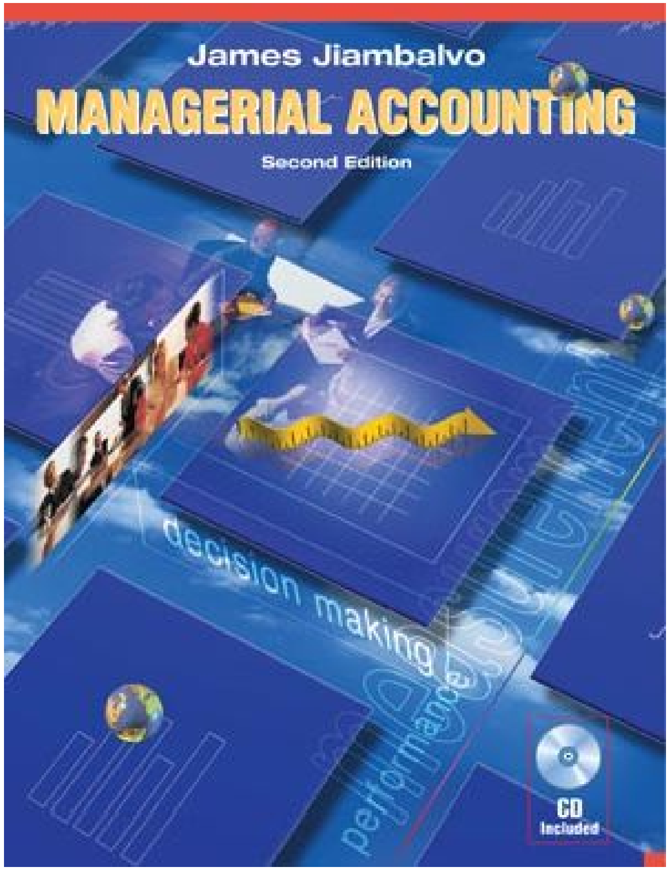
Business Environment : An introduction

Prof. Madona Robinston
Assistant Professor in commerce,
St. Xavier’s College (Autonomous),
Palayamkottai.

Managerial Accounting



Use of Budgets in Planning and Control

1. The entire planning and control process of many companies is built around budgets.

Planning

1. Budgets are useful because they enhance:
   a. Communication.
   b. Coordination.
2. The process of developing a budget forces managers to consider:
   a. Goals.
   b. Objectives.
   c. Specify means of achieving them.

