ACCT 102 – Managerial Accounting
Chapter 20 – Master Budgets and Performance Planning
Johnson

<u>Purpose:</u> The purpose of this handout is to summarize the budgeting concepts contained within the chapter.

Ponder This: If you wanted to go across country to New York, how would you go about it? Very few of you would just hop in your car and head east. That's because you would probably spend a lot more time getting there than if you were to look at your options, plan it out, and carefully follow the directions for getting to where you want to go. Think of budgeting as a financial set of driving directions. You decide where you want to go financially, and then set up a plan of attack to get you there in the quickest amount of time—kind of like driving to New York.

The Budget Process – It's quite involved and consists of various stages:

Longer Term Strategic Plans are important. Those usually span 5 – 10 years. These usually set the long term direction of the company.

Shorter Term Plans are more specific. Operating Budgets are generally shorter in nature and typically cover a year of time. ALL MANAGERS will be involved in some phase of the budgeting process.

Benchmarking Budgets. Comparing results against "the norm" which includes past performance (what has already happened) and future performance (what is yet to come and what is expected.)

Human Considerations – Can greatly affect the morale of the teams involved. What if I told you that you had to earn 99% to get an A? Most of you would leave because that's an unrealistic expectation for most. You don't want to discourage employees with unrealistic expectations. On the flip side, what if I told you that you had to get a 60% in the class to get an A. How hard would you work? Would you work up to your potential, or just put in enough effort to get an A? That's what can happen when expectations in the budget are too loose. You can create inefficiency and waste. Goals need to be attainable and measurable.

Committees, Reporting, and Timing – Read about this section in your book. Some companies uses continuous budgets, rolling budgets, some companies spend months preparing budgets, and for some it's a year round process.

Comparison of Actual to Budget – Of course, the only way to know whether you are getting to where you want to go is to assess the results. The difference between the amount budgeted and what you actually spend is termed a variance. We will have an entire chapter on variance analysis. (I know, you can hardly wait!)

The Master Budget Model

- It's a big puzzle.
- It includes components and individualized budgets that all roll into the big picture.
- One budget usually relies on the input from another budget.

Sales Budget
How Many and Expected Revenues

Merchandise Purchases
How Much You Need to Buy and What's the Cost – (Merchandiser Budgets in Appendix)
(Adjust for inventory levels)

Selling Expenses
Usually variable (commissions and advertising) and fixed components (salaries)

General and Admin Expenses – Operating expenses
The other costs of doing business. Usually variable and fixed components.

Capital Expenditures
What kind of capital outlay is needed to support budget goals and what will it cost. (We have an entire chapter on capital investment analysis.) Because these tend to be long term in nature, financing can be an issue.

Cash Budget
How will you fund all the other budgets? How much cash comes in and how much goes out (schedules to support both) and do you have a cash surplus or shortfall. This needs to consider contingencies, or loan covenants, etc. If you need to borrow money or re-arrange financing, you want to know AHEAD of time, not right before your payroll is due.

Budgeted Financial Statements -
Income statements and Balance Sheets

The major components of each will be discussed in class.

More In Depth Info for Components of a Master Budget

The Sales Budget

Prior Period Sales
Plus Projected Growth
Projected Sales in Units
X Projected Selling Price Per Unit
Projected Sales in Dollars

Purchases Budget

Projected Sales in Units (see above)
Add Estimated ending inventory (sometimes a % of next period's sales)
Units Available
Less Beginning Inventory
Units to be Purchased
X Budgeted Cost per Unit
Projected Purchases Budget

(In place of a Purchases Budget – a manufacturer would use a **Production Budget**

Sales Budget
Add desired Ending Inventory
Less Beginning Inventory
Units to be produced

Budgeted COGS

This periods Sales in Units
X Budgeted Cost per Unit
Budgeted Cost of Units Sold

Selling Expenses Budget

Variable Selling Expenses (percentage of sales)
Fixed Selling Expenses
Total Selling Expenses

General and Admin Expenses Budget

Variable G & A Expenses (percentage of sales)
Fixed G & A Expenses

Total G & A Expenses

Cash Budgets

Schedule of Cash Receipts – Cash Sales plus collections of past A/R based on patterns plus collection of new A/R based on Patterns

Schedule of Cash Payments - Purchase payments based on patterns plus A/P payments plus other payments based on terms offered and patterns.

Beginning Cash Balance
Add Receipts (schedule)
Less Payments (schedule)
Projected Ending Cash Balance
(Compare to any loan covenants or minimum balance requirements)