MASTER BUDGET OF COMPANY A

BY

FIRAS THAYEB AL MANSOORI

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DECLARATION

This Master Budget project work is my original work and has not been submitted for examination to any other university.

Signed_____ Date _____

SKYLINE UNIVERSITY COLLEGE OF

SHARJAH, UAE

This Master Budget project work has been submitted for examination with my approval as the

Course Instructor

Signed_____ Date _____

Dr. Edmund Christopher

Master of Business Administration

SKYLINE UNIVERSITY COLLEGE OF

SHARJAH, UAE

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Executive summary of master budget

The project has been undertaken on the topic “A Study on Master Budget of Company A” As the budget is playing an important role in any organization which helps to compare the actual performance with the budgeted performance .The concept of the Budget and way of adaptability, which creates new challenges to industrial sector for surviving in this current competitive edge. It indicates the progress of the concern by way of its sales or profit, market shares, process of the concern etc.

Master budget is actually a budget portfolio which provides a road map for use of available finance for performing different activities in an organization. Efficient use of available financial sources for getting reasonable output is basic motive of master budget.

In this report we discuss different types of master budget i,e sales budget, production budget, promotion budget, distribution budget, purchase budget, marketing budget etc

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Introduction

A master budget is a comprehensive projection of how management expects to conduct all aspects of business over the budget period, usually a fiscal year. The master budget summarizes projected activity by way of a cash budget, budgeted income statement and budgeted balance sheet. Most master budgets include interrelated budgets from the various departments. Managers typically use these subset budgets to plan and set performance objectives. Master budgets are generally used in larger businesses to keep many managers on the same page.

Master Budget

Definition:

A comprehensive plan of all aspects of a firm's future business and production operations

Purposes and Benefits of The Master Budget

There are a variety of purposes and benefits obtained from budgeting. Consider the following:

Integrates and Coordinates

The master budget is the major planning device for an organization. Thus, it is used to integrate and coordinate the activities of the various functional areas within the organization. For example, a comprehensive plan helps ensure that all the needed inputs (equipment, materials, labor, supplies, etc.) will be at the right place at the right time when needed, just-in-time if possible. It also helps insure that manufacturing is planning to produce the same mix of products that marketing is planning to sell. The idea is that the products should be pulled through the system on the basis of the sales budget, rather than produced speculatively and pushed on the sales force. Excess inventory and other resources hide problems and add unnecessary costs. The integrative nature of the budget provides a way to implement the lean enterprise concepts of just-in-time and the theory of constraints where the emphasis is placed on the performance of the total system (organization) rather than the various subsystems or functional areas.

Communicates and Motivates

Another purpose and benefit of the master budget is to provide a communication device through which the company's employees in each functional area can see how their efforts contribute to the overall goals of the organization. This communication tends to be good for morale and enhance jobs satisfaction. People need to know how their efforts add value to the organization and its' products and services. The behavioral aspects of budgeting are extremely important.

Promotes Continuous Improvement

The planning process encourages management to consider alternatives that might improve customer value and reduce costs. Recall that "Plan" is the first step in the Shewhart-Deming plan- do-check-action continuous improvement cycle discussed. The PDCA cycle supports specific improvements in the company's processes. The financial plan and subsequent financial performance measurements reflect the financial expectations and consequences of those efforts

Guides Performance

The master budget also provides a guide for accomplishing the objectives included in the plan. The budget becomes the basis for the acquisition and utilization of the various resources needed to implement the plan. Perfection of the guidance aspect of budgeting can significantly reduce the amount of uncertainty and variability in the company's operations. In a JIT environment, the budget can also serve as a guide to vendors. For example, suppliers to General Motors Saturn plant in Tennessee have access to Saturn's production schedule through an on-line database. This information allows Saturn's vendors to deliver the required parts in the order needed to precise locations just-in-time without a purchase order or delivery schedule.

Facilitates Evaluation and Control

The master budget provides a method for evaluating and subsequently controlling performance. We will develop this idea in considerable detail in the following chapter. Performance evaluation and control is a very powerful and very controversial aspect of budgeting.

Classification of Budgets:

A. **According to time:**

- Long term budgets: A budget is designed for a period of 5 to 10yrs.
- Short term budgets: A budget is a generally prepared for a period of Not exceeding 5 years
- Current Budgets: The budgeted is prepared for a month or a quarter.