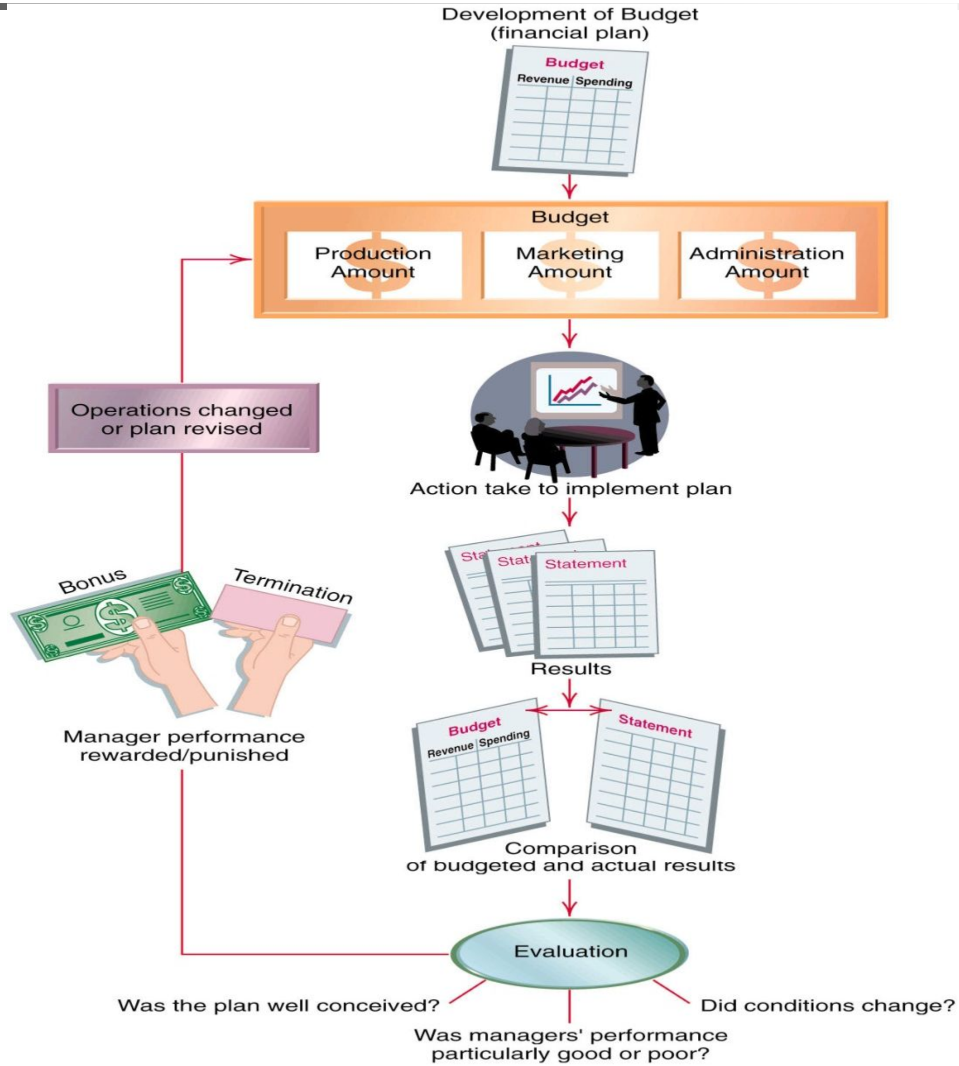
Control

1. Budgets are useful because they provide a basis for evaluating performance.
2. Performance evaluation is carried out by comparing actual performance with planned or budgeted performance.
3. Significant deviations from planned performance are associated with three potential causes.

Control: Significant Deviations From Planned Performance Are Associated With

1. Poorly conceived budgets.
2. Business conditions may have changed.
3. Managers that have done a particularly good or bad job managing operations.

Role of Budgets in Planning and Control Process



Developing the Budget

1. Budgets are prepared for
   a. Departments.
   b. Divisions.
   c. Company as a whole.
2. The Budget Committee is responsible for approval of the budget:
   a. Senior managers
   b. President
   c. CFO
   d. Various vice-presidents
   e. Controller.

Developing the Budget (Continued)

3. Top-down approach is where goals are pushed down from top management.
4. Bottom-up approach is where lower-level managers are the primary source of information used in setting the budget.

Budget Time Period

1. Budgets range from months to several years or more.
2. Key point is that there is an inverse relationship between"
   a. Length of the budget period.
   b. Detail contained within the budget.

Zero Base Budgeting

1. Zero Base Budgeting (ZBB) is a method of budget preparation which begins each period with a clean slate.
2. Managers must start from zero and justify budgets every period.
3. Used in government budgeting.
4. Not commonly used in business.

The Master Budget

Master Budget (comprehensive) Includes:

