Variance Analysis

Variance analysis is the practice of studying the financial and operating performance that was achieved by a firm compared to what was expected by that firm. Standard costs and performance are set at the beginning of the period based on past experience, budgets, and any insight managers in different departments might have. At the end of the period, actual costs and performance are then tallied and compared to these standards. Variance analysis is sort of a self-audit or a reconciliation of what was achieved with what was expected.

Variance analysis is essential in evaluating the past performance of a firm and then doing the following: revising goals, plans and budgets; rewarding those individuals or departments that truly improved and penalizing those that did not; modifying policy or taking corrective action when necessary. In short, variance analysis is instrumental in improving the performance of the firm.

Variance analysis is akin to students checking their work after an exam. If they are smart, they do not spend much time on the questions they got right. They spend most of their time studying and trying to understand the questions they got wrong. Smart students concentrate on the answers that ***varied*** from what they expected. Individuals can only really improve if they improve on the things they did wrong.