B. **According to flexibility**

- Fixed budget: A budget prepared on the basis of fixed or a standard level of activity. It does not change with respect to level of activity.
- Flexible budget: A budget is prepared depend upon the level of the Activity.

Budgeted Procedure:

The procedure followed while designing and operating a budgetary control system depends upon the nature of the business.

The procedure as follows:

1. Determination of key factor:

Key factor is that factor the extent of whose influence must first be assessed in order to ensure that functioned budgets are reasonably capable of fulfillment.

Ex: Sales, production, purchases, cash etc.

Key factor must be identified & diagnosed. Budget are meaning & unless key factor identified.

2. Making of forecasts:

Forecast is nothing but estimation of probabilities for a given period. Forecasts are made regarding sales, production cost and financial requirements of the business.

3. Consideration of alternative combinations of forecasts:

Alternative combination of forecasts is considered for efficient of overall plan with the motive to maximum profits.

4. Preparation of budgets:

After finalization of forecasts the budgets will be prepared

A. Choice between Fixed & Flexible budgets:

A fixed budget is based on a fixed volume of activity. It is ineffective & meaningless because of actual capacity utilization may vary from month to month or quarter to quarter.

A flexible budget is prepared for changing levels of activity. The flexible budget considers the fixed and the variable costs separately.

- Start with a canned budget worksheet.
- Go through your check book or bills for the last two to three months and add and delete categories from the worksheet to fit your expenditures.
- Think about your hobbies and your habits and be sure to add categories for these expenses.
- Go through your pay stubs and calculate your average monthly gross pay.
- Do the same for any interest income, dividends, bonuses, or other miscellaneous income.
- For each expense category, try to determine a budget amount that realistically reflects your actual expenses while setting targeted spending levels that will enable you to save money.

- Once you're comfortable with your expense categories and budgeted amounts, enter expenditures from your checkbook from the last month.
- Keep track of cash expenditures throughout the month and total and categorize these at the end of each month.
- Subtotal the income and expense categories.
- Subtract the total expenses from the total income to arrive at your net income.
- If the number is negative, your expenses are greater than your income. Your situation can probably be greatly improved by changing your spending habits.
- If you have a positive net income, transfer most of it to a savings or investment account at the end of each month. Extra cash left in a regular checking account has a way of getting spent.
- After you've tracked your actual spending for a month or two, analyze your spending to identify where you can comfortably make cuts.
- Once you've got the budgeting process in place, take an in-depth look at your largest spending categories, brainstorm about ways to reduce spending in specific categories, and set realistic goals

Operating Budget

Definition

In operating budget is the annual budget of an activity stated in terms of Budget Classification Code, functional/sub functional categories and cost accounts. It contains estimates of the total value of resources required for the performance of the operation including reimbursable work or services for others.

There are following types of operating budget:

- Sales Budget
- Production Budget
    - Direct Material Budget
    - Direct Labor Budget
    - Factory Overhead Budget
- Cost Of Goods Sold Budget

- Selling & Administrative Budget

Sales Budget Definition:

Forecasts future sales quantities, selling prices, and sales revenues

- Sales budget is the first and basic component of master budget and it shows the expected number of sales units of a period and the expected price per unit. It also shows total sales which are simply the product of expected sales units and expected price per unit.
- Sales Budget influences many of the other components of master budget either directly or indirectly. This is due to the reason that the total sales figure provided by sales budget is used as a base figure in other component budgets. For example the schedule of receipts from customers, the production budget, pro forma income statement, etc.
- Due to the fact that many components of master budget rely on sales budget, the estimated sales volume and price must be forecasted with sufficient care and only reliable forecast techniques should be employed. Otherwise the master budget will be rendered ineffective for planning and control.
- Where the price per unit is expected to remain constant during the period for all units in sales, the sales budget format will be simple as shown below

Company A					
Sales Budget					
For the Year Ending December 30, 2010					
	Quarter				
	1	2	3	4	Year
Sales Units	1,320	954	1,103	1,766	5,143
× Price per Unit	$91	$92	$97	$112	
Total Sales	$120,120	$87,768	$106,991	$197,792	$512,671

However if a business sells more than one product having different prices or the price per unit is expected to change during the period, its sales budget will be detailed.