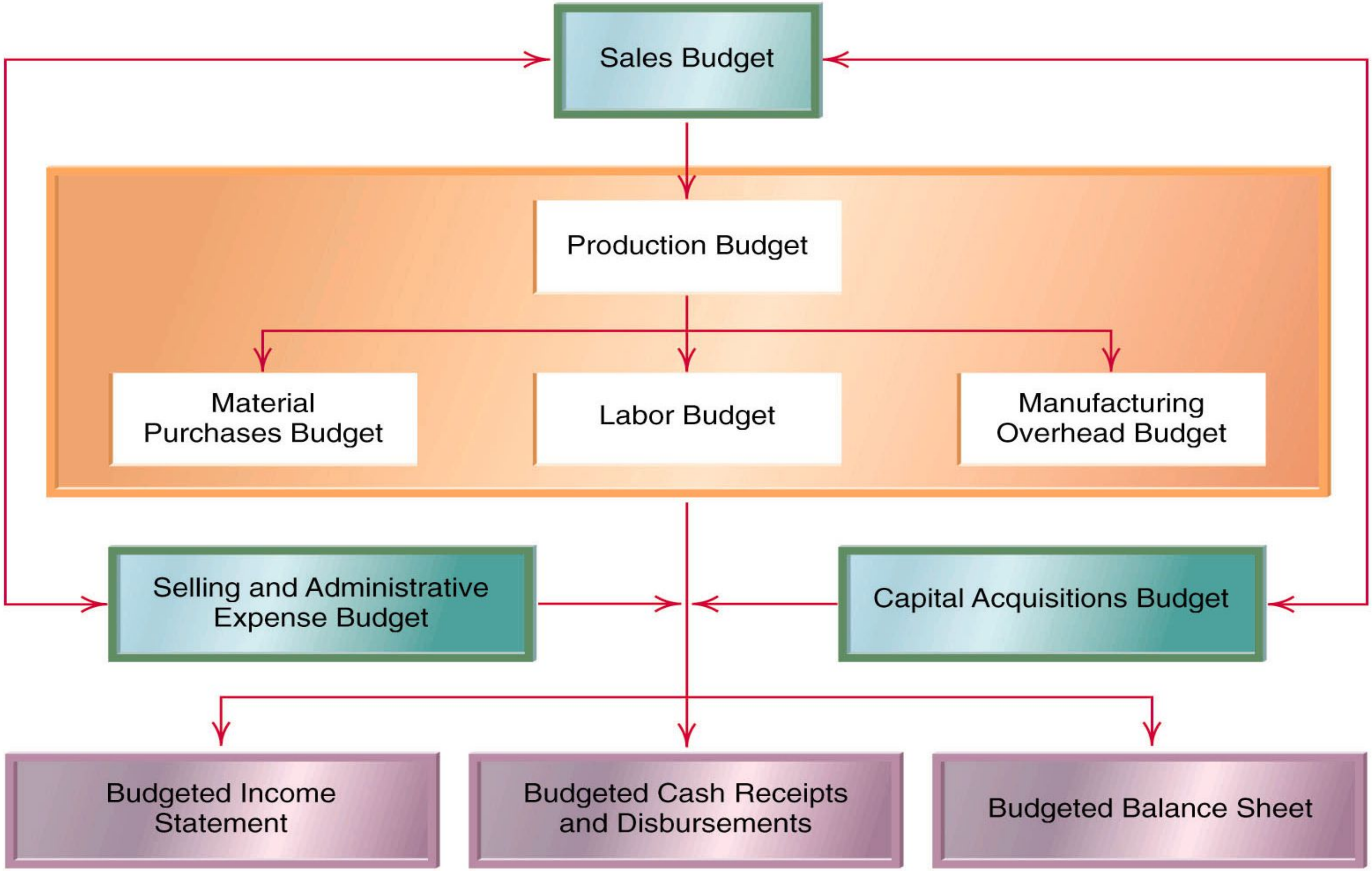
1. Sales budget.
2. Production budget.
3. Direct materials budget.
4. Direct labor budget.
5. Manufacturing overhead budget.
6. Selling and administrative budget.

The Master Budget

Master Budget Includes:

7. Capital acquisitions budget.
8. Cash receipts and disbursements budget.
9. Budgeted income statement.
10. Budgeted balance sheet.

The Master Budget: Graphic



Sales Budget

1. Sales budget is the first step in the budget process.
2. It comes first because other budgets cannot be prepared without an estimate of sales.
3. Example: production estimates are based on forecast sales.

Sales Budget (Continued)

4. Companies use a variety of methods to estimate sales:
   a. Econometric models.
   b. Previous sales trends.
   c. Trade journals and magazines.
   d. Sales force estimates.

Production Budget

Production forecasts are based on the following relationships:

Finished units to be produced

=

expected sales in units

+

desired ending inventory of finished units

–

beginning inventory of finished units

Direct Material Purchase Budget

1. **Direct materials budgets depend on:**
   a. The amount needed for production
   b. The amount need for ending inventory.

Direct Material Purchase Budget (Continued)

2. Calculated as follows:

Required purchases of direct materials

=

amount required for production

+

desired ending inventory of direct materials

–

beginning inventory of direct materials

Direct Labor Budget

Direct labor budget calculated by multiplying:

Number of units to be produced

x

Labor hours per unit

x

rate per hour

Manufacturing Overhead Budget

1. Cost per unit of production of each variable cost item is multiplied by the quantity of units produced.
2. Fixed costs remain relatively constant.

Selling and Administrative Expense Budget

Selling and administrative expense budgets include:

1. Salaries.
2. Advertising.
3. Office expenses.
4. Other general expenses.

Budgeted Income Statement

1. Sales figures come from the sales budget.
2. Cost of goods sold is based on unit cost of production (and the direct materials budget).
3. Labor cost information comes from the direct labor budget.
4. Overhead cost information is provided by the manufacturing overhead budget provides.

Capital Acquisitions Budget

1. Acquisitions of capital assets such as:
   a. Property.
   b. Plant
   c. Equipment.
2. Must be carefully planned because they consume substantial cash reserves.

