Answer on Question #54494, Economics / Finance

Describe the four accounts in the variance report. What can be done about the entertainment expense account?

Explanation:

In accounting, a variance is the difference between an expected or planned amount and an actual amount. Variance analysis explains the reasons for the difference between a budgeted amount and an actual amount. This analysis is used to maintain control over a business. In budgeting, it is a report showing the difference between the budgeted and the actual values.

Variance Reports are available in the system to assist with your analysis:

AS report provides Variance by department by each main expense category (Permanent

Salaries, OPS, Operating Expenses, OCO) and Revenues;

DI report provides Variance by account within each main expense category; drill down option to obtain department detail by account;

XA report like DI report, but includes Revenue variance.

Standard costing is a control system that enables any variances from standard cost or budget to be analysed in some detail. This allows for more effective cost control.

Variance analysis involves breaking down the total variance to explain:

1. How much of it is caused by the usage of resources differing from the standard;

2. How much is caused by cost of resources differing from the standard.

Together, variances can help to reconcile the total cost difference by comparing actual and standard cost. The main purpose of variances is to provide reasons for off-standard performance. In this way, management can improve operations, correct errors and deploy resources more effectively to reduce costs.

Direct material standards are derived from the amount of material required for each product or operation. This should take into account the most suitable material for the product specification and design. It should also include any anticipated wastage or losses in the process. The standard material used and the standard cost of the material are combined to calculate the standard material cost. By comparing the actual material price and the actual material used with the standards calculated, the material price and the material usage variance can be determined.

The direct material usage variance measures the change in total material cost caused by using a non-standard amount of material in production. It is also possible to subdivide this variance into a direct material mix variance and a direct material yield variance. This is mostly undertaken in process industries where a standard input mix is the norm. Identifiable components of input are combined during production to produce an output in which the individual components are no longer separately identifiable. The material mix variance therefore measures the change in cost caused by an alteration to the constituents of the input mix. The material yield variance measures the change in cost brought about by any deviation in output from the standard process output.

Direct labour standards are derived from the analysis of activities required for different operations. Often a time and motion study is carried out to determine the most efficient production method, including operating conditions, equipment required and best practice. The time is analysed to determine the standard hours required to complete an operation. Standard wage rates are identified using rates of pay for employees required to carry out the operation, which are normally set by the company. This standard time and standard wage rate are combined to calculate the standard labour rate.

Where overheads vary with activities, a standard variable overhead rate is used. It is important for the organisation to identify which measure influences overhead cost the most

The variable overhead rate per unit is applied to the standard labour or machine usage to calculate a standard variable cost per unit. The two variances calculated for variable overheads are:

1. The variable overhead expenditure variance, which is equal to the difference between the budgeted flexed variable overheads for the actual direct labour or machine hours of input, and the actual variable overheads incurred.

2. The variable overhead efficiency variance, which is the difference between the standard hours of input and the actual hours of input for the period, multiplied by the standard variable overhead rate.

Fixed overheads are largely independent of changes in activity and remain unchanged in the short term over wide ranges of activity. The budgeted annual fixed overhead is divided by the budgeted level of activity to determine the standard fixed overhead rate per unit of activity.

Machine hours are normally used for machine-related overheads and direct labour hours are used for more labour-related overheads. This standard rate is applied to the standard labour or machine usage per unit to calculate the standard fixed overhead cost for a product.

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Therefore under- or over-recovery may be due to a fixed overhead expenditure variance arising from actual expenditure differing from budgeted expenditure. Alternatively, a fixed overhead volume variance may arise from actual production differing from budgeted production.

Sales variances can be used to analyse the performance of the sales function in a similar way to those for manufacturing costs. Sales variances are calculated in terms of profit or contribution margin, rather than on sales value.

Variance analysis highlights the causes of the variation in income and expenses during a period compared to the budget. Variance analysis facilitates performance measurement and control at the level of responsibility centres (e.g. a department, division, designation, etc.).

There are several reasons why actual results may differ from standard. The combination of the four factors below makes standard costing and variance analysis very difficult in practice:

1. Variance may occur as a result of an error in measuring the actual outcome.

2. The standard may be out of date because of a change in operating conditions.

3. Variances might result from inefficient or efficient operations.

4. Variances can be caused by random, uncontrollable factors.

What can be done about the entertainment expense account?

All businesses have expenses. The rules for entertainment expenses apply to deductions in income tax return. Very specific rules apply to different categories of entertainment. Some entertainment expenses can be fully deducted, while others can only be 50% deducted.

It should be clear when expenses are business-related or private. An entertainment expense is business-related if person spend the money to help the business earn income.

Two common examples are:

- entertaining an existing or potential business contact;
- holding an event for employees to improve engagement, eg, a party or team-building activity.

If the expense doesn't help the business to earn gross income, it's private and business owner can't claim it as a tax deduction, even if he or she paid for it out of her/his business account. An entertainment expense where the benefits are enjoyed or received by employees may be subject to FBT. If it's a business-related entertainment expense which is only 50% deductible, it isn't subject to FBT. But there is an exception. FBT will be payable if the employer provides the 50% deductible entertainment and the benefit is not provided in the course of, or as a necessary consequence of, the employee's employment duties.

If supply entertainment to promote a business or the business's products or services to the public, it can be deducted 100% of the costs. But it can be only deducted 50% of the costs if:

•the business contacts or employees of the business being promoted have a greater opportunity to enjoy the entertainment than the general public

• anyone associated with the business being promoted has a greater opportunity to enjoy the entertainment than the general public.

Naturally, if your business is the business of entertaining, the deduction is also considered an ordinary and necessary business expense, and is not subject to the 50% cut. Entertainment facilities such as timeshares, cabins, yachts, swimming pools, etc. are also not deductible business entertainment expenses.