Production Budget

Definition:

Production budget shows the number of units of each good expected to be produced**.**

Production budget is a schedule showing planned production in units which must be made by a manufacturer during a specific period to meet the expected demand for sales and the planned finished

goods inventory. The required production is determined by subtracting the beginning finished goods inventory from the sum of expected sales and planned ending inventory of the period. Thus:

Planned Production in Units

= Expected Sales in Units

+ Planned Ending Inventory in Units

− Beginning Inventory in Units

- Production budget is prepared after sales budget since it needs the expected sales units figure which is provided by the sales budget. It is important to note that only a manufacturing business needs to prepare the production budget.

- Format and Example

- The following example illustrates the production budget format. The expected sales units are obtained from the sales budget of Company A. The planned ending units of 1st, 2nd and 3rd period are the beginning units in 2nd, 3rd and 4th period respectively.

Company A					
Production Budget					
For the Year Ending December 30, 2010					
	Quarter				
	1	2	3	4	Year
Budgeted Sales Units	1,320	954	1,103	1,766	5,143
+ Planned Ending Units	210	168	213	225	225
− Beginning Units	−196	−210	−168	−213	−196
Planned Production in Units	1,334	912	1,148	1,778	5,172

Budgeted Manufacturing Costs

Definition:

Prediction of the amounts and costs of each input required to manufacture expected production quantities

- **Direct Materials Budget**

- Direct material purchases budget shows budgeted beginning and ending direct material inventory, the quantity of direct material that will be used in production, the amount of direct material that must be purchased and its cost during a specific period. Direct material purchases budget is a component of master budget and it is based on the following formula:

- Budgeted Direct Material Purchases in Units

= Budgeted Beginning Direct Material in Units

+ Direct Material in Units Needed for Production

− Budgeted Ending Direct Material in Units

- In the above formula, the direct material in units that is needed for production is calculated as follows:

  - Budgeted Production During the Period

× Units of Direct Material Required per Unit

= Direct Material in Units Needed for Production

- Since the budgeted production figure is provided by the production budget, the direct material purchases budget can be prepared only after the preparation of production budget.

- Format and Example

- The following example shows the format of a simple direct material purchases budget. The budgeted production figures are obtained from the production budget of Company A. Note that the budgeted ending direct material of 1st, 2nd and 3rd period is the beginning direct material in 2nd, 3rd and 4th period respectively.

Company A					
Direct Material Purchases Budget					
For the Year Ending December 30, 2010					
	Quarter				
	1	2	3	4	Year
Budgeted Production in Units	1,334	912	1,148	1,778	5,172

× DM Required per Unit (lb.)	4.00	4.00	4.00	4.00	4.00
DM Required of Production (lb.)	5,336	3,648	4,592	7,112	20,688
+ Budgeted Ending DM (lb.)	547	689	1,068	961	961
– Beginning Direct Material (lb.)	−800	−547	−689	−1,068	−800
Budgeted DM Purchases (lb.)	5,083	3,790	4,971	7,005	20,849
Cost per Pound	$3.10	$3.20	$3.50	$4.00	
Budgeted DM Purchases in $	$15,757	$12,128	$17,398	$28,020	$73,304

❖ **Direct Labor Budget**

- Direct labor budget shows the total direct labor cost and number of direct labor hours needed for production. It helps the management to plan its labor force requirements. Direct labor budget is a component of master budget. It is prepared after the preparation of production budget because the budgeted production in units figure provided by the production budget serves as starting point in direct labor budget.

- Following are the calculations involved in the direct labor budget:

- Planned Production in units

× Direct Labor Hours Required per Unit

= Budgeted Direct Labor Hours Required

× Cost per Direct Labor Hours

= Budgeted Direct Labor Cost

- Format and Example

- Following is an example showing a simple direct labor budget format. The planned production figures are obtained from the production budget of Company A.

Company A
Direct Material Purchases Budget
For the Year Ending December 30, 2010

	Quarter				
	1	2	3	4	Year
Planned Production in Units	1,334	912	1,148	1,778	5,172
× Direct Labor Hours per Unit	3.5	3.5	3.5	3.5	3.5
Budgeted Direct Labor Hours	4,669	3,192	4,018	6,223	18,102
× Cost per Direct Labor Hour	$4	$5	$5	$5	
Budgeted Direct Labor Cost	$18,676	$15,960	$20,090	$31,115	$85,841

Manufacturing Overhead Budget

- The factory overhead budget shows all the planned manufacturing costs which are needed to produce the budgeted production level of a period, other than direct costs which are already covered under direct material budget and direct labor budget. The overhead budget is an operational budget contained in the master budget of a business. It has two sections, one for variable overhead costs and other for fixed overhead costs.

