

Intro to Budgeting

Key Concepts for Budgeting

- Organizations use the budgets to aid in the planning and control process
- Managers use budgets to communicate their intended goals and objectives, use of resources, and to coordinate activities within the organization
- Budgets represent a key method of measuring performance by comparing actual results with those expected/planned in budgets

Budgeting Process - Master Budget

Master budget is an overall summary of an organizations planned/targeted operation for the period. This will generally include the preparation of several separate but interdependent budgets. The process traditionally culminates with the preparation of a budgeted Income Statement, budgeted Balance Sheet and Cash Flow Budget.

- A Sales Budget
- A Production Budget
- A Materials, Labour and Manufacturing OH Budget
- Ending Finished Goods Inventory Budget
- Selling & Admin Expense Budget
- A Budgeted Balance Sheet
- A Budgeted Income Statement
- A Cash Budget

** Tackle most questions differently**

Budgeting - Example

Touchstone Limited makes wool blankets from locally sourced wool. The company is preparing the budget for the third quarter. The blankets sell to retail outlets for \$85 each. The sales forecast is below:

Budgeted sales in blankets	
May	1,700
June	1,900
July	2,000
August	2,600
September	3,900
October	4,100

- A)** Prepare a sales budget for July, August, September and in total for the third quarter.
- B)** Touchstone Limited has an inventory policy of holding 10% of the next month's sales in ending inventory each month. Prepare the production budget for Touchstone for July, August, September and in total for the third quarter.
- C)** The company requires 0.5 kilograms of wool for each blanket. The inventory policy is to hold 20% of the next month's production needs in ending inventory each month. Local sheep farmers are contracted to supply wool at \$26 per kilogram for the 2016 year. Prepare the direct materials budget for July & August

Budgeting - Example

Touchstone Company, a retailer, makes both cash and credit sales (i.e., sales on open account). Information regarding budgeted sales for the last quarter of the year is as follows:

	October	November	December
Cash Sales	100,000	120,000	80,000
Credit Sales	100,000	150,000	90,000
Total	\$ 200,000	\$ 270,000	\$ 170,000

Past experience shows that 5% of credit sales are uncollectible. Of the credit sales that are collectible, 60% are collected in the month of sale; the remaining 40% are collected in the month following the month of sale. Customers are granted a 1.5% discount for payment within 10 days of billing. Approximately 75% of collectible credit sales take advantage of the cash discount.

Inventory purchases each month are 100% of the cost of the following month's projected sales. (The gross profit rate for Touchstone Company is approximately 30%.) All merchandise purchases are made on credit, with 25% paid in the month of purchase and the remainder paid in the following month. No cash discounts for early payment are available.

Required:

1. Calculate the budgeted total cash receipts for November and December.
2. Calculate budgeted cash disbursements for November and December. Assume Jan sales are budgeted for \$200,000.

Budgeting - Example

Touchstone Products, a distributor of organic beverages, needs a cash budget for September. The following information is available (amounts in \$):

1. The cash balance at the beginning of September is \$4,000.
2. Actual sales for July and August and expected sales for September are as shown below. Sales on account are collected over a three-month period as follows: 10% collected in the month of sale, 70% collected in the month following sale, and 18% collected in the second month following sale. The remaining 2% is uncollectible:

	July	August	September
Cash Sales	8,000	6,500	8,900
Credit Sales	20,000	30,000	40,000
Total Sales	28,000	36,500	48,900

3. Purchases of inventory will total \$25,000 for September. 20% of a month's inventory purchases are paid for during the month of purchase. The accounts payable remaining from August's inventory purchases total \$16,000, all of which will be paid in September.
4. Selling and administrative expenses are budgeted at \$13,000 for September. Of this amount, \$4,000 is for depreciation.
5. Equipment costing \$18,000 will be purchased for cash during September, and dividends totalling \$3,000 will be paid during the month.
6. The company maintains a minimum cash balance of \$5,000. An open line of credit is available from the company's bank to bolster the cash position as needed. Assume any borrowings occur at the beginning of the month and repayments occur at the end of the month. Interest on outstanding loan balances during the month must be paid at the end of each month. The monthly interest rate is 0.5%.

Required:

1. Prepare a schedule of expected cash collections for September.
2. Prepare a schedule of expected cash disbursements during September for inventory purchases.
3. Prepare a cash budget for September. Indicate in the financing section any borrowing that will be needed during September.

Budgeting - Example

Touchstone Inc. has the following budgeted data for the coming year:

Cash balance, beginning	\$ 15,000
Collections from customers	\$ 145,000
Direct materials purchases	\$ 25,000
Expenses:	
Operating expenses	\$ 50,000
Payroll	\$ 75,000
Income taxes	\$ 6,000
Other:	
Machinery purchases	\$ 30,000

Operating expenses include \$20,000 depreciation for buildings and equipment. All purchases of materials are paid for in the period of purchase. The company requires a minimum cash balance of \$25,000.

Required: Prepare a Cash Budget in the format of a cash flow statement for Touchstone Inc.

Budgeting - Example

Question from: Blocher et al. Cost Management: A Strategic Emphasis, 8th edition, © 2019, McGraw-Hill Education ISBN: 978-1-260-09172-4

10-32 **Retailer Budget** D. Tomlinson Retail seeks your assistance in developing cash and other budget information for May, June, and July. The store expects to have the following balances at the end of April:

Cash	\$ 5,500
Accounts receivable	437,000
Inventories	309,400
Accounts payable	133,055

The firm follows these guidelines in preparing its budgets:

- **Sales.** All sales are on credit with terms of 3/10, n/30. Tomlinson bills customers on the last day of each month. The firm books receivables at gross amounts and collects 60% of the billings within the discount period, 25% by the end of the month, and 9% by the end of the second month. The firm's experience suggests that 6% is likely to be uncollectible and is written off at the end of the third month.
- **Purchases and expenses.** All purchases and expenses are on open account. The firm pays its payables over a 2-month period with 54% paid in the month of purchase. Each month's units of ending inventory should equal 130% of the next month's cost of sales. The cost of each unit of inventory is \$20. Selling, general, and administrative (SG&A) expenses, of which \$2,000 is depreciation, equal 15% of the current month's sales.

Actual and projected sales follow:

Month	Dollars	Units	Month	Dollars	Units
March	\$354,000	11,800	June	\$342,000	11,400
April	363,000	12,100	July	360,000	12,000
May	357,000	11,900	August	366,000	12,200

Required

1. Prepare schedules showing budgeted merchandise purchases for May and June.
2. Prepare a schedule showing budgeted cash disbursements during June.
3. Prepare a schedule showing budgeted cash collections during May.

