quickly and accurately, to make the best possible business decisions.

Having access to accurate data as soon as possible also helps CFOs and other leaders identify and address potential variances *before* they affect business performance and require approvals (and potential delays and additional expense) to mitigate.

Investing in a complete, cloud-based procure-to-pay solution like PLANERGY helps you optimize your business processes with automation, data management, and powerful analysis tools. A best-in-class solution supports accurate budgeting by helping you:

- **Collect, manage, and analyze *all* your data.** Centralize data from a wide range of internal and external sources. Break down data and work silos that hamper information sharing and collaboration. Access and analyze data from anywhere with Internet access, on any platform, using customizable dashboards and reporting tools to create detailed budgets

based on real-time insights.

- **Automate your business processes.** The more efficient and accurate your workflows, the more quickly you'll have the data you need for budgeting. Boost the accuracy, speed, and efficiency of all your business processes while eliminating human error and delays.
- **Gain better control over variable expenses.** You can't predict every little hiccough in the market or your yearly spend. But you *can* minimize the impact of your variable expenses by ensuring your business processes for budgeting include sufficient flexibility and optimization to account for uncertainty while still keeping those tricky variable expenses as low as possible. Advanced, real-time analytics make it easier to create, adjust, and optimize budgets in time to put them to optimal use.
- **Track performance, compliance, and more.** Set and track a wide range of KPIs to measure and compare spend under management, contract compliance, short- and long-term spending trends, and much more. Over time, you can use this data to fine-tune your processes and strategic spending even further, reducing variances while boosting performance and profits.

Better Financial Reporting Powers Better Financial Planning

Invest in software tools, track and adjust your variances when building your budgets, and optimize your business processes to ensure clean and complete financial data for analysis and reporting.

Taking the time to bring variances under control can simplify actual comparisons and help ensure your company's budgets are built to promote healthy cash flow, minimize needless expense, and support your goals for profitability, innovation, and competitive strength.

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