- Total variable overhead may be calculated as the product of estimated variable cost per unit (also called variable overhead rate) and the budgeted production units (obtained from production budget). However most businesses will prefer to prepare a detailed overhead budget showing individual variable costs such as electricity, fuel, supplies etc.. The fixed overhead costs are calculated as the sum of individual fixed overhead costs for example rent, depreciation, etc. which are planned for the period.

- It is also useful to calculate the expected cash disbursements for factory overhead costs at the end of overhead budget.

- Format and Example

- The following example illustrates the format of a simple overhead budget. The variable overhead per unit of Company A during the first, second, third and fourth quarter is estimated to be $12, $15, $16 and $19 respectively. The production units figures are obtained from the production budget of the company. The company expects to incur monthly depreciation of $3,000 and monthly rent of $2,500. There are no other fixed costs.

Company A
Factory Overhead Budget

For the Year Ending December 30, 2010					
Lo					
	Quarter				
	1	2	3	4	Year
Variable Factory Overhead:					
Budgeted Production Units	1,334	912	1,148	1,778	5,172
× Variable Overhead Rate	$12	$15	$16	$19	
Total Variable Overhead	$16,008	$13,680	$18,368	$33,782	$81,838
Fixed Factory Overhead:					
Depreciation	9,000	9,000	9,000	9,000	36,000
Rent	7,500	7,500	7,500	7,500	30,000
Total Fixed Overhead	$16,500	$16,500	$16,500	$16,500	$66,000
Total Factory Overhead	$32,508	$30,180	$34,868	$50,282	$147,838
– Depreciation	9,000	9,000	9,000	9,000	36,000
Cash Disbursements for FOH	$23,508	$21,180	$25,868	$41,282	$111,838

Selling and Administrative Expense Budget

Definition

Prediction of all selling costs required for attaining forecasted sales levels; prediction of administrative costs

- Selling and administrative expense budget is a schedule of planned operating expenses other than manufacturing costs. It is a component of master budget and it is prepared by all types of businesses (i.e. manufacturers, retailers and service providers) before the preparation of budgeted income statement. Usually it is divided in two sections: the selling expenses and the administrative expenses.

- Both selling expenses and administrative expense may be fixed or variable (see cost behavior). For example sales commission and freight cost on sales are variable selling expenses where as sales salaries are fixed selling expenses. Similarly depreciation and rent on office building are fixed administrative expenses whereas office supplies and utilities expense are variable administrative expenses.
- Different variable selling and administrative expenses vary with different types activities. For example sales commission vary with number of units sold, entertainment expenses with number of employees in the organization etc., therefore an accurate selling and administrative expenses budget can be made by using activity based costing.
- Format and Example

The following example illustrates the format of a typical selling and administrative expense budget.

Company A					
Selling and Administrative Expense Budget					
For the Year Ending December 30, 2010					
	Quarter				
	1	2	3	4	Year
Budgeted Selling Expenses:					
Sales Commission	$2,620	$2,380	$2,410	$3,590	$11,000
Freight-out	3,890	3,510	3,050	5,030	15,480
Budgeted Admin. Expenses:					
Office Rent	8,000	8,000	8,000	8,000	32,000
Office Salaries	10,000	10,000	10,000	10,000	40,000
Office Supplies	1,120	1,030	1,560	2,370	6,080
Miscellaneous Expenses	700	700	700	700	2,800
Total Selling & Admin. Expense	$26,330	$25,620	$25,720	$29,690	$107,360

Cost of Goods Manufactured Budget

Cost of goods manufactured budget is an operational component of master budget. It is prepared to calculate the manufacturing costs that are expected to be incurred on budgeted finished goods. The cost of goods manufactured budget is based on direct material purchases budget, direct labor cost budget and factory overhead budget

The figures from direct labor budget and overhead budget are directly used in the preparation of cost of goods manufactured budget but the direct material purchase cost needs to be adjusted as shown below:

- Direct Material Purchases
  + Direct Material Beginning Inventory
  − Direct Material Ending Inventory
  = Cost of Direct Material Used in Production

- The next step is to calculate the budgeted cost of goods manufactured as follows: Cost of Direct Material used in Production
  + Direct Labor Cost
  + Factory Overhead Cost
  = Manufacturing Cost
  + Beginning Work in Process
  − Ending Work in Process
  = Cost of Goods Manufactured
- Format and Example

The format of cost of goods manufactured budget is shown in the following example. For the sake simplicity, we have assumed zero work in process at the beginning and at the end of the periods.

