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Benefits and limitations of variance analysis in management accounting

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Adequate planning, monitoring and controlling of various activities in meeting organization objectives and goals are essential. One of the tools that could be used by management to monitor and control all activities at the operational level is by applying variance analysis. Referring to CIMA Official Terminology 2005, variance is the evaluation of performance by means of variances, whose timely reporting should maximise the opportunity for managerial action (Edwards-Nutton & Technical Information Services, 2008). In other words, variance analysis is the difference between the actual and budgeted data.

Balakrishnan and Sprinkle (2002) reported that variance analysis can be used as part of a framework to improve managerial information and decision making. Recently, a survey conducted on 154 senior finance executives at Fortune 500 companies revealed that on average the respondents rated the importance of variance analysis at 8.7 on a 10 point scale (Conine & McDonald, 2018). Fowler (2011) and Tan, Fowler and Hawkes (2004) reported that variance analysis ranks consistently higher in importance to practitioners than to educators and that its practical importance had increased between 2001 and 2010. These findings indicate that variance analysis is a valuable tool in business review for meeting the objectives and goals.

There are several benefits of implementing variance analysis in the business organisation. Implementation of variance analysis could assist cost control at the operation activities. It allows cost control by comparing actual and budgeted figures. The difference from expectations should be investigated and interpreted as to why the variance occurred. In addition, the result from the investigation of variances facilitates corrective action or problem solving for issues that occurred in the organisation. Management could focus on important issues that need to be given attention. On top of that, variance analysis could be used as a performance evaluation tool. It is a systematic process that assesses an individual's performance and productivity in relation to achievement of target objectives or goals that has been set before. Lastly, the feedback from variance analysis will be important input for preparing the future budget. The effective variance analysis can assist the management in predicting patterns, trends and issues that should be considered in planning.

Despite the benefits of variance analysis, there are several limitations related to it. Time factor is the most common issue that has been highlighted. The variances are normally compiled at the end of the month where the actual data is derived. However, the management needs earlier feedback especially if it relates to production line. Furthermore, in a modern business, standard quickly becomes out of date and this of course will lead to a misleading comparison. Next is the cost benefit of getting the information. The process of preparing the variance analysis is tedious and costly. In addition, some variances such as overhead variances are complex and difficult to elaborate to managers and this will only contribute to an ineffective and inefficient control purpose. Lastly, the variance analysis report is normally presented to superiors and sometimes it is not passed to the problem solving team.

In summary, variance analysis is one of the important tools that can be applied by the practitioner to analyse and monitor the performance of the company. Effective variance analysis can assist a company to identify trends and opportunities to further probe in order to find solutions for corrective action in the future.

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