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| Chapter 20 Outline  1. **Budget Process and Administration---**ensures that activities of employees and departments contribute to meeting the company’s overall goals. **Budgeting** is the process of planning future business actions and expressing them as formal plans. 2. Budget Process 3. Budget⎯formal statement of a company’s plans, expressed in dollars. 4. Cover short periods such as a month, quarter, or year. 5. Useful in controlling operations. 6. Budgetary control process refers to management’s use of budgets to see that planned objectives are met. Control process has four steps:    1. Develop the budget from planned objectives    2. Compare actual results to budgeted amounts and analyze differences    3. Take corrective and strategic actions    4. Establish new objectives and a new budget 7. Benefits of Budgeting—benefit key managerial functions of planning and controlling. 8. Plan: focuses on future opportunities and threats to the organization. Forces management to plan for the future. 9. Control: requires management to evaluate (benchmark) business operations against some norm. 10. Coordinate: activities so all employees and departments understand and work toward company’s overall goals. 11. Communicate: written budget effectively communicate management’s specific action plans to all employees. 12. Motivate: budgets can be used to motivate employees. Provide goals to attain or exceed. 13. Budgeting and Human Behavior 14. Budgeting can affect the attitudes of employees evaluated by them. 15. Three guidelines to ensure positive motivating force. 16. Employees affected by budget should help prepare it (participatory budgeting). 17. Goals should be challenging but attainable. 18. Evaluation offer opportunities to explain differences between actual and budgeted amounts. 19. Potential Negative Outcomes of Budgeting 20. Managers must be aware of negative outcomes. |
| 1. Employees may understate the sales budget and/or overstate the expense budget to allow a budgetary slack in meeting targets. 2. Pressure to meet budgeted results may lead to unethical or fraud. 3. Some employees may spend budgeted amounts even on unnecessary times to make sure their budgets are not reduced in the next period 4. Budget Reporting and Timing 5. Usually coincides with the company’s fiscal year. 6. To help control operations, the annual budget usually is separated into quarterly or monthly budgets. 7. Short-term budgets allow quick performance evaluation and corrective action. 8. Budget Timing - Many companies apply continuous budgeting by preparing rolling budgets. In continuous budgeting: 9. Company continually revises its budgets as time passes. 10. Entire set of budgets added each quarter to replace quarter that just elapsed. 11. Management is continuously planning ahead. 12. **Operating Budgets** 13. Master Budget Components 14. Contains several interconnected. 15. Includes budgets for sales, production (or merchandise purchases), expenses, capital expenditures and cash. 16. Begins with the sales budgets and ends with budgeted financial statements. 17. Sequence required; certain budgets cannot be prepared until other budgets are complete. Direct Materials and Direct Labor budgets can’t be prepared until a Production Budget is prepared. |
| 1. Sales Budget   1. First step in preparing master budget – shows planned unit sales and budgeted dollars from those sales   1. Comes from analysis of forecasted economic and market conditions, business capacity and advertising plans. 2. To develop sales budget, companies must estimate both unit sales and selling price per unit. 3. Production Budget – shows number of units to be produced each period to meet budgeted sales and a desired inventory level. 4. Companies will keep enough inventory on hand to protect against lost sales caused by unfulfilled demands from customers or delays in shipments from suppliers (called safety stock). 5. Sales budget used as basis for production budget. 6. Production budget does not show costs – it is always expressed in units of product. 7. Units to be produced is determined by:   Budgeted sales units  + Desired ending finished goods inventory units   Required units needed for the period  - Beginning finished goods inventory units  Total units to be produced in the period   1. Production budgeted viewed in two parts: 2. Total required units – budgeted sales plus desired ending inventory units. 3. Units to produce – total required units minus beginning inventory units. 4. Direct Materials Budget -- shows budgeted costs for direct materials that must be purchased to meet the budgeted production.   Units to produce x Materials required per unit  Materials needed for production + Desired ending materials inventory  Total required materials - Beginning materials inventory   Direct materials to purchase x Materials price per unit of materials  Cost of direct materials purchases 5. Direct Labor Budget -- shows budgeted costs for direct labor that will be needed for the budgeted production for the period.     