Company A					
Cost of Goods Manufactured Budget					
For the Year Ending December 30, 2010					
	Quarter				
	1	2	3	4	Year
Direct Material Purchases	$15,757	$12,128	$17,398	$28,020	$73,304
Beginning Direct Material	2,400	1,696	2,205	3,738	2,400
Ending Direct Material	−1,696	−2,205	−3,738	−3,844	−3,844
Direct Material Cost	$16,461	$11,619	$15,865	$27,914	$71,860
Direct Labor Cost	18,676	15,960	20,090	31,115	85,841
Manufacturing Overhead	23,508	21,180	25,868	41,282	111,838
Total Manufacturing Costs	$58,645	$48,759	$61,823	$100,311	$269,539
Beginning Work in Process	0	0	0	0	0
Ending Work in Process	−0	−0	−0	−0	−0
Budgeted Cost of Goods Manufactured	$58,645	$48,759	$61,823	$100,311	$269,539

Financial budget

Definition

It is a plan including a budgeted balance sheet, which shows the effects of planned operations and capital investments on assets, liabilities, and equities.

- Schedule of Expected Cash Collections
- Schedule of Expected Cash Payments
- Cash Budget
- Budgeted Balance Sheet

- Budgeted Income Statement

Schedule of Expected Cash Collections

- Schedule of expected cash collections from customers shows the budgeted cash collections on sales during a period. It is a component of master budget and it is prepared after the preparation of sales budget and before the preparation of cash budget.
- The calculation of expected cash collections is based on the total sales figure obtained from sales budget. The management estimates the proportion in which sales are expected to be collected in the current and following periods. This is used to determine how much sales are expected to be collected during a period.
- Format and Example

The master budget of Company A continues here with the preparation of schedule of expected cash collections. The sales figures are obtained from the sales budget of the company. 70% of sales are expected to be collected in the quarter in which sales are made and the rest are expected to be collected in the next period. Bad debts are negligible.

a) Q1 Sales = $120,120
Collections in Q1 = $120,120 × 70% = $84,084 Collections in Q2 = $120,120 × 30% = $36,036

b) Q2 Sales = $87,768
Collections in Q2 = $87,768 × 70% = $61,438 Collections in Q3 = $87,768 × 30% = $26,330

c) Q3 Sales = $106,991
Collections in Q3 = $106,991 × 70% = $74,894 Collections in Q4 = $106,991 × 30% = $32,097

d) Q4 Sales = $197,792
Collections in Q4 = $197,792 × 70% = $138,454

Company A
Schedule of Expected Cash Collections

For the Year Ending December 30, 2010					
	Quarter				
	1	2	3	4	Year
Beginning AR	$62,130				$62,130
Quarter 1 Sales (a)	84,084	$36,036			120,120
Quarter 2 Sales (b)		61,438	$26,330		87,768
Quarter 3 Sales (c)			74,894	$32,097	106,991
Quarter 4 Sales (d)				138,454	138,454
Total Collections	$146,214	$97,474	$101,224	$170,551	$515,463

Schedule of Expected Cash Payments

- Schedule of expected cash payments to suppliers shows the budgeted cash payments on purchases during a period. The schedule of expected cash payments is a component of master budget and it is prepared after direct material purchases budget but before cash budget.

The expected cash collections during a period is calculated on the basis of total purchases figure, that is obtained from direct material purchases budget, and on the percentage / proportion in which purchases are to be paid for in the current and following periods.

Format and Example

The following example shows the format of schedule of expected cash payments to suppliers. The purchases figures are obtained from the direct material purchases budget of company A. The company expects to pay 80% of the purchases in the period of purchase and 20% in following period.