Cash Receipts and Disbursements Budget

1. Managers plan for the
   a. Amount of cash flows and the
   b. Timing of cash flows.
2. VERY important budget because...
3. The timing of cash inflows and outflows may diverge substantially from the income statement.

Budgeted Balance Sheet

1. The last component of the master budget.
2. A function of all of the other budgets.
3. Sometimes referred to as a pro-forma balance sheet.
4. Used to assess the effect of planned decisions on future financial position.

Use of Computers in The Budget Planning Process

1. Computers are very useful in the preparation of budgets.
2. Spreadsheets, like Excel or Lotus 1-2-3, are very effective in modeling budget relationships.
3. Spreadsheets allow for “what if” analysis:
   a. What if direct labor increases to $14.45
   b. What if fixed factory overhead decreases by 3.5%…

Budgetary Control

1. In addition to:
    a. Planning
    b. Communicating goals
    c. Coordinating activities
2. Budgets also facilitate control of operations.

Budgets as A Standard For Evaluation

1. Budgets facilitate control by providing a standard for evaluation.
2. The standard is the budgeted amount against which actual results are compared.
3. Differences between budgeted and actual amounts are called <u>budget variances</u>.
4. Material differences between actual and budgeted should investigated.

Static and Flexible Budgets

1. Make sure that the level of activity used in the budget is equal to the actual level of activity.
2. Production budgets are a function of planned sales.
3. If sales suddenly, production must increase to meet demand , thus total variable production costs will rise.

Static and Flexible Budgets

4. A static budget is not adjusted for the actual level of production and is not suited for performance measurement.
5. A flexible budget is a set of budget relationships that can be adjusted to various activity levels. It is suited for performance measurement.

Investigating Budget Variances

1. Variances may have three causes:
   a. May be ill conceived
   b. Conditions have changed
   c. Job performance
2. Variances should be investigated.
3. <u>Management by exception</u> is an approach that is economical and often used.
4. Only exceptional variances are investigated.

Conflict in Planning and Control Uses of Budgets

1. Conflict is inherent in the planning and control uses of budgets.
2. Result is that managers:
    a. Pad their budgets.
    b. Shift income between accounting periods to increase their compensation.

Why Budget-Based Compensation Can Lead To Budget Padding and Income Shifting

1. Hurdle bonuses and variable bonuses are commonly used.
2. Two problems:
   a. Managers have an incentive to “pad” their budgets resulting in “slack” budgets that are easy to achieve.
   b. Managers have an incentive to shift income from one accounting period to another to achieve “hurdle” targets.

Evaluation, Measurement, and Management Behavior

1. Managers pay close attention to how their performance is measured and evaluated.
2. Budgets are usually measured in dollars and cents.
3. Some types of non-monetary measures of performance are likely to be advantageous.
4. "<u>You Get What You Measure</u>!"

Quick Review Question #1

1. Which of the following items do not requre a cash outflow?
   a. Salaries.
   b. Purchase of raw material.
   c. Advertising.
   d. Depreciation.

Quick Review Answer #1

1. Which of the following items do not requre a cash outflow?
   a. Salaries.
   b. Purchase of raw material.
   c. Advertising.
   d. Depreciation.

Quick Review Question #2

2. Which of the following comes **last** in the budget process.
   a. Sales budget.
   b. Cash receipts/disbursements budget.
   c. Budgeted balance sheet.
   d. Production budget.

Quick Review Answer #2

2. Which of the following comes **last** in the budget process.
   a. Sales budget.
   b. Cash receipts/disbursements budget.
   c. Budgeted balance sheet.
   d. Production budget.

Quick Review Question #3

3. The difference between a budgeted and actual amount is called
   a. An error.
   b. A flexible budget.
   c. A variance.
   d. Fraud.

Quick Review Answer #3

3. The difference between a budgeted and actual amount is called
   a. An error.
   b. A flexible budget.
   c. A variance.
   d. Fraud.

Quick Review Question #4

4. Beginning inventory is 3,200 units. Required ending inventory is 3,500 units. Sales are forecasted at 14,500 units. The production budget calls for how many units?
   a. 21,200
   b. 14,200
   c. 14,800
   d. Cannot be determined

Quick Review Answer #4

4. Beginning inventory is 3,200 units. Required ending inventory is 3,500 units. Sales are forecasted at 14,500 units. The production budget calls for how many units?
   a. 21,200
   b. 14,200
   c. 14,800
   d. Cannot be determined

Copyright