Units to produce x Direct labor hours required per unit   Total direct labor hours needed x Direct labor cost per hour  Cost of direct labor 6. Factory Overhead Budget -- shows budgeted costs for factory overhead needed to complete the budgeted production for the period.   Direct labor hours needed x Variable overhead rate  Budgeted variable overhead + Budgeted fixed overhead  Budgeted total overhead 7. Budgeted Cost of Goods Sold   Once we have completed the three manufacturing budgets, we can compute the budgeted cost per unit and cost of goods sold budget.   * 1. Budgeted cost per unit is computed as the cost of direct materials (Exhibit 20.10), plus cost of direct labor (Exhibit 20.8), plus variable overhead (Exhibit 20.9), plus fixed overhead.   2. Cost of goods sold budget includes the budgeted sales (Sales budget) times the budgeted cost per unit.  Selling Expense Budget  1. Based on sales volume. 2. Shows types and amounts of selling expenses during budget period. 3. Commonly includes sales commissions (variable), salary of sales manager (fixed), advertising and delivery expenses. 4. General and Administrative Expense Budget: 5. Reports general and administrative expenses expected during the budget period. 6. Commonly includes administrative salaries, property taxes, office expenses, and insurance and depreciation on non-manufacturing assets. 7. Investing and Financing Budget 8. Capital Expenditures Budget (Investing Budget) 9. Reports expected cash receipts and cash payments related to the sale and purchase of plant assets. 10. Usually prepared after the operating budgets. 11. Cash Budget (Financing Budget) 12. Cash Budget⎯shows budgeted cash receipts and payments during budget period. Managing cash is vital and helps company meet cash balance goal. 13. Most companies set a minimum cash balance to have available. |
| Beginning cash balance  + Budgeted cash receipts  Total available cash  - Budgeted cash payments  Preliminary Cash balance + or – Loan activity  Ending Cash Balance   1. Cash Receipts from Sales 2. Expected cash sales – from sales budget. 3. Expected cash collections of accounts receivable. 4. Other expected cash receipts such as interest revenue, sale of assets, etc. 5. Cash Payments for Direct Materials 6. Expected direct materials payments for a manufacturer. 7. Expected cash payments on accounts payable. 8. Loan Activity: if company has agreement with bank to keep a minimum cash balance, company will borrow if preliminary balance is less than this minimum amount. They will repay any loan balance when preliminary balance is greater than the minimum amount. 9. **Budgeted Financial Statements** 10. Budgeted Income Statement 11. Managerial accounting report showing budgeted amounts of sales and expenses. 12. Summarizes the income effects of the previously prepared budgets. 13. Income tax expense predicted at this level. 14. Budgeted Balance Sheet 15. Shows budgeted amounts for assets, liabilities, and equity as of end of the budget period. 16. Prepared using information from other budgets (see notes to budgeted balance sheet for sources of amounts). 17. Using the Master Budget 18. Planning – at any stage in the master budget process, might show results that require new plans. Management can change its plans to aim for better results. 19. Controlling – managers can compare actual results to budgeted results and examine variances to identify areas to improve and take corrective action. 20. Sensitivity analysis – technologies such as Excel and ERP systems enable managers to quickly compute alternative master budgets under different assumptions, allowing a better plan and adaption to changing conditions. 21. Budgeting for Service Companies – service providers also use master budgets but typically need fewer operating budgets than manufacturers. Budgets include Sales, Direct labor, Cash, Capital expenditures, Selling and general and administrative expenses, and Budgeted financial statements. |
| 1. **Decision Analysis—Direct Labor Budget and Revenue per Employee --** Direct labor budget is key for a service firm. 2. Budgeted direct labor cost is computed as budgeted direct labor hours times direct labor cost per hour.   1. Business can assess effectiveness of their workforce using revenue per employee ratio computed as total revenue divided by total employees. |
| 1. **Appendix 20A – Merchandise Purchases Budget** 2. Merchandisers⎯Sales budget used as basis for merchandise purchases budget. 3. Preparing the merchandise purchases budget: expressed in both units and dollars.   Budgeted sales for the period  x Ratio of inventory to future sales = Desired ending inventory units  + Budgeted unit sales = Required units  - Beginning inventory units  Total units to be purchased  x Budgeted cost per unit  Budgeted cost of merchandise purchases (dollars) |