a) Q1 Purchases = $15,757
Payments in Q1 = $15,757 × 80% = $12,606 Payments in Q2 = $15,757 × 20% = $3,151

b) Q2 Purchases = $12,128
Payments in Q2 = $12,128 × 80% = $9,702 Payments in Q3 = $12,128 × 20% = $2,426

c) Q3 Purchases = $17,398
Payments in Q3 = $17,398 × 80% = $13,918 Payments in Q4 = $17,398 × 20% = $3,480

d) Q4 Purchases = $28,060

Payments in Q4 = $28,060 × 80% = $22,448

Company A					
Schedule of Expected Cash Payments					
For the Year Ending December 30, 2010					
	Quarter				
	1	2	3	4	Year
Beginning AP	$2,350				$2,350
Quarter 1 Purchases (a)	12,606	$3,151			15,757
Quarter 2 Purchases (b)		9,702	$2,426		12,128
Quarter 3 Purchases (c)			13,918	$3,480	17,398
Quarter 4 Purchases (d)				22,448	22,448
Total Expected Payments	$14,956	$12,853	$16,344	$25,928	$70,081

Cash Budget

Cash budgeting (cash planning) is a critical part of budgeting because it is essential to have the right sums of cash available at the right times.

Cash budget is a financial budget prepared to calculate the budgeted cash inflows and outflows during a period and the budgeted cash balance at the end of the period. Cash budget helps the managers to determine any excessive idle cash or cash shortage that is expected during the period. Such information helps the managers to plan accordingly. For example if any cash shortage in expected in future, the managers plan to change the credit policy or to borrow money and if excessive idle cash is expected, they plan to invest it or to use it for the repayment of loan.

All businesses need to maintain a safe level of cash to enable them to carry on business activities. The managers of a business need to determine that safe level. The cash budget is then prepared by taking into consideration, that safe level of cash. Thus, if a cash shortage is expected during a period, a plan is made to borrow cash.

Format and Example

The following example illustrates the format of cash budget. Company A maintains a minimum cash balance of $5,000. In case of a deficiency, loan is obtained at 8% annual interest rate on the first day of the period.

Company A		
Cash Budget		
For the Year Ending December 30, 2010		
	Quarter	

	1	2	3	4	Year
Beginning Cash Balance	**$5,200**	**$5,000**	**$5,000**	**$11,740**	**$5,200**
Add: Budgeted Cash Receipts:	**37,150**	**54,190**	**53,730**	**62,300**	**207,370**
Total Cash Available for Use	**$42,350**	**$59,190**	**$58,730**	**$74,040**	**$212,570**
Less: Cash Disbursements					
Direct Material	**14,960**	**16,550**	**16,810**	**19,410**	**67,730**
Direct Labor	**8,830**	**9,610**	**9,750**	**11,900**	**40,090**
Factory Overhead	**10,020**	**10,400**	**11,000**	**11,780**	**43,200**
Selling and Admin. Expenses	**7,640**	**8,360**	**8,500**	**9,610**	**34,110**
Equipment Purchases		**6,000**		**14,000**	**20,000**
Total Disbursements	**$41,450**	**$50,920**	**$46,060**	**$66,700**	**$205,130**
Cash Surplus/(Deficit)	**$900**	**$8,270**	**$12,670**	**$7,340**	**$7,440**
Financing:					
Borrowing	**4,100**				**4,000**
Repayments		**–3,188**	**–912**		**–4,000**
Interest		**–82**	**–18**		**–100**
Net Cash from Financing	**$4,100**	**–$3,270**	**–$930**		**–100**
Budgeted Ending Cash Balance	**$5,000**	**$5,000**	**$11,740**	**$7,340**	**$7,340**

Budgeted Income Statement

The budgeted or pro forma income statement is prepared after the operating budgets have been completed. The cost of goods sold on the income statement is calculated using the per unit cost of $11.25, which consists of $1.40 per unit for direct materials, $7.00 per unit for direct labor, and a manufacturing overhead rate of $2.85. The overhead rate is calculated by multiplying the predetermined overhead rate of $5.70 per direct labor hour times the direct labor hours per unit of one * half hour

	Quantity	Unit Cost	Total Cost
Direct Materials	Various	$ 1.40	$ 1.40
Direct Labor	.5 hour	14.00	7.00
Manufacturing Overhead	.5 hour	5.70	2.85
Total Unit Cost			$11.25

Budgeted income statement

Sales (100,000 × $15)		$1,500,000
Cost of Goods Sold (100,000 × $11.25)		1,125,000
Gross Profit		375,000
Operating Expenses		
Selling Expenses	$120,000	
Administrative Expenses	81,000	
Total Operating Expenses		201,000
Income from Operations		174,000
Interest Expense		2,880
Income before Income Taxes		171,120
Income Taxes (40%)		68,448
Net Income		$102,672

Budgeted Balance Sheet

Definition

A budgeted balance sheet shows estimated financial position of a company.

By seeing budgeted balance sheet, we can expect same at the end of the financial year. But this is not real balance sheet. When it is not real, then what is the need of preparing it and why I am here to explain it? Reason behind this is very clear. It is useful tool for management for decision making. We

know management makes almost all type of budget. We should see all these budget's effect on our future financial position. Future is in our hand. We have made cash budget, material budget, production budget, sales budget, purchase budget and master budget and other departments' budgets. After this, we should make budgeted balance sheet to check whether all budget's effect is positive on on our estimated financial position or not. Now, I am explaining the steps to make it

1. **Take the Beginning Real Balance Sheet**

For making budgeted balance sheet, we take all the data of real balance sheet of beginning of financial year.

2. **Collect the Data of All Budget**

For making budgeted balance sheet, you need to collect the data of various budget like cash budget, purchase budget, finished goods budget, raw material budges, projected sales or purchase deal of fixed assets on credit.

3. **Adjustment of Beginning Real Balance Sheet with Data of Different Budgets** If your hand is good on ms excel, within just few minutes, you can make budgeted balance sheet.

Balance Sheet Items	Adjustment	Basis of Budget
a) Cash in Hand and at bank	Take the figure of closing cash in hand balance from cash budget	Cash Budget
b) Sundry Debtors	Opening Debtors + New Credit Sale - Cash Received	Sales Budget and Cash Budget
c) Sundry Creditors	Opening Creditors+ New Credit Purchase - New Payment	Purchase budget and Cash Budget
d) Finished Stock	Opening Finished Stock + New Production - New total Sales (Cash+ Credit)	Production, Sales and Cash Budgets
e) Raw Material Stock	Opening Raw Material Stock + New Purchase (Cash+Credit) - New Consumption	Material, production and Cash Budget

f) Fixed Assets	**Opening Balance+ New Purchase - New Sale (Cost Value)**	**Cash Budget and Projected Plan Report and<u>Plant Utilization budget</u>**
g) Loan Liabilities	**Opening Balance of Loan Liabilities + New Loan Taken - Repayments**	**Cash Budget**
h) Accumulated Depreciation	**Opening Balance Accumulated Depreciation + New Depreciation**	**Overhead Budget**
i) Paid in Capital	**Opening Balance of Paid in Capital + Additional Paid in Capital**	**Cash Budget**
j) Retained Earning	**Opening Retained Earning + Estimated Net Profit - (Estimated Dividend declared + Estimated Dividend Paid)**	**Cash Budget and Budgeted Income Statement**
k) General Reserve	**Opening Balance of General Reserve + New General Reserve on Specific Rate as per law**	
l) Taxation	**Opening Payable Tax + New Payable Tax - (Advance+ TDS)**	**Tax Returns, As per the law of UAE**

Relation between Budgeting and Forecasting

Budgeting" and "forecasting" are used interchangeably According to the national association of accountants (USA)"forecasting is a process of predicating or estimating a future happening", Forecasting is an essential part of the budgeting process. Forecasting is estimating future events and their effects

on the budget. Forecasting comes to an end after mere estimating. Budgeting is a process of preparing budgets and further control aspects are involved in its procedure

Essentials of Budget:

- It is prepared in advance based on a future plan of action.
- It relates to a future period and based on objective to be attained.

It is a statement expressed in monetary and for physical units prepared for the implementation of policy formulated by the management.

Control and performance evaluation:

Budgeting entries into control at three points:

- When a budgeted is being formulated, departments analyze their plans for the future and submit estimates as per their requirements, justifying each of their demands by demon string a need.
- After budgets of different departments have been reviewed and approved they become targets that set desirable limits on spending.

At the end of the budget period, a comparison of actual expenditure with budget expenditure is made as a means of judging performance and fixing responsibility foe deviation.

Advantages of Budgeting:

- Budgeting plays an important role in the effective use of resources and achieving overall organizational goals.
- Budgeting compels and motivates management to make an early and timely study of its problem.
- budgeting provides a valuable means of controlling income and expenditure of a business as it is a "plan for spreading"
- Budgeting provides a too through which managerial polices and goals are periodically evaluated, tested and established as a guidelines for the entire organization.
- Budgeting help in directing capital and others resources into the most profitable channels.
- Budgeting coordinates and correlates all business activates.

The use of budgeting in an organization develops an attitude of "Cost Consciousness", stimulates the effective use of resources, and creates an environment of profit-mindedness throughout the organization.

- The uppermost point is that budgets provide a discipline that brings planning to the fore front as a key managerial responsibility".
- Budgeting encourage productive competition

Limitations and Problems

There are several limitations and problems associated with the master budget that need

to be considered by management. These problems involve uncertainty, behavioral bias and costs

Uncertainty:

Budgeting includes a considerable amount of forecasting and this activity involves a considerable amount of uncertainty. Uncertainty affects both sides of the financial performance dichotomy,but uncertainty on the revenue side presents a more serious limitation for planning. The sales budget is frequently based on a forecast supported by a variety of assumptions about the economy, the actions of the federal reserve board and congress in implementing monetary and fiscal policy, and the actions of competitors, suppliers, and customers. The uncertainty associated with sales forecasting creates a greater problem than uncertainty on the cost side because the other parts of the budget are derived from the sales forecast. This forces management to constantly monitor and analyze changes in the economic environment. From the planning perspective, the inability to accurately forecast the future reduces the usefulness of the original budget estimates for materials requirements planning (MRP) and planning for other resource needs. Uncertainty on the cost side tends to be less of a problem because management has more influence over the quantities of resources consumed than over the quantities of their own products purchased by customers. From a performance evaluation and control perspective, uncertainty on both sides of the financial performance dichotomy is not as much of a problem because flexible budgets are used to fine tune the original budget to reflect expectations at the current level of activity.

Behavioral Bias

A second problem involves a variety of behavioral conflicts that are created when the budget is used as a control device. To be effective, the budget must be used by the managers it is designed to help. Thus, it must be acceptable to all levels of management. The behavioral literature on budgeting supports the view that the budget should reflect what is most likely to occur under efficient operating conditions. If a budget is to be used as an effective planning and monitoring device, it should encourage a high level of performance and efficiency, but at the same time, it should be fair and obtainable. If the budget is viewed by managers as unfair, (too optimistic) it may intimidate rather than

motivate. One way to gain acceptance is referred to as participative (rather than imposed) budgeting. The idea is to include all levels of management in the budget preparation process. Of course this process must be coordinated by a budget director to ensure that a fair budget is obtained that will help achieve the goals of the total organization.

Another way to reduce the behavioral bias against budgeting is to recognize the concepts of variation and interdependence when using the budget to evaluate performance. Recall from our discussion of the statistical control concept in Chapter 3 that there is variation in all performance and most of this variation is caused by the system , (i.e., common causes) not the people working in the system. The concept of interdependence refers to the fact that the various segments of a company are part of a system. Inevitably, these segments, or subsystems influence each other. Failure to adequately recognize the interdependencies within an organization tends to cause behavioral conflicts and motivate participants to optimize the performance of the various segments (subsystems) rather than to optimize the performance of the overall system

Finally, the behavioral conflicts associated with budgeting are reduced by using flexible budgets when evaluating performance

Costs

A third problem or limitation is that budgeting requires a considerable amount of time and effort. Many companies maintain a twelve month budget on a continuous basis by adding a future month as the current month expires.4 While this does not create a major expenditure for large or medium sized organizations, smaller companies may find it difficult to justify the costs involved. Many small, potentially profitable firms, do not plan effectively and eventually fail as a result. Cash flow problems are common, e.g., not having enough cash available (or accessible through a line of credit with a bank) to pay for merchandise or raw materials or to meet the payroll. Many of these problems can be avoided by preparing a cash budget on a regular basis.

The Assumptions of the Master Budget

Typically, the following simplifying assumptions are made when preparing a master budget:

1.) Sales prices are constant during the budget period

2.) Variable costs per unit of output are constant during the budget period

3.) Fixed costs are constant in total

4.) Sales mix is constant when the company sells more than one product.

These assumptions facilitate the planning process by removing many of the economic complexities. Instead of planning on the basis of the more complicated non-linear model on the left, the master budget is very similar to the more easily understood linear model on the right. In addition, a practical approach for analyzing the differences between budgeted and actual sales prices, unit cost, sales mix and sales volume.

Conclusion:

A budget is a detailed quantitative plan for acquiring and using financial and other resources over a specified forthcoming time period.

1. The act of preparing a budget is called The act of preparing a budget is called budgeting.

2. The use of budgets to control an organization's activity is known as budgetary control

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